The Plymouth Rock Company
INCORPORATED
695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 15, 1992

To Our Shareholders:

Last year's letter warned that the simultaneous creation of three new businesses would tax our entrepreneurial resources. I now say amen to that. The workload for our holding company officers was greater in 1991 than in any prior year. We should thank our lucky stars that this was an especially good year for Plymouth Rock Assurance Corporation, which is still our mainstay business. A combination of entrepreneurial demands and those of a troubled operation would have made for a hazardous load. Our central task for 1992 is to nurture the management teams of the various subsidiaries so that they may carry as much of the future weight as possible. Our ability to handle growth and the inevitable crises that lie ahead may depend on achieving that shift during this period of relatively strong performance.

Several years ago, our company reached an important fork in its development. We had built a middle-sized Massachusetts personal lines company that came tolerably close to meeting our standards of excellence in its relationships with customers, employees and shareholders. One option was to face inward and raise the scale of that business. The other, the course selected, was to expand into other property and casualty insurance businesses and other jurisdictions. The risk was always evident that we might lack what it takes to run a larger and inescapably less focused enterprise. That risk is still with us. The Plymouth Rock Company now owns two insurers and the SRB Corporation, which in turn controls three insurance service companies. I have devoted many hours to puzzling over how these spreading operations should be managed. It is probably worth a few paragraphs here to continue sketching the approach proposed in last year's letter.

Our plan is to centralize the shaping of the corporate culture and to decentralize operational responsibility. One of the five holding company officers serves as the chairman of each company in the group. The chairman is charged with rigorously maintaining those elements of corporate behavior that are common to all of our companies, such as

the emphasis on service, the way we treat employees, the quality of financial reporting, and our approach to corporate good citizenship. To this degree, our governance differs sharply from the more familiar models of autonomy.

A strong and independent president serves as the chief executive officer of each operating company. The president is responsible for all operating decisions, for bottom line success or failure, and, more generally, for everything unique to that company's business. Very few corporate services will be made available to the subsidiaries by the parent. The parent company will thus remain small in staffing and highly dependent for its prosperity on dividends from successful subsidiaries. In this sense, our governance has little in common with the traditional model of centralized management, a model long prevalent in most of the property and casualty insurance industry.

A number of wise advisors have cautioned that, by ignoring economies of scale in central services, we will be sacrificing some efficiency. This is undoubtedly true, but there are tradeoffs. A more centralized enterprise can never really be a community. At Plymouth Rock Assurance, with a staff of about two hundred people, every employee can still get to know every single colleague. There is something destructive in larger firms about the notion that a stranger somewhere, with other goals and priorities, can affect your performance. And central services are inextricably linked to central decision making, which by its very nature weakens desirable leadership traits. Leadership is a delicate thing, and our presidents will need all of it they can muster. The greater their sense of entrepreneurial responsibility and control, the more likely they will be to succeed. Large and centralized organizations seldom develop the strongest or most creative leaders.

This does not mean our various businesses will fail to communicate or teach one another. The chairmen must make sure that they do. A number of intercompany advisory committees have been established as forums for the exchange of specific techniques and disciplines, and as resources to which any subsidiary can turn for help with its thorniest problems. The personnel and accounting committees are already functioning well in this manner. Participation at committee meetings is voluntary and committee decisions are non-binding, but I expect the committees to play an increasingly important role as the family of companies grows larger and more diverse. It is only when the presidents are in command and the committees are fully functional that the workload of the chairmen can become manageable.

Financially, we passed some important milestones in 1991. The Plymouth Rock Companies closed the books for the first time with both gross revenues and assets in excess of $100 million. Our cash flow exceeded $25 million, and our net income of $6.8 million

exceeded last year's net by nearly 50 percent. A new presentation format for our financials should help to highlight these quantities. I had been uncomfortable with mentioning gross revenues every year in this letter and then finding the number nowhere in the accompanying statements. Gross numbers can now be found in Footnote 3, which displays the total revenues of each subsidiary and thus our scale as an enterprise, and also in the Statements of Cash Flow. The latter represents the most significant presentation change. For years I had been asking other insurance executives if they could use or understand the cash flow statements they published, and I have yet to hear a positive response. So, with help from our greatly strengthened accounting team and our outside auditors, we designed a new form that begins with gross cash receipts and ends with the changes in investments shown on the balance sheet. I hope readers will find it worth the effort.

Plymouth Rock Assurance Corporation, the Massachusetts homeowners and auto writer, is our only mature company. Its 1991 volume of $97.2 million represented three percent of the personal lines market in this state. We are now the eleventh largest writer, and that may be about enough. Our goal has always been to build the best company in the state, not the biggest one. I am thrilled that our people seem to take more pride in the occasional indicia of excellence than in growth statistics. Our voluntary pure loss ratio, which reflects the quality of our agency force and our underwriting, remains one of the industry's lowest and is a source of satisfaction whenever published. Mail from agents and customers on the quality of our service is widely circulated at our office. When the Insurance Department told us we had the "best complaint record among the top auto writers" for 1990, that letter went up on a bulletin board. And a survey of our customers with claims serviced under the Crashbusters van program came in with a remarkable ninety-six percent of respondents rating our service as "exceptional".

Net income for Plymouth Rock Assurance was $6.7 million in 1991, almost a million dollars ahead of budget. A hurricane in August cut into our homeowners profits, but the automobile results and realized investment gains more than made up the adverse impact. We entered the Massachusetts auto insurance market in 1984, a time when the state-set premium rates were inadequate but the residual market offered an incentive for new and growing companies. We were always conscious of the unheralded race between the winding down of the growth incentives and a return to adequate rates which would render the incentives unnecessary for us. This past year was uniquely blessed. It was a time of adequate premium rates, and the residual market incentives, in the final stage of phase-out, were still of significant value.

While I think of long term cycles as neither avoidable nor predictable, the 1992 automobile rate picture looks promising for several reasons. First, the whole industry

continues to have better than expected success with "direct pay" programs designed to put auto damage claim checks in the hands of the customers as rapidly as possible. The result is happier customers and lower costs. Second, there has been solid progress on the depopulation of the automobile residual market pool, which has fallen in market share from 68 percent in 1989 to 28 percent last year. Because a smaller pooled market inevitably spurs professionalism in industry claims practices, it would be appealing to see the pooled market cut to ten percent of the total someday. Third and finally, there is an evolving consensus among public policy makers that it is time to reformulate Massachusetts' tired no-fault law. If proposals for a truly effective tort threshold are enacted, and temptations to accept a phony threshold resisted, our state will have about as rational a system as is likely to exist in any urban jurisdiction.

No picture is perfect, however. At Plymouth Rock Assurance, we have still not conquered the costs of providing first class service. The gross expense ratio, including investment and claims adjustment expenses, fell from over 40 percent the prior year to 39 percent in 1991. The improvement was not as much, though, as we had hoped and leaves us with at least three more points to eke out over the years without hurting our service level. On a regulatory level, we are wary about calls for "competitive" rating if by that proponents mean allowing rates for urban drivers to rise to unaffordable levels. Auto insurance premiums have too much in common with regressive taxes for that type of pricing to be politically stable. Plymouth Rock Assurance has prospered in stormy seas, but we would prefer a bit of calm in Massachusetts for a change.

In New Hampshire, Mt Washington Assurance Corporation has been serving policyholders since last July. That company's biggest challenge in 1992 is to attract a sufficient volume of decent business to begin bringing its mile-high expense ratio into line. Mt Washington's total premiums in force as of yearend 1991 were about $280,000. The goal for 1992 is $3.5 million, which would still leave Mt Washington short of the five million dollar mark we see as the barest minimum for break-even economies of scale. Even our best scenarios for New Hampshire, therefore, envision a net loss of several hundred thousand dollars in 1992. Sluggish volume would probably consign us to a loss in 1993 as well.

An operating New Jersey subsidiary is still a glint in the eyes of our Palisades Management team, but we now have a proposal before the New Jersey Department of Insurance to form a replacement carrier for a company seeking exit from that state. New Jersey planning has taken up a major share of senior officer time for almost two years now, and there are plenty of seasoned New Jersey veterans warning us that we will regret the whole undertaking. I remain convinced that we are on a sound path. All things in life are cyclical

except those that are not. To be infinitely successful, of course, one only needs to divine the difference.

From where we stand, New Jersey's regulatory woes look to be in the cyclical category. Governor Florio inherited a huge residual market deficit, claim laws deficient in cost containment, and rate levels that were unaffordable and inadequate at the same time. All of these problems are being dealt with, and short of a state takeover they must all be dealt with in a way that allows a healthy automobile insurance industry to function in New Jersey. Our bet is that the bottom has been reached and, with exiting carriers offering to help finance the entry of replacement carriers, the fundamentals look favorable. Is it still risky? Of course it is, but I have thought for many years about establishing a company in the form of a membership organization, established for the benefit of drivers who have explicitly chosen to equip their vehicles with the most effective safety technologies and who accordingly can take some measure of responsibility for their own premium rates. New Jersey may well be the right place for that kind of company, and I hope 1992 is the right time.

Pilgrim Insurance Company, our service arm, and Boston Risk Management Corporation, our brokerage firm, both strengthened in 1991. Their mandate is to build reputations, staffs, and stable financial postures in traditional brokerage and service businesses while reinvesting their profits in the development of a workers' compensation "alternative markets" capability. We remain as convinced as ever that the alternatives to traditional insurance policies, alternatives such as pools, captives, and other forms of self insurance, will constitute the fastest growing segment of the vast and troubled workers' compensation business. Traditional insurance capital simply can not do the job, and traditional insurance relationships fail to put the right emphasis on loss minimization or workplace safety.

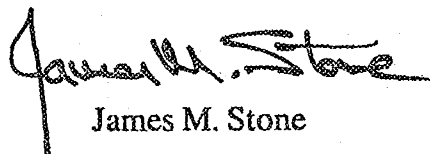
Pilgrim once again earned a modest profit in 1991, while Boston Risk Management operated at a small loss in its first year of business. Although all of our service businesses taken together contributed only a small proportion of group net income for 1991, we consider progress in these companies an extremely important indicator of our future prospects. With Plymouth Rock Assurance having reached maturity, growth for the next few years is likely to come primarily in the form of service revenues.

News on the investment side remains pleasingly scant. Our holdings of marketable securities, presently in excess of $88 million, are as conservative as ever. We still own no real estate, no high yield or long maturity bonds, and no common stocks. Investment income was $8.1 million for the year, but that figure includes nearly a million dollars in non-recurring capital gains from our bond portfolio. As long as the current low interest rate environment persists, we can not expect to repeat this kind of investment income

performance. Perhaps by this time next year we will be taking a modicum more of risk, at least with the capital of the holding company. That has always been our plan. We will be as careful as ever, however, not to let investment activity divert us from attention to our core skills. It is ample, full time work to know the property and casualty insurance business.

Our boards of directors were enhanced in 1991. No one left any of the boards, and I am pleased to report that Alexander Ellis, III has joined the board of Boston Risk Management. Hap Ellis, who was one of the most successful brokers in Boston, would be a welcome addition to that board under any circumstances, but the fact that he is Sandy Ellis' son makes his service something special. The late Sandy Ellis recruited me to the insurance business two decades ago and served on our board until his death, so his spirit was here anyway. Hap adds to that presence, and I expect we will soon owe Hap as we surely owed Sandy.

The year ahead promises more entrepreneurial excitement, and all of the accompanying strains. The leaders of the operating subsidiaries have plenty to challenge them. Can they imbue their customer service with a sense of urgency that borders on perfectionism? Can they encourage their staffs to take pride in working harder than counterparts in other companies and in accomplishing more than they thought themselves capable of? Can they produce profits for the shareholders by offering recognizable value to the public they serve? These are fair tests for a chief executive officer. Since I continue to serve as the president of one of the operating companies, I have some idea how hard these tests are and how much harder they will become if passivity is ever allowed to set in. Passivity of spirit is one of the harshest curses growth can inflict on a business. We will do our best at Plymouth Rock to turn back that tendency, and to chart a growth path on which striving and creativity are always rewarded.



James M. Stone