The Plymouth Rock Company
INCORPORATED
177 Milk Street
Boston, Massachusetts 02109

Chairman's Letter

March 31, 1986

To Our Shareholders:

Our projections for Plymouth Rock Assurance Corporation in 1985 had set out a tough objective: profitability in our second year. It is satisfying to be able to report that we recorded, in fact, a modest net income for the year. Welcome as these results may be, I hope they will not be misunderstood. Our performance must be measured over decades, rather than months or years. Insurance is more a marathon than a sprint, and Plymouth Rock is but a few inches from the starting line.

Growth is the commanding feature of our 1985 numbers. Net Premiums Earned, the top line of the income statement, rose from $2.2 million to $4.1 million. A better measure of the expansion might be Gross Premiums Written, a figure not customarily displayed in the financials. This is the volume our agents entrusted to us, the amount our policyholders were billed, and the index of our staff's workload. Our Gross Premiums Written rose from $3.7 million in 1984 to $11.7 million in 1985. We had roughly 7,500 policyholders in 1984; by the end of 1985 we had close to 25,000.

Our management budget envisioned a $10.1 million year for Gross Premiums Written. As things turned out, we passed our marks in homeowners and in servicing carrier automobile volume. In both lines I believe the extra volume was induced by Plymouth Rock's growing reputation for good service. If I am right, the same conditions bode well for next year's business growth.

Our Loss Ratio in 1985 was 69%, almost identical to our 1984 Loss Ratio. This is better than industry averages and looks better still if we are compared to other newly formed companies. Rigorous risk selection and rapid growth are compatible for a new company only in the presence of careful pre-screening by agents and intensive computer support for underwriters. Traditionally equipped underwriters in affordable numbers would never have time enough to consider each new risk to the point of sophisticated judgment. One strategy available to new companies is to grow for a time with highly tolerant underwriting, accepting a high initial loss ratio. Then later they can begin to refine and season the book of business as full staffing becomes more affordable. We have committed ourselves instead to concentrate on underwriting from inception. This

requires a considerable expenditure for mathematical and statistical talent as well as state-of-the-art data management capability in our computers.

The piper must be paid for all of this support. The costs show up in the Expense Ratio. We think we can save more than a dollar in losses for every expense dollar committed to underwriting rigor. Even if it were an even trade, though, we would take it. An excessive Expense Ratio can be trimmed more easily than a wayward Loss Ratio can be set back on the straight and narrow. We feel more secure confronting the harder of the two tasks first.

It will get tougher to keep the Loss Ratio in line before it gets easier. Even the most carefully selected book of business changes in character over time. Families with children become families with additional drivers. Cars and homes get older and eventually deteriorate. People undergo changes in their habits, sometimes for the worse. We have selected each new risk with great care. Now, beginning in 1986, we will look at our book afresh each year, removing dangerous automobile risks to the state reinsurance pool and pulling improved risks back out of the pool. There are no illusions that our present Loss Ratio will maintain itself automatically.

Our Loss Ratio for 1985 would have been even better had it not been for Hurricane Gloria, which hit us on September 27. The press had portrayed the nascent storm as an apocalypse, so we prepared for the worst. When it was over, the press described it as a dud. They must not have seen the insurance statistics. Gloria did more insured damage in Massachusetts than all previous hurricanes of the last three decades put together. Eloise and Belle, the big storms of the mid-seventies, did about $2 million apiece in the kind of damage that shows up in the Massachusetts claim statistics. Gloria will have been responsible for at least $40 million in damages. Storm claims cost us about $200,000 before reinsurance and just over $105,000 net of reinsurance. We wish Gloria hadn't visited, of course, but we also realize that the unpredictability of events like Gloria is precisely what makes people need us.

The silver lining in Gloria's cloud was a letter we received soon afterwards from one of our agents. While other carriers were calling and writing agents before the storm to tell them to restrict new coverages, we had written to say that we would be open all weekend to help with immediate claims needs. One agent responded with a note calling our planning "superb...right out of the book *In Search of Excellence.*" We couldn't buy that kind of advertising.

Our expenses for the year were almost precisely on budget. Since our premiums were a bit higher than projected, our Expense Ratio was a shade better than the forecast. That means that it ended the year at 46% rather than 48%. This compares with 56% last year, and it keeps us on our five year course to a ratio no greater than 30%. We are struggling hard to provide exceptional service for our agents and customers, a constructive and pleasant working environment for our staff, and the most sophisticated tools for our underwriting... all within a strict budget. One of our most serious tests

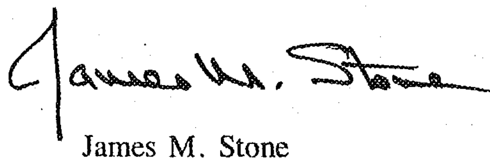
in the future will be to maintain these high standards and still be competitive with respect to expenses. We haven't yet proved we can do that.

Our portfolio remains conservative. Liquidity risk and equity performance risk were kept low by confining 1985 investments to heavily traded fixed-income issues. Credit risk was kept just as low, with more than 85% of our portfolio in securities issued or guaranteed by the Federal government. The rest is in high-grade corporate or municipal bonds. Interest rate exposure is also quite low by industry standards. Our portfolio contains no fixed-maturity instruments more than six years out, and our variable-maturity GNMA holdings have an average expected life not much longer than that. Someday we may purchase less liquid bonds, bonds with longer maturities, preferred stock, common equities, or real estate. But it remains our preference at this stage to rivet all possible attention on the task of building a profitable insurance base and to keep the portfolio simple. Our average current return was about ten percent in 1985. We ended the year with an unrealized capital gain of over half a million dollars.

The coming year will be a time for growth, for reducing our Expense Ratio and for further sharpening our underwriting skills. The real challenge for 1986, though, has no simple reflection in the numbers. Two years ago, Keith Rodney and I could put our fingers on any piece of paper in the office. We could overhear the handling of almost every telephone inquiry. The level of customer service was ours to command. With tens of thousands of policyholders, this will be less and less the case. Effective control of service quality has gravitated toward department managers and supervisors. Keith's task and mine are becoming more abstract.

We must be able to communicate the company's goals and standards to a greater number of people than we can personally train. We will have to inculcate our emphasis on friendly and personal treatment of those who do business with us into the lasting culture of our emerging organization. We must somehow cause the high service notion to become instinctive throughout the company and make sure it is reinforced on all possible occasions. At the same time, we will have to find ways to keep up the flow of thoughts and suggestions from our employees so that we continue to learn about service too. The company will be fifty people by year end, and these tasks are getting harder. They do not lend themselves to rigorous formal solutions like our computerized underwriting, nor has anyone pointed us to a good hornbook. But the importance of these challenges can scarcely be overstated.

Growth in our environment depends absolutely on the market's opinion of us. And for that, in turn, we depend just as absolutely on the quality of our service. Customer satisfaction is the most important thing we have to offer.



James M. Stone