



Management Letter – A Year in Review

Frederick Mutual Insurance Company is privileged to serve over 23,000 policyholders in Maryland and Pennsylvania through a network of professional Independent Agencies. The word privileged must be emphasized as we understand there are many other carriers and we are pleased that you have chosen to place your business with Frederick Mutual. This is a responsibility that we take very seriously. We feel it is our responsibility to provide our policyholders and agents with corporate integrity, financial security, sound products, and ease of doing business, competitive pricing, and unparalleled customer service. I can assure you that the professional staff of Frederick Mutual is strongly committed to meeting the needs of our policyholders and agents in these areas.

2008 was an historic year in many ways. The presidential election, global economic crisis, natural catastrophes and soft insurance market had great effects on the insurance industry. Frederick Mutual, like many other carriers, felt the impact of the financial and economic crisis along with the soft insurance market. Our written premiums, policies in-force, total assets and policyholder surplus decreased from 2007 as a result of these factors; however, our balance sheet and financial security remain very strong.

Financial Condition

In 2008 total assets decreased 9.5% to \$44,776,273 from \$49,470,292 in 2007. Most of this was a result of the decrease in value of our equity portfolio. Written premium decreased 4.5% to \$20,537,914 from \$21,510,392. This was a result of the soft market and the economy with a number of small business owners and contractors either going out of business or reducing operations. The Policyholders Surplus for 2008 was \$25,226,619 compared to \$29,009,945 in 2007 which is a decrease of 13%. Once again, this is a result of the losses from our investments. We realized an underwriting gain of \$793,195 in 2008 compared to an underwriting gain of \$1,942,593 in 2007. Net investment loss for 2008 was (\$774,985) compared to net investment gain of \$2,687,369 in 2007. Therefore, we had a net loss of (\$279,807) in 2008 compared to a net income of \$3,987,398 in 2007. As stated earlier in spite of the financial losses of 2008, Frederick Mutual maintains a solid balance sheet and is financially strong entering 2009.

Operations

During 2008 Frederick Mutual completed a number of business initiatives to promote premium and policy growth along with enhancing our products and customer service. Some of the highlights include the following:

- The ability for an insured or agent to report losses on a 24/7 basis
- Customer surveys for lost business and claims
- Equipment Breakdown coverage added as an option to our Homeowners program
- Identity Theft coverage added as an option to the Homeowners program

Our Information Technology department has completed a number of initiatives to support premium growth and enhance disaster recovery. These initiatives include:

- Automated Renewals for Personal Lines to increase internal efficiencies
- An upgrade to our *Allenbrook* policy and claims management system to the newest version, *Phoenix 8*
- Enhanced disaster recovery efforts
- Agency Interface which will allow our agents to rate and quote our products in their offices is nearly complete

Michael Evans was hired as Chief Underwriting Officer and has begun research and development on Commercial Middle Market products to complement our existing Small Commercial and Personal Lines products.

Outlook for 2009

As we enter 2009 it is anticipated that this will be another historic year with financial uncertainty in the global economy and it is our responsibility to be good stewards of the business and make prudent decisions. In the fall of 2008 our Board and Managing Officers met to develop a five-year strategic plan. Our goal over the next five years is to expand our agency force in Maryland and Pennsylvania to nearly 300 agencies combined. We have also begun to implement a Business Development Team to appoint new agencies and increase production from existing agencies. We will continue marketing our existing products while developing Commercial Middle Market products which will increase our product portfolio and allow our agencies more opportunities to meet the needs of our policyholders. Our Information Technology Department is continuing the development of initiatives to allow ease of doing business and internal efficiencies. These initiatives include Agency Interface, Automated Renewals for Commercial Lines, Agency Download for Commercial Lines, and *PremiumBill* which will enhance our billing program. We are also going to make payment by credit card and electronic funds transfer available for our insureds.

We have a number of aggressive initiatives and goals for 2009 and into the next five years. I am confident that our professional staff and agents will execute these initiatives to help us achieve those goals. It is our overall objective not only to grow in volume, but to be certain the growth is profitable in order to maintain our financial strength and continue our unparalleled customer service. As always, I thank you for your continued trust in Frederick Mutual.

Very truly yours,

Kevin R. Filler, CIC, AU
President and CEO