THE CONTINENTAL CORPORATION • 1990 ANNUAL REPORT

THE PURSUIT OF • EXCELLENCE

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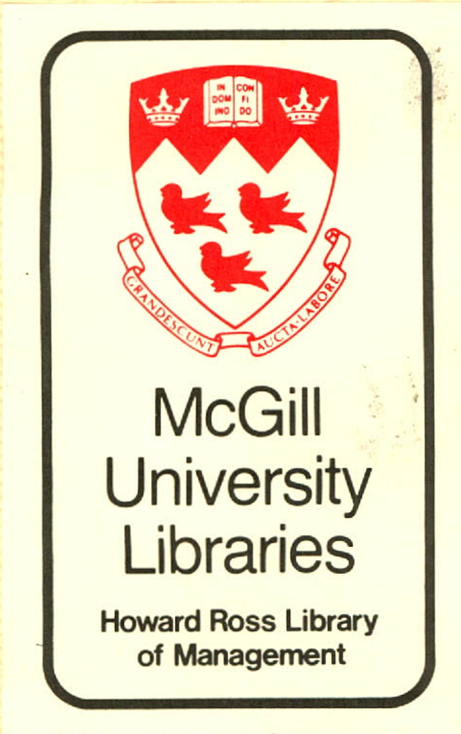
NEW BOX

(on the Cover)

Excellence and professionalism have kept the relationship between Continental and W. Bruce Martin strong for 25 years. Meredith Dodd, associate commercial underwriter, confers with Michael R. Martin, president and general manager of W. Bruce Martin Insurance Limited, A Continental Canada Inner Circle distributor.

THIS IS CONTINENTAL

The Continental Corporation, headquartered in New York City, is a property/casualty insurance organization with over $5 billion in annual revenues. Its subsidiaries are leading writers of commercial and personal package policies and select specialty coverages through major independent agents and brokers.



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FINANCIAL HIGHLIGHTS

(millions, except per share data)	1990	1989
Revenues	$ 5,705.2	$ 6,111.5
Net Income Available to Common Shareholders	137.3	147.9
Total Assets	13,927.0	14,259.0
Shareholders' Equity	2,060.9	2,287.1
PER COMMON SHARE:		
Net Income	2.53	2.74
Book Value	37.83	42.24
Dividends	2.60	2.60

DEAR SHAREHOLDER,

Being ahead of the game has its advantages.

As market withdrawals by property and casualty insurers disrupt coverage availability and public concern over financial stability makes headlines, we at Continental can take great comfort in the soundness of decisions we reached some years ago.

These decisions, which are more and more proving their worth, have been guided by two fundamentals:

1. The importance of financial strength: investing in high quality assets while maintaining adequate reserves; and
2. The importance of strategic focus: building upon our competitive strengths—commercial and personal package policies and select specialty lines—while cutting back in areas where we have no special advantage, such as auto-only insurance policies.

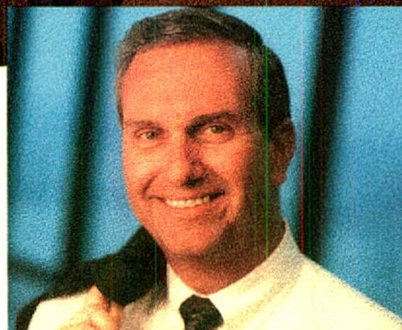
We believe that all the restructuring we've done over the last several years has not only ensured our financial strength, but also given us a clarity of strategic purpose and mission that will enable us to emerge from the current underwriting downturn demonstrably stronger and better positioned than we've been for two decades.

FINANCIAL STRENGTH Insurance is a business of promises: first and foremost, the promise to pay a claim in the event of an insured loss. The ability to honor that obligation requires a strong commitment to financial strength. We believe that real growth in the value of our company must be firmly grounded in unimpeachable balance sheet integrity.

Continental has one of the highest quality investment portfolios in the industry, a direct result of the company's long-held conviction that it doesn't pay to sacrifice quality to chase after higher yields.

We've been able to sustain a high level of investment income—$765 million pretax in 1990—while preserving the top quality of our $9.3 billion investment portfolio, 84% of which are fixed maturities investments with an average quality of AA+. Common stocks represent 8% and mortgage loans account for only 2% of investments. Less than 1% of the portfolio is below investment grade (see accompanying chart).

Maintaining financial strength also means setting adequate reserves for the future payment of losses and loss expenses. Over the past several years, we've increased our reserves at a rate that has considerably outpaced the rate of increase in claims paid. Furthermore, we've continued to increase reserves over the past two years, even as we've reduced the amount of risk we've been underwriting in response to the industry downturn in commercial lines pricing.



JOHN P. MASCOTTE

CHAIRMAN AND

CHIEF EXECUTIVE OFFICER

WILLIAM E. THIELE

PRESIDENT AND

CHIEF OPERATING OFFICER

Strategic Focus Our other most significant and essential strength is a clear and unambiguous strategic focus.

Simply put, we seek preeminence in a few select areas where we have a competitive edge.

We've demonstrated a consistent willingness over the past several years to take tough steps to achieve that focus, including distilling and upgrading our independent agent network, driving off a large book of monoline personal auto insurance long before the wisdom of such a move was recognized and divesting a whole series of nonstrategic operations, which culminated in the sales of our life and health insurance subsidiaries.

During the recent downturn, we've shrunk our book of business despite the inevitable strain on cash flow caused by the lag between premium reductions and a corresponding drop in developing claims. And during 1990, we continued to use the soft market as an opportunity to improve our mix of business.

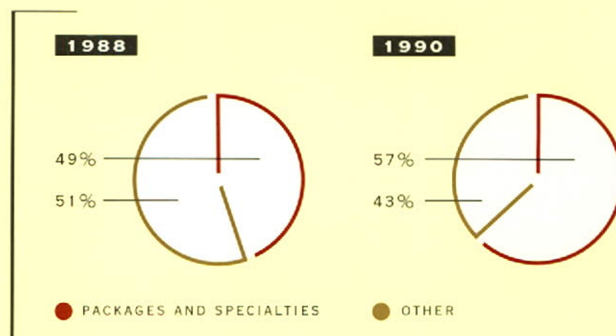
There are early indications that our hard work is paying off: not only did we write fewer risks, but by driving off marginal accounts and exposures in nonstrategic lines of business, we improved the quality of our book.

First, the growth in paid claims has begun to slow. Paid claims rose only 7% during 1990, down from 11% in 1989. This is an "apples to apples" comparison, removing distortions to the underlying trend from purchases and sales of operations and the unprecedented volume of claims resulting from Hurricane Hugo.

Growth in paid claims also slowed in the second half of 1990 from its first-half pace. And operations contributed $80 million of cash even before gains from the sales of investments.

Net of losses from Hugo, sales of subsidiaries, recognition of capital gains and their tax consequences, our underlying operating results in 1990 are about the same as in 1989. In other words, we've successfully fended off deterioration from yet another year of a weak pricing environment by improving the quality of our book. We've cut poorly performing accounts, walked away from underpriced risks while holding onto quality renewals and—in very select instances—written new business where our competitive strengths together with market pricing have allowed us to grow profitably.

As a result, we've succeeded in raising the proportion of our business written in our chosen areas of preeminence—commercial and personal package accounts and select specialty lines—to 57% of total premium, up eight points in just two years (see accompanying chart). Looked at in another way, since 1988 we've been able to grow our package and specialty writings 2.5% while cutting back other activity 23%. And even in the downturn, the combined ratios in



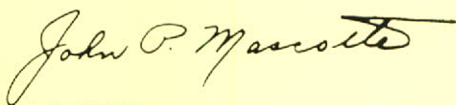
our package and specialty businesses have averaged a full 14 points better than those in our other lines.

OUTLOOK In sum, we've been able to earn our shareholder dividend over the last two years despite being in a soft market and making considerable investments in overhauling and repositioning a number of our operations.

We'll continue to work hard at improving our business mix, holding the line on expenses and maintaining a strong balance sheet. We think these actions will enable us to ride out the downturn and emerge in a better position when pricing eventually firms.

Meanwhile, the political aftermath of the savings and loan crisis and the widely publicized troubles of some commercial banks have led a number of legislators—at both the state and federal levels—to develop an increased interest in the regulation of our industry. The resulting debate over rules of conduct and standards of financial strength will undoubtedly give rise to even greater public scrutiny and criticism of insurance companies' business and investment decisions. In this climate, we find all the more reason to take comfort and pride in the impeccable strength of our balance sheet and the clarity and soundness of our strategy.

We think it's a good time to stick to our knitting.



John P. Mascotte
Chairman and
Chief Executive Officer

William E. Thiele
President and
Chief Operating Officer

THE PURSUIT OF EXCELLENCE

At Continental, the pursuit of excellence distinguishes everything we do: the insurance coverages we design, our service to distributors and insureds, the quality of our balance sheet and—most critical of all—the professionals we attract and retain as employees. For in the increasingly complex and difficult property and casualty insurance business, the pursuit of excellence demands a great deal from our people.

Just what does it take? We believe that four core attributes are essential to accomplishing our mission:

CLEAR DIRECTION AND ACCOUNTABILITY

An unambiguous focus on what needs to be done and an eagerness to make decisions and be judged on their results;

PROFESSIONALISM

A high level of technical expertise, sound business judgment and ethical behavior;

A STANDARD OF EXCELLENCE

A resolute insistence on quality in product and delivery, with untiring attention to detail;

EFFECTIVE MANAGEMENT

Disciplined management practices and rigorous financial controls to ensure sensible risk-taking, crisp execution and profitable growth.

In the following pages, we will discuss the many ways we are pursuing excellence at Continental: in our products, expertise, customer service and people.

Continental is a leading U.S. property and casualty insurer, offering businesses and individuals protection against financial losses stemming from damage and injury.

The company is a preeminent writer of commercial package policies in North America, meeting the multiple-coverage needs of small to medium-sized businesses.

An industry innovator, Continental was the first to package a broad range of commercial coverages in a single policy with the introduction of the Comprehensive Business Policy (CBP) in 1963. Today our premier product, CBP offers customers a flexible and extensive array of coverages born of nearly three decades of experience.

Continental is also a leader in specialized insurance products and services, and in personal package policies (combining homeowners, auto and other personal coverages), another Continental innovation.

Complementing these core strengths, the company has considerable capabilities for handling specialized reinsurance, international and selected large accounts.

AGENCY & BROKERAGE

AGENCY

The Agency Group generates over 40% of Continental's business, including nearly three quarters of Continental's commercial package writings. The Group also writes workers' compensation and other standard lines of insurance in support of its commercial package operation.

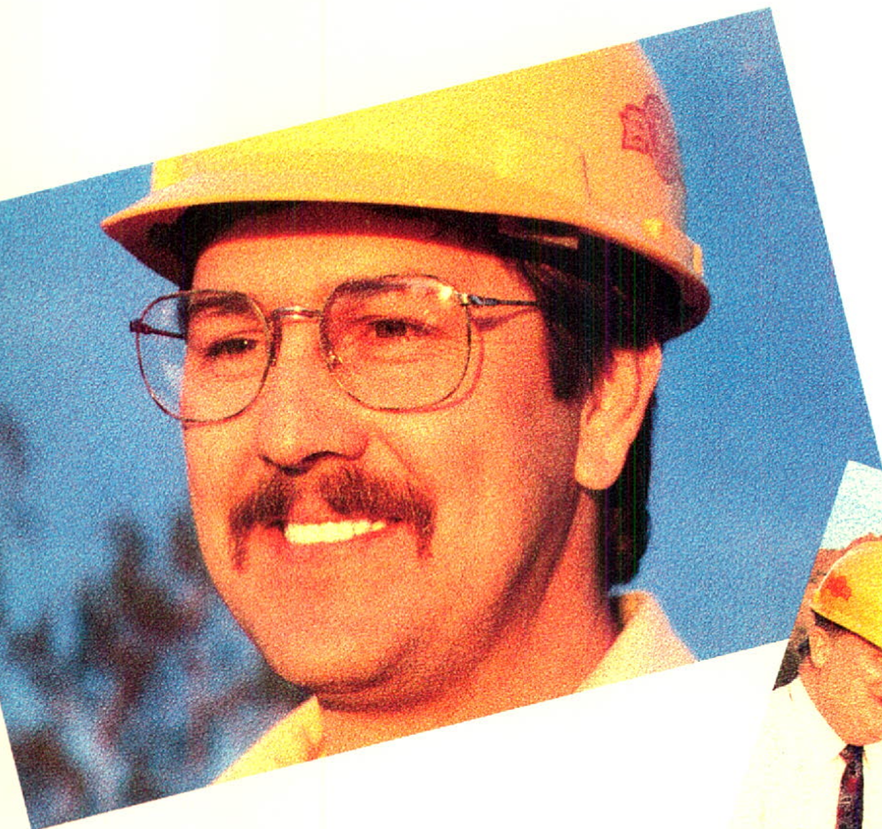
In personal insurance, Agency Group has distinguished itself as a major provider of packaged coverages for upscale individuals with its Continental Link Plus® policy. Growth in this operation focuses on selected states through about 400 distributors.

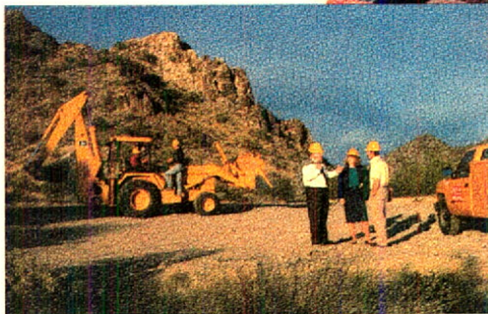
Agency is further capitalizing on its experience in package policies by stepping up its marketing effort to small businesses, now the fastest growing segment of the commercial arena. We are streamlining our handling of small commercial packages to generate large numbers of these accounts in target classes and territories and thereby enable our distributors to compete cost-effectively in this market.

Like most of Continental's business units, Agency Group markets its products through independent distributors. Its core group of distributors consists of about 1,200 major independent insurance agents, called Circle Agents,SM who write three-quarters of the Group's premium. In exchange for access to choice books of

Pictured this page l-r: Michael, Looney, Klyce

INDEPENDENT AGENT JEFFERSON F. MICHAEL OF CLAY & LAND AGENCY AND INSURED BRIG KLYCE, PRESIDENT OF WHITE ROSE RENTAL LAUNDRY OF MEMPHIS, GET EXPERT ADVICE ON CLAIMS AND COST CONTROL FROM CONTINENTAL SENIOR CLAIMS ADJUSTER LINDA LOONEY.





BILL PAULEY, AREA MANAGER FOR THE FISHEL COMPANY, DISCUSSES WAYS TO PREVENT OR LIMIT INJURIES AT A WORK SITE IN PHOENIX, ARIZONA, WITH CONTINENTAL'S RUSS MCCOY AND KATHLEEN DURSO.

business, we provide these preferred producers with support in new business development, advertising, training, automation, financing and other service enhancements.

Agency Group has improved the quality and timeliness of its service to both distributors and insureds by decentralizing its underwriting and claims operations and moving decision-making authority to the local level. Now 95% of all underwriting decisions on new accounts are made at Agency's 79 territorial offices. Being closer to our markets has helped us respond faster and more effectively to local market needs.

Continental Canada

Continental is one of the top three commercial insurers in Canada. Like Agency Group, Continental Canada specializes in commercial packages for small to mid-sized businesses and in personal coverages for upscale insureds. It, too, writes most of its business through an elite group of distributors, known in Canada as Inner Circle Agents.

Responding to an opportunity created by the 1990 U.S.–Canadian Free Trade Agreement, Continental established a Cross Border Unit to provide comprehensive insurance protection and service to Canadian and U.S. companies that do business on both sides of the border.

A constantly evolving global economy has encouraged increasing expansion and investment into Canada from the Pacific Basin, particularly Hong Kong. To service this fast-growing market, Continental has set up facilities to meet the needs of distributors and insureds who conduct business on both sides of the Pacific.

National Brokerage Services

Continental established National Brokerage Services (NBS) to meet the distinctive business needs of large national insurance brokers. Concentrating on commercial packages for mid-sized businesses, NBS nationally markets standard commercial coverages for select industries, including hotels, senior living care, bowling centers and health clubs. NBS has restructured its field organization to better respond to distributors' needs and has consolidated back office functions to control costs.

Special Risk

Continental Special Risk Underwriters offers sophisticated, custom-tailored casualty coverages primarily for Fortune 1000 companies. Special Risk targets financially strong companies interested in funding a substantial portion of their own losses as a cost-effective alternative to paying full premiums for conventional coverage. In turn, these accounts rely on Continental for a wide range of risk management services, such as claims handling, loss control and safety engineering.

At Continental, we are striving to be more responsive to our distributors and insureds by fostering a customer-oriented spirit among our employees. We are measuring our progress by monitoring processing times, exploring new ways to organize work flows and asking distributors, policyholders and claimants to rate our service.

We continue to introduce systems designed to increase the efficiency of our daily transactions. Agency Group has reduced handling costs by centralizing the processing and renewal underwriting for personal lines from 28 different locations into two regional Automated Business Centers. We

Pictured in group l-r: McCoy, Durso, Pauley

developed an "easy quote" software diskette to help producers rate and price personal package policies faster and more accurately.

Automating the policy writing and processing of our commercial package business has enabled us to significantly lower the time required to quote and issue a policy. We are currently developing computerized workstations that will enhance decision-making by giving underwriters and claims adjusters quick and easy electronic access to a wealth of account, technical and procedural information.

To contain insurance costs, we have introduced programs such as NOVUS Windshield Repair, which seeks to repair rather than automatically replace damaged windshields. In addition to holding down claims costs, this program offers insureds the convenience of drive-in service and on-the-spot repairs nationwide. In the workers' compensation line, teams of Continental underwriters, claims adjusters, loss control representatives and rehabilitation specialists are working with producers, employers, workers, doctors and hospitals to manage health care expenses while preserving quality services.

Specialized Commercial

In addition to our leadership in commercial and personal packages, Continental is a major provider of specialized coverages and services for selected commercial insureds. These include ocean and inland marine, aviation, fidelity and surety, geographically focused workers' compensation, specialized casualty and liability for health care professionals.

Pictured in group l-r: Smith, Murphy, Balmer

MOAC

Marine Office of America Corporation (MOAC) is one of the largest and most respected providers of ocean and inland marine insurance in the world. Along with traditional ocean marine coverage such as hull and cargo, MOAC markets inland marine, aviation, large property and boiler and machinery coverages and related services to medium-sized and large commercial enterprises throughout North America and in selected overseas markets.

MOAC has successfully carved out several new specialty niches, including warranties to service and repair hospital technical equipment and data processing equipment. It is also developing innovative, comprehensive package policies for industries with special needs, such as exporters and freight forwarders. MOAC supports all these coverages with specialized claims handling, surveying, loss control and recovery services.

Casualty

Focus, expertise and service are the key elements in the success of Casualty Insurance, Continental's workers' compensation specialist.

CONTINENTAL HEALTHCARE LOSS CONTROL CONSULTANT LEONA SMITH AND SENIOR UNDERWRITING SPECIALIST PETER MURPHY REVIEW INSURANCE NEEDS WITH DR. JARED BALMER, PSYCHOLOGIST AND EXECUTIVE DIRECTOR OF THE RIVENDELL OF UTAH CHILDREN AND YOUTH CENTER IN SALT LAKE CITY.

PURSUIT OF EXCELLENCE

QUALITY

CHILDREN OF THE METRO CATHOLIC PARISH, DIOCESE OF CLEVELAND, PARTICIPATE IN THE "LEARN NOT TO BURN" FIRE SAFETY PROGRAM FUNDED BY THE CONTINENTAL CORPORATION FOUNDATION. ASSISTING SISTER EVE STANONICK ARE DAVID VIDAL, FOUNDATION VICE PRESIDENT, AND ROGER KRUMHANSL, DIRECTOR OF RISK MANAGEMENT FOR THE DIOCESE. A TOTAL OF 149 SCHOOLS IN THE DIOCESE, A CONTINENTAL INSURED, HAVE TAKEN ADVANTAGE OF THIS PROGRAM.

The number one writer of workers' compensation in Illinois, Casualty emphasizes mid-sized manufacturers and artisan contractors in a 100-mile radius around Chicago. This sharp focus has enabled it to develop considerable underwriting expertise in its target classes of risk, as well as knowledge of its local market.

Casualty pioneered the use of preferred provider organizations and medical bill audits to control medical costs associated with workers' compensation claims. Such programs are now common practice in the workers' comp industry, and last year they enabled Casualty to save approximately 8% on medical costs. This winning formula has been transplanted to Southern California, and Casualty recently launched another satellite operation in Milwaukee, Wisconsin.

Guaranty & Credit

Continental Guaranty & Credit (CG&C) is a leading writer of surety, fidelity and related specialty coverages for contractors and financial institutions. CG&C's surety operation targets small to mid-sized general contractors on such projects as government and commercial office buildings, schools, libraries and roads. Surety bonds insure against losses resulting from failure to perform a specified job within a certain time.

Fidelity bonds protect against losses from theft and fraud committed by employees. CG&C writes fidelity and other comprehensive coverages for financial institutions, such as financially sound commercial banks and stock exchanges.

Strict adherence to risk selection criteria and a strong commitment to quick, expert service are the key ingredients in CG&C's outstanding results. A network of 37 surety and 26 fidelity field offices around the country allows CG&C to take a hands-on approach grounded in extensive local market knowledge.

Pictured in group l-r: Vidal, Krumhansl, Stanonick

Excess and Select

Continental Excess and Select (E&S) provides expert underwriting of umbrella, high excess casualty and specialized casualty coverages for selected industries and professional groups, including stop loss protection on group health insurance plans, directors' and officers' liability and casualty coverages for the railroad industry.

E&S recently expanded its specialized industry capabilities with programs for mining, ski resorts and sports arenas, and is presently developing an advanced technologies program to cover potential liability of biotechnology and genetic engineering firms.

HealthCare

Continental Insurance HealthCare (CIHC) specializes in malpractice, general liability and umbrella coverages for hospitals, health care facilities and group practices of ten or more physicians. It is also the insurer of choice for approximately 65% of all podiatrists and 25% of all chiropractors in the United States.

CIHC is staffed by underwriters, claims examiners, loss control representatives and other service personnel with experience in the medical field. HealthCare builds its underwriting knowledge base, establishes market presence and achieves operating efficiencies by concentrating over 70% of its business in eight key states.

Alternative Markets

Continental Retention and Specialty Managers (CRSM) offers a broad range of

support services to large companies and industry or professional groups that elect to self-insure rather than purchase coverage from the traditional market. Among the Continental services CRSM can deliver are captive insurance company management, regulatory compliance expertise, investment management, claims handling, loss prevention and control, automated risk management systems and cost containment programs.

INTERNATIONAL & REINSURANCE

INTERNATIONAL

Continental International offers property and casualty coverages to both U.S. and, increasingly, foreign multinational corporations. As a large commercial writer in a global business community, Continental has the ability to service the exposures of U.S. multinationals worldwide. And our extensive knowledge of American markets and ability to provide comprehensive international coverage within a single global program afford convenient quality protection for foreign multinationals with operations in the United States. We also insure local mid-sized commercial and upscale personal accounts in a limited number of countries outside North America.

REINSURANCE

Continental Reinsurance Corporation (CRC) primarily writes four types of reinsurance: treaty and facultative reinsurance for domestic regional, specialty and mutual insurers; specialized U.S. casualty coverages, particularly medical liability, sourced through our London office; property treaties in select markets in Europe and the Pacific Basin; and sophisticated financial reinsurance products. In addition to assuming reinsurance, CRC designs and places a substantial portion of the reinsurance ceded by Continental's own primary insurance operations.

Along with our insurance operations, which contribute about 95% of revenues, Continental owns the largest premium financing company in the United States, as well as several small service operations, including an administrator of pension plans.

By leveraging the quality of our products, expertise, customer service, financial strength and employees—our combined human and financial resources—we at Continental are striving to provide consistent excellence to our insureds, our distributors and our shareholders.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS OPERATIONS The company's principal business is property and casualty insurance. This business ("Insurance Operations") is divided into three segments: Agency & Brokerage, Specialized Commercial and International & Reinsurance. The company's other segments are Premium Financing and Corporate & Other, the latter of which includes investment management, claims adjusting and risk management. Insurance Operations generated 95% of 1990 consolidated revenues, including 80% from premiums earned and 15% from investment activities (net investment income and realized capital gains). The Premium Financing and Corporate & Other segments (combined with gains on sales of subsidiaries) generated the remaining 5% of consolidated revenues.

RESULTS OF OPERATIONS—1990 COMPARED WITH 1989

SUMMARY Net income for 1990 was $141 million, compared with $153 million for 1989. In 1990, underwriting results for Insurance Operations improved from 1989, largely due to lower catastrophe losses, but this improvement was more than offset by lower realized capital gains.

Insurance Operations had income before income taxes of $226 million for 1990, down from $252 million for 1989. The underwriting loss for 1990 of $644 million represented a $36 million improvement from 1989. Premiums earned declined $345 million due to the company's strategic withdrawal from certain markets, as well as its decision not to write severely underpriced risks and continued intense price competition in certain commercial and personal insurance markets. Losses and loss expenses declined $245 million as a result of the decrease in business written and lower 1990 catastrophe losses. Catastrophe losses in 1990 totaled $66 million, including $26 million from European wind storms, compared with catastrophe losses of $171 million in 1989, including $80 million from Hurricane Hugo, $19 million from the California earthquake and $17 million from winter storms. Insurance operating expenses declined $136 million, primarily due to lower commission expenses as a result of the decrease in business written. The underwriting loss improvement was more than offset by a decrease in investment results of $62 million, comprised of a $67 million decline in realized capital gains and a $5 million increase in net investment income.

For 1990, the company's other segments, combined with gains on sales of subsidiaries, generated a loss of $56 million, compared with a loss of $67 million for 1989. In 1990, the company recorded an income tax expense of $29 million, compared with an income tax expense of $32 million for 1989.

INSURANCE OPERATIONS Premiums earned and underwriting results for the three insurance segments were as follows:

(millions)	*For the Year Ended December 31*			
	Premiums Earned		*Underwriting Results*	
*Business Segment**	1990	1989	1990	1989
Agency & Brokerage	$2,933	$3,094	$(353)	$(421)
Specialized Commercial	1,060	1,071	(96)	(77)
International & Reinsurance	595	768	(195)	(182)
Total Insurance Operations	$4,588	$4,933	$(644)	$(680)

**Distinct investment portfolios are not maintained for each segment, and accordingly, meaningful allocation of net investment income and realized capital gains to each segment is not practicable.*

The Agency & Brokerage segment's premiums earned decreased $161 million from 1989, primarily due to (1) reduction of exposures in certain commercial markets where competition has limited price increases and potential profitability; (2) strategic withdrawal from writing certain personal lines; and (3) reduction of writings in certain businesses, primarily workers' compensation and monoline automobile, in states and locations that are undesirable due to related assessments of historically unprofitable involuntary assigned risk business. Involuntary assigned risk business is generally comprised of mandated state programs that require insurance companies to provide coverage to those unable to purchase insurance in the traditional marketplace. The segment's 1990 premiums earned included $200 million from involuntary assigned risk business ($17 million less than in 1989). These reductions in Agency & Brokerage premiums earned were partially offset by an increase of $62 million in premiums earned from Canadian operations, primarily due to the July 1989 acquisition of additional property and casualty operations in Canada.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The underwriting loss for the Agency & Brokerage segment improved $68 million from 1989, due to greater reductions in losses and loss expenses and insurance operating expenses than in premiums earned. The $135 million reduction in losses and loss expenses was primarily due to lower catastrophe losses and decreases associated with reduced exposures. Catastrophe losses for this segment declined $84 million to $31 million in 1990. Commission expenses decreased $77 million, due to a decline in business written, a $14 million reduction in profit-sharing commissions and a $29 million increase in servicing carrier income, which is recorded as a reduction of commission expenses.

The Specialized Commercial segment's premiums earned decreased $11 million from 1989, due to the company's decision to decrease writings in certain specialty lines, for which it believes prices are currently inadequate, while increasing writings in other lines. Consequently, premiums earned increased $36 million in fidelity and surety insurance and $32 million in workers' compensation business in selected markets, but declined in marine and other specialized commercial lines by $52 million and $23 million, respectively. The segment's underwriting loss increased $19 million from 1989, primarily due to an additional $33 million of reserves for losses from the 1988 Piper Alpha oil rig disaster. The total reserves established for this event are deemed sufficient by management to cover all remaining losses from Piper Alpha. The increase in this segment's underwriting loss was limited by improved results in medical malpractice and excess casualty business, due to lower losses ($23 million), and in business assumed through participation in domestic pools ($18 million), primarily due to lower 1990 catastrophe losses. There were no significant catastrophe losses for this segment in 1990, compared with $11 million in 1989.

The International & Reinsurance segment's premiums earned decreased $173 million from 1989, due to (1) strategic withdrawal from certain reinsurance markets ($87 million); (2) the sale in January 1990 of the company's German reinsurance operation ($59 million); and (3) strategic withdrawal from certain international markets ($13 million). The segment's underwriting loss increased $13 million from 1989, primarily due to a $19 million charge for settlement of a 1982 reinsurance treaty and increased reinsurance losses, partially offset by an $8 million decrease in catastrophe losses from 1989.

Net investment income for Insurance Operations was $740 million, up $5 million from 1989. The increase was primarily due to (1) a slightly higher average level of invested assets; and (2) portfolio shifts from tax-exempt and short-term securities into higher-yielding investment grade taxable intermediate-term securities, primarily mortgage-backed securities issued by U.S. Agencies and Canadian Government issues. These actions improved net investment income by approximately $16 million and $11 million, respectively. The increase in net investment income was limited by (1) lower available yields in investment grade short-term issues ($9 million); (2) lower equity earnings from minority affiliates due to the 1989 sale of a substantial interest in a minority affiliate ($7 million); and (3) lower dividends from common stock investments as a result of portfolio reallocations ($7 million).

Realized capital gains for Insurance Operations were $130 million, down from $197 million in 1989. During 1990, capital gains resulting from strategic reallocations of the common stock portfolio were $177 million, compared with $105 million in 1989. Realized capital losses of $9 million were generated from transactions in the fixed maturities trading portfolio, primarily to modify the maturity of the portfolio in response to changing interest rates. Because the fixed maturities trading portfolio was first identified in December 1989, that portfolio did not have separately reportable realized capital gains or losses in 1989. In 1990, realized capital losses of $40 million were generated from sales in the fixed maturities investment portfolio, compared with realized capital gains of $93 million in 1989. These sales were executed to reallocate certain fixed maturities investments in response to (1) the company's continued underwriting losses, which made conditions favorable for reallocation of tax-exempt securities into higher-yielding taxable securities; and (2) an unforeseen increase in interest rates during the first six months of 1990.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NON-INSURANCE OPERATIONS Pretax income (loss) is set forth below:

(millions)	*Year Ended December 31* 1990	1989
Premium Financing	$ 23	$ 20
Corporate & Other	$ (101)	$ (100)
Gains on Sales of Subsidiaries	$ 22	$ 13

Premium Financing's pretax income increased $3 million from 1989. The increase was due to increases in the volume of, and the financial margin for, premiums financed. The average interest rate at which the segment borrowed funds decreased from 9.1% to 8.3% in 1990, while the average rate the segment charged for financing premiums decreased from 13.6% to 13.2%.

Corporate & Other's pretax loss increased $1 million to $101 million in 1990, primarily due to a $9 million increase in realized capital losses on certain equity investments and a $7 million increase in interest on corporate borrowings, substantially offset by lower corporate operating expenses and improved results from the other non-insurance operations.

Gains on sales of subsidiaries increased $9 million from 1989, primarily due to the 1990 sales of the company's German reinsurance subsidiary, Deutsche Continental Rückversicherungs, A.G. ($16 million gain), and the business assets and liabilities of its subsidiary Puerto Rican-American Insurance Company ($6 million gain). The $13 million gain for 1989 primarily reflected the sale of 58% of the company's investment in MBIA, Inc. The balance of this investment was sold in 1990, and the resulting gain was included in realized capital gains.

INCOME TAXES The income tax expense for 1990 was $29 million, compared with an income tax expense of $32 million for 1989. In 1990 and 1989, federal income tax benefits attributable to underwriting and Corporate & Other losses were limited to the federal income tax expense provided for taxable investment income, realized capital gains and Premium Financing income, since the company has fully utilized its previously accrued deferred tax liability. Foreign tax expenses for 1990 and 1989 were $20 million and $24 million, respectively, and the federal Alternative Minimum Tax expense for both 1990 and 1989 was $4 million. During 1990 and 1989, the company incurred other taxes (primarily state taxes) of $5 million and $4 million, respectively. The 1990 and 1989 income tax expenses did not reflect "fresh start" benefits. For financial statement reporting purposes, $442 million in unused net operating loss carryforwards, including "fresh start" deductions, is available for reducing the domestic tax on future reported earnings. (See also Note 8 of Notes to Consolidated Financial Statements.)

RESULTS OF OPERATIONS—1989 COMPARED WITH 1988

SUMMARY Net income for 1989 was $153 million, compared with $1 million for 1988, which included $122 million of losses from the company's discontinued life insurance operations. In 1989, investment results (net investment income and realized capital gains) improved $307 million from 1988, but this improvement was substantially offset by a larger underwriting loss.

Insurance Operations had income before income taxes of $252 million for 1989, up from $185 million for 1988. The underwriting loss for 1989 of $680 million was $242 million worse than 1988. This was primarily due to (1) a $121 million increase in catastrophe losses, including $80 million from Hurricane Hugo, $19 million from the California earthquake and $17 million from winter storms and (2) a $111 million decrease in premiums earned, due to the company's strategic withdrawal from certain markets, as well as its decision not to write severely underpriced risks and intense price competition in certain commercial and personal insurance markets. The 1988 underwriting loss included $76 million of reserve strengthening. The larger underwriting loss was more than offset by a $309 million increase in investment results, comprised of a $118 million increase in net investment income and a $191 million increase in realized capital gains.

For 1989, the company's other segments, combined with gains on sales of subsidiaries, generated a loss of $67 million, compared with a loss of $71 million for 1988. In 1989, the company recorded an income tax expense of $32 million, compared with an income tax benefit of $9 million for 1988.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INSURANCE OPERATIONS Premiums earned and underwriting results for the three insurance segments were as follows:

(millions)	For the Year Ended December 31			
	Premiums Earned		Underwriting Results	
Business Segment*	1989	1988	1989	1988
Agency & Brokerage	$3,094	$3,183	$(421)	$(192)
Specialized Commercial	1,071	976	(77)	(41)
International & Reinsurance	768	885	(182)	(205)
Total Insurance Operations	$4,933	$5,044	$(680)	$(438)

**Distinct investment portfolios are not maintained for each segment, and accordingly, meaningful allocation of net investment income and realized capital gains to each segment is not practicable.*

The Agency & Brokerage segment's premiums earned decreased modestly from 1988 despite a $112 million or 54% increase in premiums earned from Canadian operations, primarily due to the July 1989 acquisition of additional property and casualty operations in Canada. The net reduction in the segment's premiums earned was due to reduced writings and the cession of $63 million of premiums under a new reinsurance contract. The segment's 1989 premiums earned included $217 million from involuntary assigned risk business ($6 million more than in 1988).

The underwriting loss for the Agency & Brokerage segment increased $229 million from 1988, due to a decrease in premiums earned, coupled with increases in losses and loss expenses and insurance operating expenses. The increase in losses and loss expenses included an $80 million increase in catastrophe losses and a $20 million increase in underwriting losses from involuntary assigned risk business. Insurance operating expenses increased $36 million, including a $17 million increase in the cost of restructuring Agency field operations, even though commission expenses declined $27 million due to reduced writings and profit-sharing commissions.

The Specialized Commercial segment's premiums earned increased $95 million from 1988, primarily due to a $54 million increase in workers' compensation business in selected markets and a $19 million increase in fidelity and surety insurance, in keeping with the segment's growth objectives. The segment's underwriting loss increased $36 million from 1988, primarily due to increased losses and loss expenses, including $17 million in large case losses (those exceeding $1 million) from marine and aviation business and a $9 million increase in catastrophe losses. The 1988 underwriting loss included $25 million for reserve strengthening.

The International & Reinsurance segment's premiums earned decreased $117 million from 1988, due to a strategic reduction of reinsurance written. The segment's underwriting loss improved $23 million from 1988, primarily due to a $39 million decrease in losses and loss expenses on international business and reinsurance assumed, partially offset by a $31 million increase in catastrophe losses. The 1988 underwriting loss included $36 million of reserve strengthening.

Net investment income for Insurance Operations was $735 million, up $118 million from 1988. The increase was primarily due to the (1) investment of sizable cash flows from operations and the sale of a subsidiary into investment grade taxable intermediate-term securities; (2) higher available yields in investment grade short-term investments; and (3) portfolio shifts from tax-exempt bonds and common and preferred stocks to mortgage-backed securities issued by U.S. Agencies. These actions improved net investment income by approximately $85 million, $30 million and $10 million, respectively.

Realized capital gains for Insurance Operations were $197 million, up from $6 million in 1988. During 1989, capital gains realized from strategic reallocations of the common stock portfolio were $105 million, compared with $14 million in 1988. Realized capital gains of $89 million were generated from transactions in the fixed maturities portfolio, primarily to reallocate certain fixed maturities investments in response to the company's continued underwriting losses, which made conditions favorable for reallocation of tax-exempt securities into higher-yielding taxable securities.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NON-INSURANCE OPERATIONS Pretax income (loss) is set forth below:

(millions)	*Year Ended December 31* 1989	1988
Premium Financing	$ 20	$ 17
Corporate & Other	$ (100)	$ (91)
Gains on Sales of Subsidiaries	$ 13	$ 3

Premium Financing's pretax income increased $3 million from 1988. The increase was primarily due to an increase in the length of the average term for which premiums financed were outstanding and a decrease in the proportion of borrowed funds to premiums financed. The average interest rate at which the segment borrowed funds increased from 7.8% to 9.1% in 1989, while the average rate the segment charged for financing premiums increased from 12.3% to 13.6%.

Corporate & Other's pretax loss increased $9 million to $100 million in 1989, primarily due to a $17 million increase in interest on corporate borrowings, partially offset by improved results from the other non-insurance operations.

Gains on sales of subsidiaries increased $10 million from 1988, primarily due to the 1989 sale of 58% of the company's investment in MBIA, Inc. The $3 million gain in 1988 primarily reflected the sale of 40% of the company's investment in its subsidiary First Insurance Company of Hawaii, Ltd.

INCOME TAXES The income tax expense for 1989 was $32 million, compared with an income tax benefit of $9 million for 1988. The 1988 federal income tax benefit included $28 million attributable to the utilization of domestic net operating losses. No comparable benefit was recorded in 1989 because the company had no regular federal income tax expense and had fully utilized its previously accrued deferred tax liability. Accordingly, federal income tax benefits attributable to underwriting and Corporate & Other losses were limited to the federal income tax expense provided for taxable investment income, realized capital gains and Premium Financing income. Foreign tax expenses for 1989 and 1988 were $24 million and $12 million, respectively, and the federal Alternative Minimum Tax expense for both 1989 and 1988 was $4 million. During 1989 and 1988, the company incurred other taxes (primarily state taxes) of $4 million and $3 million, respectively. The 1989 income tax expense and the 1988 income tax benefit did not reflect "fresh start" benefits. (See also Note 8 of Notes to Consolidated Financial Statements.)

DISCONTINUED OPERATIONS Discontinued life insurance operations for 1988 produced an after-tax loss of $122 million. This loss was primarily due to losses of $80 million on accident and health insurance, including $65 million from business written through multiple employer trust arrangements, and $29 million from the sale of certain life insurance subsidiaries. The company completed the sale of its life insurance operations in 1989.

OTHER DEVELOPMENTS

ECONOMIC ISSUES Price levels in the property and casualty insurance markets are cyclical and materially affect the company's underwriting results. Prices in many commercial and personal lines remain inadequate relative to loss costs, and the company expects this trend to continue in the near term. The company's response has been to write less business; as a result, premiums and operating cash flow will continue to be adversely affected. It is not possible to determine when the markets will permit more adequate pricing or whether current market conditions will persist. However, because of its ongoing underwriting losses, the company will continue its efforts to increase writings in lines of business for which it believes prices are currently adequate and to reduce writings in other lines. It will also continue its efforts to raise prices. As a result, the company anticipates that it may lose additional business to competitors that offer lower prices.

When pricing is inadequate for sustained periods, insurance company insolvencies generally increase. Insurance companies remaining in business are then required to contribute to state insolvency funds to pay for the losses of the insolvent companies. In 1990, the company made payments of $9 million to such funds, a decrease of $7 million from 1989. It is likely that operating results will continue to be adversely affected by these insolvency fund assessments.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Public frustration over the high cost of automobile insurance has recently led to the passage of legislation in several states (including California, New Jersey and Pennsylvania) mandating premium rate reductions and new rate-making procedures. Generally, these laws require greater data collection and reporting, thereby increasing insurance companies' costs of doing business. They may also limit potential profit opportunities in the affected lines of insurance in those states, but the company does not expect such legislation to be sufficiently widespread, in terms of either geography or lines of business, to have a significant effect on its financial results.

On the federal level, insurer solvency and possible modification of the McCarran-Ferguson Act of 1945 are important insurance industry concerns. Several Congressional inquiries are considering the adequacy of existing state regulations related to the financial health of insurance companies. In reaction, the National Association of Insurance Commissioners has developed several proposals to intensify the existing state regulatory system, including a call for actuarial certification of reserves and independent audits of insurer financial statements. Legislation to eliminate or limit the McCarran-Ferguson Act's exemption of the insurance business from federal anti-trust laws is also being considered by Congress.

The company favors stronger solvency standards, but recognizes that more regulation, at either the state or the federal level, will increase the cost of doing business. The company believes that some cooperative activity among insurers is essential for a sound industry and is in the public interest, but that limitation or elimination of the McCarran-Ferguson anti-trust exemption would have no significant effect upon the company's financial results.

INFLATION Inflation generally increases the cost of financial losses covered by insurance contracts. However, the effects of inflation vary by line of business. Since the overall rate of inflation has declined considerably in recent years, such effects have been less significant than in previous years, except in medical care costs. The much higher medical care inflation rate significantly affects loss costs in lines of insurance involving bodily injury, such as automobile, workers' compensation and medical malpractice. These lines comprised 40% of the company's premiums written in 1990. The methods used by the company to estimate individual case reserves and reserves for claims incurred but not yet reported implicitly consider the effect of inflation in the projection of ultimate costs.

Inflation is also an important consideration in the management of the company's investment portfolio, since changes in interest rates, which reflect expectations of changes in the rate of inflation, and changes in market prices of fixed maturities investments are inversely correlated. Consequently, the company manages its investments to mitigate the negative effects of rising inflation. The fixed maturities portfolio had an average maturity of 7.8 years at December 31, 1990 (8.1 years at December 31, 1989).

RECESSION The United States is currently experiencing an economic recession. This recession may adversely affect the company's future profitability, although the magnitude of the effect will depend on the recession's length and severity. Management believes that a mild recession of short duration will not significantly affect revenues or net income. However, a prolonged recession could have a significant effect on revenue growth and reported losses, the latter of which tend to increase during recessions; this effect may be mitigated by lower inflationary pressures on loss costs.

OTHER EVENTS Due to the instability in the Persian Gulf region, the company has evaluated its insurance risk in that region and determined that such risk is not significant. In addition to the insurance risk in the Persian Gulf, there is also a potential for loss due to ancillary terrorist actions associated with this instability. The impact of such actions cannot be estimated or quantified. The company does not have any significant physical or invested assets in the Persian Gulf region.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NEW ACCOUNTING PRONOUNCEMENTS The Financial Accounting Standards Board issued a financial accounting standard (FAS) that will change the way the company accounts for income taxes. FAS 96, "Accounting for Income Taxes," is required to be implemented for fiscal years beginning after December 15, 1991. The company has not yet determined the effect of the adoption of this FAS on its financial results.

An additional FAS has been issued regarding the accounting for postretirement costs, such as health care, life insurance and other nonpension benefits expected to be provided to currently active employees and retirees. FAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which will be effective for calendar year 1993 financial statements, will require the company to project the expected future cost of benefits and record the discounted liability for such costs. This FAS will permit a 20-year transition period to record such liability, although the company would be permitted to immediately recognize the cost in the year of transition. The company's current health care and life insurance benefits are based on an employee's years of service and age at retirement and are not directly related to the actual cost of such health care benefits. The company has not yet decided on how it will record the transition liability; currently the company anticipates that it will be required to record a discounted liability for postretirement benefits that will approximate $210 million.

FINANCIAL RESOURCES AND LIQUIDITY

CASH FLOW ANALYSIS The Consolidated Statements of Cash Flows on page 30 set forth the cash and cash equivalents provided from or used for operating, investment and financing activities during 1990 and the prior two years.

Operating activities for 1990 provided $80 million of cash and cash equivalents, whereas operating activities for 1989 provided cash and cash equivalents of $551 million. The principal causes for the decrease in 1990 were (1) a $342 million increase in losses and loss expenses paid; (2) a $121 million decrease in premium collections, net of commissions paid; and (3) a $95 million increase in reinsurance recoverables. These increased cash uses were partially offset by a $45 million net cash increase from the sales of subsidiaries and a $32 million increase in net investment income received, primarily due to a slightly higher level of average invested assets and portfolio shifts described below.

Investment activities for 1990 provided $47 million of cash and cash equivalents, whereas investment activities for 1989 used $616 million of cash and cash equivalents. Increases in investments are reported as uses of cash and cash equivalents, and proceeds from sales and maturities of investments are reported as provisions of cash and cash equivalents. The company's continued underwriting losses made conditions favorable for reallocation of certain fixed income securities; as a result, the company shifted more of its portfolio into taxable securities. Consequently, during 1990, proceeds from sales of tax-exempt bonds and maturities of short-term investments were primarily invested in U.S. Treasury obligations, mortgage-backed securities (primarily those issued by U.S. Agencies) and other direct issues of U.S. Agencies. Investments in U.S. Treasury obligations, other direct issues of U.S. Agencies and mortgage-backed securities increased approximately $320 million, $162 million and $135 million, respectively, while investments in tax-exempt bonds and short-term investments declined approximately $539 million and $247 million, respectively. To maximize its after-tax investment return and modify the maturity of its fixed maturities portfolio, the company trades a portion of the portfolio, including certain international securities and U.S. Treasury obligations (but excluding securities held on statutory deposit). This trading portfolio is reported at market value in the balance sheet. (See also Investments in Note 1 of Notes to Consolidated Financial Statements.)

At December 31, 1990, the cost basis of the company's common stock portfolio increased by $81 million from December 31, 1989, primarily as a result of strategic reallocations. These reallocations generated realized capital gains of $167 million. The market value of the common stock portfolio at December 31, 1990, declined $202 million from December 31, 1989. The unrealized appreciation in the nonredeemable preferred stock portfolio declined $10 million, while the unrealized appreciation in the fixed maturities trading portfolio increased $7 million. As a result of all the above activity, unrealized appreciation of investments declined $286 million before income tax benefits, and investments valued at balance sheet amounts declined $367 million at December 31, 1990, as compared with December 31, 1989. Investment income growth is therefore expected to be lower in 1991 than in 1990; this trend will probably continue in the near future, unless operating conditions or interest rates change substantially.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Financing activities for 1990 used $153 million of cash and cash equivalents, whereas financing activities for 1989 provided cash and cash equivalents of $31 million. Increases in borrowings are reported as provisions of cash and cash equivalents. Short-term debt decreased $11 million, compared with a $213 million increase in 1989, a $224 million use of cash in 1990. The $11 million decrease in 1990 was comprised of a $42 million increase in short-term borrowings by the Premium Financing segment (which was used to fund the increased volume of premiums financed) offset by a reduction of $45 million in corporate borrowings and a reduction of $8 million in borrowings of other subsidiaries. Long-term debt increased $6 million, primarily due to an increase in Premium Financing segment borrowings. Dividends paid to common and preferred shareholders totaled $145 million for 1990, compared with $146 million for 1989.

As a result of the operating, investment and financing activities described above, cash and cash equivalents at December 31, 1990, decreased $26 million from December 31, 1989.

FINANCIAL RESOURCES: INVESTMENTS At year-end, cash and cash equivalents, short-term investments, securities in the fixed maturities trading portfolio and securities in the fixed maturities investment portfolio maturing within one year amounted to $2.9 billion, and securities in the fixed maturities investment portfolio and preferred stock portfolio, excluding those maturing within one year, had a market value of approximately $5.7 billion. The fixed maturities investment portfolio consists primarily of investment grade bonds and redeemable preferred stocks, and has an average Standard & Poor's rating of AA+ (or its Moody's equivalent). The fixed maturities trading portfolio consists primarily of U.S. Government issues and international issues, and has an average Standard & Poor's rating of AAA (or its Moody's equivalent). At December 31, 1990, the market value of the consolidated fixed maturities portfolio was $37 million greater than its balance sheet carrying value. The mortgage-backed securities included in the company's fixed maturities investment portfolio had a carrying value of $1,080 million at December 31, 1990 ($945 million at December 31, 1989) and a market value of $1,099 million at December 31, 1990 ($952 million at December 31, 1989). These mortgage-backed securities are primarily investment grade securities with an average Standard & Poor's rating of AAA (or its Moody's equivalent) and have an average maturity of 7.8 years. The company also had a $157 million investment, at carrying value, in privately placed direct mortgages, which are included in the balance sheet caption "Other Long-Term Investments." At December 31, 1990, the company had an insignificant amount of fixed maturities investments that are considered to be permanently impaired; such investments have been recorded in the accompanying balance sheets at their net realizable value. The company also maintains a consolidated common stock portfolio, the market value of which was $710 million at December 31, 1990.

The company's book value per common share, with investment securities valued at balance sheet amounts, was $37.83 at December 31, 1990. With securities valued at market prices, the book value per common share was $38.29. The comparable amounts for year-end 1989 were $42.24 and $43.22, respectively.

FINANCIAL RESOURCES: REINSURANCE RECOVERABLE The company reviews the creditworthiness of its reinsurers and the adequacy of its reserves for uncollectible reinsurance. It has taken and is continuing to take steps to settle existing reinsurance arrangements with troubled reinsurers. To minimize potential problems, the company's policy is to purchase reinsurance from carriers who meet the company's credit quality standards. During 1990, the company incurred $9 million in charges for uncollectible reinsurance, as compared with $8 million in 1989, bringing total charges for uncollectible reinsurance in the last five years to $93 million. At December 31, 1990, reinsurance recoverable on paid losses amounted to $455 million. The company's reserves for outstanding losses and loss expenses are recorded net of $1.8 billion of losses ceded to unaffiliated reinsurers. At December 31, 1990, the company had an insignificant amount of reinsurance recoverable from insolvent reinsurers, and such reinsurance recoverable has been reserved for in the accompanying balance sheets. In addition, the company has an insignificant amount of reinsurance recoverable, net of deposits and letters of credit, from reinsurers who do not meet the company's current credit quality standards.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL RESOURCES: SALE OF PREMIUMS RECEIVABLE Due to the sale of premiums receivable balances due within the next twelve months, the balance sheet caption "Premiums Receivable" at December 31, 1990, is lower by $459 million than it otherwise would have been. This sale accelerated the cash flow from premiums receivable, increasing operating cash flow in the year of sale and reducing it during the following year when such receivables would otherwise have been collected. Cash received from the sale is net of financing costs. The sale increased net cash provided by operations by $444 million in 1990, whereas the sale in 1989 decreased net cash provided by operations by $436 million in 1990. The 1990 receivables sale will decrease operating cash flow in 1991. These receivables are sold on a nonrecourse basis by the company. In the event of nonpayment, the company's credit risk is limited to the amount that the purchaser of the receivables holds as a deposit ($13 million at December 31, 1990).

LIQUIDITY To ensure its ability to meet its cash obligations, including claims payments, operating expenses, interest on corporate debt and shareholder dividends, the company holds cash reserves, short-term money market instruments and bonds with maturities of less than one year.

The parent company borrows short-term funds through lines of credit, and at December 31, 1990, approximately $323 million remained available. Other lines of credit, which amounted to $582 million at December 31, 1990, are available, virtually all for use by the Premium Financing segment. The amount of lines of credit and related borrowings under such lines will change from time to time, but it is not expected to increase substantially during 1991.

STATUTORY SURPLUS AND DIVIDEND RESTRICTIONS The surplus of the insurance subsidiaries must be sufficient to support ongoing insurance operations and meet specific requirements of state regulatory authorities. The company believes it has sufficient surplus to support its ongoing insurance operations and meet such requirements for the forseeable future.

Statutory and regulatory restrictions, applicable generally to each insurance company in its state of domicile, limit the amounts of dividends, loans and advances that the subsidiaries may pay to the company. (See Note 10 of Notes to Consolidated Financial Statements.)

During 1990, certain insurance subsidiaries paid $200 million in dividends to the company. The amount of future dividends from these subsidiaries may be limited by business, as well as legal, considerations. The company anticipates that such dividends, when combined with tax payments from its subsidiaries and current operating cash flow, will enable it to meet its cash obligations for interest, expenses, dividends and taxes in 1991.

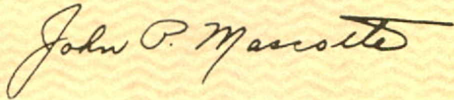
REPORT ON FINANCIAL STATEMENTS

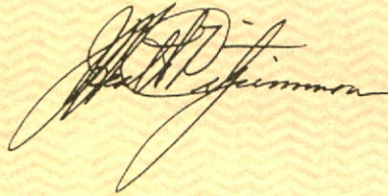
The accompanying financial statements were prepared by the company, which is responsible for their integrity and objectivity. The statements have been prepared in conformity with generally accepted accounting principles, appropriate in the circumstances, and necessarily include some amounts that are based on the company's best estimates and judgments. The financial information contained elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

The company maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that the financial records are reliable for use in preparing financial statements and maintaining accountability of assets. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control must not exceed the related benefits. The system is continuously reviewed through an extensive program undertaken by a team of internal auditors.

The company's financial statements have been examined by KPMG Peat Marwick, independent auditors, whose examinations were made in accordance with generally accepted auditing standards and included a review of internal accounting controls to the extent necessary to opine on the fairness of the consolidated financial statements.

The Audit Committee of the Board of Directors, comprised solely of directors from outside the company, meets regularly with financial management, the independent auditors and the internal auditors to review the work and procedures of each. The independent auditors and the internal auditors have free access to the Audit Committee, without management being present, to discuss the results of their work and their opinions on the adequacy of the company's internal accounting controls and the quality of the company's financial reporting. The Board of Directors, upon the recommendation of the Audit Committee, appoints the independent auditors, subject to shareholder approval.





John P. Mascotte
Chairman of the Board
and Chief Executive Officer

J. Heath Fitzsimmons
Senior Vice President
and Chief Financial Officer

February 13, 1991

CONSOLIDATED INCOME STATEMENTS

Year Ended December 31 (millions, except share and per share amounts)	1990	1989	1988
REVENUES:			
Premiums	$ 4,587.7	$ 4,932.6	$ 5,044.1
Net Investment Income	764.5	766.0	652.5
Realized Capital Gains (Losses)	106.5	193.4	(0.2)
Other Revenues	224.7	206.0	201.9
Gains on Sales of Subsidiaries	21.8	13.5	2.8
Total Revenues	5,705.2	6,111.5	5,901.1
EXPENSES:			
Losses and Loss Expenses	3,685.9	3,931.2	3,846.5
Insurance Operating Expenses	1,545.7	1,681.4	1,635.6
Other Expenses	250.0	267.6	276.1
Interest on Corporate Borrowings	53.5	46.1	29.1
Total Expenses	5,535.1	5,926.3	5,787.3
Income before Income Taxes	170.1	185.2	113.8
Income Taxes (Benefits):			
Current	23.7	29.0	26.5
Deferred	5.3	3.1	(35.2)
Total Income Taxes (Benefits)	29.0	32.1	(8.7)
Income from Continuing Operations	141.1	153.1	122.5
Loss from Discontinued Operations	—	—	(121.6)
Net Income	$ 141.1	$ 153.1	$ 0.9
Net Income (Loss) Available to Common Shareholders	$ 137.3	$ 147.9	$ (5.2)
PER COMMON SHARE:			
Income from Continuing Operations	$ 2.53	$ 2.74	$ 2.06
Loss from Discontinued Operations	—	—	(2.15)
Net Income (Loss)	$ 2.53	$ 2.74	$ (0.09)
Weighted Average Shares of Common Stock Outstanding	54,181,481	54,036,994	56,342,112

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

December 31 (millions, except par values and share amounts)	1990	1989
ASSETS:		
Fixed Maturities Investment Portfolio at Amortized Cost (Markèt $5,817.7; 1989—$5,886.7)	$ 5,780.4	$ 5,812.1
Fixed Maturities Trading Portfolio at Market (Amortized Cost $1,369.1; 1989—$1,024.5)	1,376.4	1,024.5
Equity Securities at Market (Cost $865.6; 1989—$989.1)	933.3	1,349.9
Other Long-Term Investments	340.5	363.7
Other Short-Term Investments	891.6	1,139.0
Total Investments	9,322.2	9,689.2
Cash and Cash Equivalents	270.3	296.2
Premiums Receivable	1,147.9	1,172.2
Loans and Accounts Receivable	930.9	881.8
Accrued Interest and Dividends	164.7	183.6
Reinsurance Recoverable	454.5	359.6
Deferred Policy Acquisition Costs	439.7	452.7
Property and Equipment, Net	517.5	557.1
Other Assets	679.3	666.6
Total Assets	$ 13,927.0	$ 14,259.0
LIABILITIES:		
Outstanding Losses and Loss Expenses	$ 7,194.8	$ 7,140.8
Unearned Premiums	1,898.5	1,972.3
Short-Term Debt	959.3	970.3
Long-Term Debt	796.3	790.1
Accounts Payable and Accrued Expenses	167.1	145.8
Deferred Income Taxes	33.9	70.2
Other Liabilities	795.7	853.9
Total Liabilities	11,845.6	11,943.4
Redeemable Preferred Stocks at Redemption Value	20.5	28.5
SHAREHOLDERS' EQUITY:		
Preferred Stock—$4 Par Value	0.3	0.3
Common Stock—$1 Par Value	65.7	65.7
Authorized Shares: 100,000,000		
Issued Shares: 65,699,233; 1989—65,685,609		
Outstanding Shares: 54,387,687; 1989—54,062,373		
Paid-in Capital	616.1	615.4
Retained Earnings	1,757.8	1,761.6
Unrealized Appreciation of Investments	49.6	293.8
Cumulative Foreign Currency Translation Adjustment	(31.4)	(44.8)
Common Stock in Treasury at Cost (11,311,546 shares; 1989—11,623,236 shares)	(397.2)	(404.9)
Total Shareholders' Equity	2,060.9	2,287.1
Total Liabilities, Redeemable Preferred Stocks and Shareholders' Equity	$ 13,927.0	$ 14,259.0

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 (millions)	1990	1989	1988
CASH FLOWS FROM OPERATING ACTIVITIES:			
Income from Continuing Operations	$ 141.1	$ 153.1	$ 122.5
Loss from Discontinued Operations	—	—	(121.6)
Net Income	141.1	153.1	0.9
Adjustments to Reconcile Net Income to Net Cash Provided from Operating Activities:			
Realized Capital (Gains) Losses	(106.5)	(193.4)	0.2
Outstanding Losses and Loss Expenses	155.4	617.5	881.9
Unearned Premiums	(55.1)	(21.5)	48.5
Premiums Receivable	21.0	(55.0)	62.1
Reinsurance Recoverable	(94.9)	(111.0)	(6.6)
Discontinued Operations	—	122.7	303.4
Depreciation and Amortization	50.9	48.8	49.6
Other—Net	(31.7)	(10.3)	(3.4)
Net Cash Provided from Operating Activities	80.2	550.9	1,336.6
CASH FLOWS FROM INVESTMENT ACTIVITIES:			
Purchase of Property and Equipment	(16.8)	(45.1)	(160.2)
Cost of Investments Purchased	(8,508.2)	(9,472.9)	(11,224.9)
Proceeds from Investments Sold	7,978.8	8,489.0	10,283.9
Proceeds from Investments Matured	344.8	352.3	274.9
Increase in Net Receivable on Sale of Securities	(21.8)	(18.4)	(22.8)
Net (Increase) Decrease in Other Long-Term Investments	23.2	77.6	(167.4)
Net (Increase) Decrease in Other Short-Term Investments	247.1	1.2	(192.0)
Net Cash Provided from (Used in) Investment Activities	47.1	(616.3)	(1,208.5)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Sale (Purchase) of Treasury Shares	8.4	5.0	(259.6)
Redemption of Redeemable Preferred Stock	(8.0)	(8.0)	(24.0)
Dividends to Shareholders	(144.9)	(145.6)	(152.9)
Increase (Decrease) in Short-Term Debt	(11.0)	213.1	103.4
Increase (Decrease) in Long-Term Debt	2.3	(33.9)	251.5
Net Cash Provided from (Used in) Financing Activities	(153.2)	30.6	(81.6)
Net Increase (Decrease) in Cash and Cash Equivalents	(25.9)	(34.8)	46.5
Cash and Cash Equivalents at Beginning of Year	296.2	331.0	284.5
Cash and Cash Equivalents at End of Year	$ 270.3	$ 296.2	$ 331.0
Supplemental Cash Flow Information:			
Federal, Foreign and State Taxes Paid	$ 13.9	$ 18.8	$ 21.5
Interest Paid	$ 173.9	$ 160.6	$ 114.1

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(millions)	*Preferred Stock*	*Common Stock*	*Paid-in Capital*	*Retained Earnings*	*Unrealized Appreciation of Investments*	*Cumulative Foreign Currency Translation Adjustment*	*Common Stock in Treasury*	*Consolidated Total*
YEAR ENDED DECEMBER 31, 1988								
Balance at Beginning of Year	$ 0.4	$65.6	$613.0	$1,905.7	$166.3	$(45.0)	$(147.9)	$2,558.1
Net Income				0.9				0.9
Increase in Unrealized Appreciation of Investments					73.7			73.7
Increase from Foreign Currency Translation Adjustment						8.0		8.0
Dividends:								
Preferred				(6.1)				(6.1)
Common				(146.4)				(146.4)
Conversion of Preferred Shares into Common Shares	(0.1)	0.1						—
Treasury Stock Purchased, Net of Sales			1.3				(260.9)	(259.6)
Balance at End of Year	$ 0.3	$65.7	$614.3	$1,754.1	$240.0	$(37.0)	$(408.8)	$2,228.6
YEAR ENDED DECEMBER 31, 1989								
Balance at Beginning of Year	$ 0.3	$65.7	$614.3	$1,754.1	$240.0	$(37.0)	$(408.8)	$2,228.6
Net Income				153.1				153.1
Increase in Unrealized Appreciation of Investments					53.8			53.8
Decrease from Foreign Currency Translation Adjustment						(7.8)		(7.8)
Dividends:								
Preferred				(5.2)				(5.2)
Common				(140.4)				(140.4)
Treasury Stock Sold			1.1				3.9	5.0
Balance at End of Year	$ 0.3	$65.7	$615.4	$1,761.6	$293.8	$(44.8)	$(404.9)	$2,287.1
YEAR ENDED DECEMBER 31, 1990								
Balance at Beginning of Year	**$ 0.3**	**$65.7**	**$615.4**	**$1,761.6**	**$293.8**	**$(44.8)**	**$(404.9)**	**$2,287.1**
Net Income				**141.1**				**141.1**
Decrease in Unrealized Appreciation of Investments					**(244.2)**			**(244.2)**
Increase from Foreign Currency Translation Adjustment						**13.4**		**13.4**
Dividends:								
Preferred				**(3.8)**				**(3.8)**
Common				**(141.1)**				**(141.1)**
Treasury Stock Sold			**0.7**				**7.7**	**8.4**
Balance at End of Year	**$ 0.3**	**$65.7**	**$616.1**	**$1,757.8**	**$ 49.6**	**$(31.4)**	**$(397.2)**	**$2,060.9**

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements are presented in accordance with generally accepted accounting principles and include the accounts of The Continental Corporation and its majority-owned subsidiaries (collectively, "company"). Certain reclassifications have been made to the 1989 and 1988 financial information to conform to the 1990 presentation. Equity interests in minority affiliates are classified as investments, and income recognized from the investment in these minority affiliates is classified as investment income.

Investments: The fixed maturities investment portfolio consists of certain bonds and redeemable preferred stocks that are reported at amortized cost. Investments are classified in the fixed maturities investment portfolio when management believes that such investments will be held for the foreseeable future. The fixed maturities trading portfolio consists of certain debt instruments, including certain international securities and U.S. Treasury obligations (except those securities held on deposit in accordance with insurance regulations). Investments are classified in the fixed maturities trading portfolio when management intends to trade such investments in the short term, primarily to adjust the average maturity of the overall investment portfolio. Securities in the fixed maturities trading portfolio are reported at quoted market values. Equity securities, consisting of common stocks and nonredeemable preferred stocks, are reported at quoted market values. Other investments are comprised of money market instruments, mortgages receivable and certificates of deposit, which are reported at amortized cost; notes receivable and time deposits, which are reported at cost; venture capital investments, which are reported at lower of cost or market; investments in minority affiliates, which are reported under the equity method of accounting; and federal funds sold and securities purchased under resale agreements. These other investments are classified as short term if their maturity date is within one year of the balance sheet date. All investment transactions are recorded on the settlement date.

Realized capital gains and losses on the sales of investments are included as a component of revenues, based upon the specific identification method. Provision for impairments of investments that are considered other than temporary is included in realized capital losses. Unrealized gains and losses on investments reported at market value, net of related deferred taxes, are reflected in shareholders' equity.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand and certain money market funds and other debt issues that have an original maturity of ninety days or less and that are designated as necessary for use by operations.

Insurance: Premiums are reflected as revenues on a pro rata basis over the terms of the policies and include estimates for audit and retrospectively rated policies.

In December 1990, the company sold $458.7 million in premiums receivable balances due within the next twelve months ($434.8 million were sold in December 1989). These sales accelerated the cash flow associated with the premiums receivable, increasing cash in the year of the sale and reducing it during the following year, when such receivables would otherwise have been collected. These receivables are sold on a nonrecourse basis by the company. In the event of nonpayment, the company's credit risk is limited to the amount that the purchaser of the receivables holds as a deposit ($13.5 million in 1990 and $12.4 million in 1989).

The liability for outstanding losses and loss expenses is necessarily based upon estimates for all reported and unreported claims incurred. The amount reported is shown net of reinsurance ceded and has been reduced by an allowance for salvage and subrogation. Workers' compensation pension reserves are discounted to present value using an assumed market yield of 7%. This rate is higher than the discount assumption used for statutory accounting purposes, and the use of this discount rate instead of the statutory discount rate increased income before income taxes by $4.0 million in 1990 ($4.5 million in 1989; no impact in 1988).

Deferred Policy Acquisition Costs: Variable costs that are directly related to the production of business, such as commissions and premium taxes, are deferred and amortized over the period in which the related premiums are earned. Deferred policy acquisition costs are limited to their net realizable value after consideration of investment income on the related premiums.

Policy acquisition costs deferred during the year amounted to $1,487.2 million (1989—$1,608.4 million; 1988—$1,613.4 million). Deferred policy acquisition costs amortized to income during the year amounted to $1,488.8 million (1989—$1,618.8 million; 1988—$1,595.1 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Property and Equipment: Property and equipment are reported at depreciated cost using the straight-line method over the estimated useful lives of the assets. Included in property and equipment is accumulated depreciation of $158.0 million and $125.2 million at December 31, 1990 and 1989, respectively. Depreciation expense charged to operations amounted to $47.3 million for the year ended December 31, 1990 (1989—$46.9 million; 1988—$47.9 million).

Income Taxes: The company provides for federal income taxes currently payable and for deferred income taxes resulting from differences in the timing of reporting of expenses and revenues between financial statements and tax returns. Foreign subsidiaries are taxed under applicable foreign regulations. In addition, the company provides for deferred taxes on the net unrealized appreciation of investments that are reported at a market value.

Premium Financing: Income from installment premium financing is reported in other revenues and is recognized on the accrual basis, using the effective-yield method. Interest expense of this activity is included in other expenses.

Earnings per Common Share: Earnings per common share are computed using net income less preferred dividends declared (1990—$3.8 million; 1989—$5.2 million; 1988—$6.1 million) divided by the weighted average number of common shares and common share equivalents outstanding. Shares issuable under the company's Long-Term Incentive Plan are considered as common share equivalents in computing earnings per share. There is no significant difference between earnings per share on a primary or fully diluted basis.

New Accounting Pronouncements: The Financial Accounting Standards Board issued a Financial Accounting Standard (FAS) that will change the way the company accounts for income taxes. FAS 96, "Accounting for Income Taxes," is required to be implemented for fiscal years beginning after December 15, 1991. The company has not decided whether it will implement FAS 96 for its 1991 or 1992 financial statements, and has not yet determined the effect of the adoption of this FAS on its financial results.

An additional FAS has been issued regarding the accounting for postretirement costs, such as health care, life insurance and other nonpension benefits expected to be provided to currently active employees and retirees. FAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which will be effective for calendar year 1993 financial statements, will require the company to project the expected future cost of benefits and record the discounted liability for such costs. This FAS will permit a 20-year transition period to record such liability, although the company would be permitted to immediately recognize the cost in the year of transition. The company's current health care and life insurance benefits are based on an employee's years of service and age at retirement and are not directly related to the actual cost of such health care benefits. The company has not yet decided how it will record the transition liability; currently, the company estimates its unfunded, discounted liability for postretirement benefits to approximate $210 million.

NOTE 2 ACQUISITIONS AND DISPOSITIONS

Effective in 1990, the company sold the business assets and liabilities of its subsidiary Puerto Rican-American Insurance Company. The net sale proceeds of $15.1 million resulted in a pretax gain of $6.3 million ($2.1 million after-tax). The company also sold its German reinsurance subsidiary, Deutsche Continental Rückversicherungs, A.G. The sale proceeds of $55.1 million resulted in a pretax gain of $15.5 million ($10.2 million after-tax).

In 1989, the company purchased the majority of the surety operations of Transamerica Insurance Company for $2.0 million. The company also purchased two Canadian property and casualty insurers for approximately $48.5 million in cash, and the business of those two companies was consolidated with the company's existing Canadian operations. The effect on 1989 revenues and net income from these acquisitions was immaterial.

In 1989, the company sold 58% of its holdings in MBIA, Inc., and recognized a pretax gain of $13.5 million ($8.9 million after-tax).

In 1988, the company purchased the surety operations of The Travelers Corporation for $4.1 million. The company also acquired the remaining 32% of the equity in its Hong Kong-based property and casualty insurance operations for approximately $15.0 million in cash. The effect on 1988 revenues and net income from these acquisitions was immaterial.

In 1988, the company sold 40% of its shares in its wholly owned subsidiary First Insurance Company of Hawaii, Ltd. The company realized a pretax gain of $2.8 million ($1.2 million after-tax) on this transaction.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 DISCONTINUED OPERATIONS

In September 1987, the company announced its intention to divest itself of its life insurance operations. The accompanying consolidated financial statements reflect these operations as discontinued operations. Revenues of life insurance operations, including realized capital gains and losses, were $735.4 million for 1988. The net loss from discontinued operations, after tax expense of $14.7 million, was $121.6 million in 1988. The company completed the divestiture of these operations in 1989.

NOTE 4 INVESTMENTS

FIXED MATURITIES INVESTMENT PORTFOLIO

The amortized cost and estimated market values of the fixed maturities investment portfolio at December 31, 1990 and 1989, are as follows:

	1990			
(millions)	*Amortized Cost*	*Gross Unrealized Appreciation*	*Gross Unrealized Depreciation*	*Market Value*
U.S. Treasury Securities	$ 103.5	$ 2.2	$ 0.3	$ 105.4
U.S. Agency Securities	356.4	4.3	6.8	353.9
Tax-Exempt Securities	941.2	55.6	16.9	979.9
Canadian Government, Provincial and Municipal Securities	572.5	3.8	8.8	567.5
Other International Securities	1,307.2	14.7	11.2	1,310.7
Corporate Securities	1,237.8	11.8	26.5	1,223.1
Mortgage-Backed Securities	1,079.9	21.0	2.3	1,098.6
Redeemable Preferred Stocks	181.9	0.8	4.1	178.6
	$ 5,780.4	$ 114.2	$ 76.9	$ 5,817.7

	1989			
	Amortized Cost	*Gross Unrealized Appreciation*	*Gross Unrealized Depreciation*	*Market Value*
U.S. Treasury Securities	$ 74.0	$ 9.8	$ 7.9	$ 75.9
U.S. Agency Securities	194.3	0.6	1.8	193.1
Tax-Exempt Securities	1,480.2	68.7	19.3	1,529.6
Canadian Government, Provincial and Municipal Securities	427.7	1.2	1.2	427.7
Other International Securities	1,426.7	20.9	9.5	1,438.1
Corporate Securities	1,197.0	39.0	33.0	1,203.0
Mortgage-Backed Securities	945.3	9.7	2.6	952.4
Redeemable Preferred Stocks	66.9	0.6	0.6	66.9
	$ 5,812.1	$ 150.5	$ 75.9	$ 5,886.7

The amortized cost and estimated market value of the fixed maturities investment portfolio at December 31, 1990, by contractual maturity date are shown in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are segregated in the maturity schedule because the underlying mortgages amortize principal on a monthly basis.

(millions)	*Amortized Cost*	*Market Value*
Due in One Year or Less	$ 342.6	$ 341.7
Due after One Year through Five Years	1,603.6	1,604.2
Due after Five Years through Ten Years	1,397.7	1,394.9
Due after Ten Years	1,356.6	1,378.3
Mortgage-Backed Securities	1,079.9	1,098.6
	$ 5,780.4	$ 5,817.7

Proceeds from sales of investments from the fixed maturities investment portfolio during 1990 were $4,508.9 million. Gross gains of $25.8 million and gross losses of $65.1 million were realized on those sales.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FIXED MATURITIES TRADING PORTFOLIO AND EQUITY SECURITIES

The amortized cost and estimated market values of the fixed maturities trading portfolio and the equity securities portfolio at December 31, 1990 and 1989, are as follows:

1990 (millions)	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Net Unrealized Appreciation (Depreciation)	Market Value
Fixed Maturities Trading Portfolio:					
U.S. Treasury Securities	$ 1,314.5	$ 15.0	$ 7.6	$ 7.4	$ 1,321.9
Other International Securities	54.6	—	0.1	(0.1)	54.5
	1,369.1	15.0	7.7	7.3	1,376.4
Equity Securities Portfolio:					
Common Stocks	645.7	170.9	106.6	64.3	710.0
Nonredeemable Preferred Stocks	219.9	12.2	8.8	3.4	223.3
	$ 865.6	$ 183.1	$ 115.4	67.7	$ 933.3
Net Unrealized Appreciation (Depreciation)				75.0	
Deferred Taxes				25.4	
Unrealized Appreciation of Investments				$ 49.6	

1989	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Net Unrealized Appreciation (Depreciation)	Market Value
Fixed Maturities Trading Portfolio—U.S. Treasury Securities	$ 1,024.5	$ —	$ —	$ —	$ 1,024.5
Equity Securities Portfolio:					
Common Stocks	564.6	394.4	46.7	347.7	912.3
Nonredeemable Preferred Stocks	424.5	18.9	5.8	13.1	437.6
	$ 989.1	$ 413.3	$ 52.5	360.8	$ 1,349.9
Net Unrealized Appreciation (Depreciation)				360.8	
Deferred Taxes				67.0	
Unrealized Appreciation of Investments				$ 293.8	

From time to time, the company enters into foreign currency exchange contracts, which require delivery of foreign currency in exchange for United States dollars. These exchange contracts are generally negotiated in order to protect the value of some of the company's foreign currency-denominated investments and to enhance income. The company's aggregate exposure at December 31, 1990, in the event of nonperformance by the other party to these transactions, is $121.4 million.

NOTE 5 NET INVESTMENT INCOME AND REALIZED CAPITAL GAINS (LOSSES)

Net investment income by source is as follows:

(millions)	1990	1989	1988
Fixed Maturities Investment Portfolio:			
Bonds	$498.6	$570.4	$466.8
Redeemable Preferred Stocks	10.5	5.9	4.6
Fixed Maturities Trading Portfolio*	110.5	—	—
Equity Securities:			
Common Stocks	30.9	36.7	34.6
Nonredeemable Preferred Stocks	29.2	40.2	36.5
Minority Affiliates†	10.5	19.4	20.7
Other Long-Term Investments	21.3	22.9	19.9
Other Short-Term Investments	106.3	131.9	106.6
Investment Income	817.8	827.4	689.7
Less: Applicable Expenses	(53.3)	(61.4)	(37.2)
Net Investment Income	$764.5	$766.0	$652.5

** The fixed maturities trading portfolio was designated in December 1989; consequently, there are no comparative net investment income or realized capital gains (losses) for 1989 and 1988.*

† Earnings in minority affiliates are shown net of taxes accrued by such affiliates. Dividends paid by minority affiliates aggregated $0.9 million in 1990 (1989—none; 1988—$0.6 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Set forth below are summaries of realized capital gains (losses) before income taxes (benefits) for the year ended December 31:

(millions)	1990	1989	1988
Fixed Maturities Investment Portfolio	$ (39.3)	$ 88.2	$ (2.7)
Fixed Maturities Trading Portfolio*	(8.6)	—	—
Equity Securities	167.2	107.6	3.5
Other	(12.8)	(2.4)	(1.0)
Realized Capital Gains (Losses)	106.5	193.4	(0.2)
Income Taxes (Benefits)	36.9	67.2	(0.6)
Realized Capital Gains after Income Taxes	$ 69.6	$126.2	$ 0.4

**The fixed maturities trading portfolio was designated in December 1989; consequently, there are no comparative net investment income or realized capital gains (losses) for 1989 and 1988.*

NOTE 6 REINSURANCE

Reinsurance enables an insurance or reinsurance company, by assuming or ceding reinsurance, to diversify its risk and limit its financial exposure to risk and catastrophic events. However, reinsurance does not relieve the primary insurer from its obligation to the insured. In the ordinary course of business, the company's insurance subsidiaries assume business from other insurance organizations. The insurance subsidiaries also reinsure certain risks with other insurance organizations.

The following is a summary of premiums from continuing operations. Reinsurance assumed for 1990 includes $515.4 million in premiums assumed by subsidiaries whose primary business is not reinsurance (1989—$459.5 million; 1988—$410.0 million).

(millions)	1990	1989	1988
Direct Business	$4,857.1	$5,085.5	$5,037.7
Reinsurance Assumed	785.1	796.6	936.4
Reinsurance Ceded	1,054.5	949.5	930.0
Premiums	$4,587.7	$4,932.6	$5,044.1

Outstanding losses and loss expenses and unearned premiums are stated net of reinsurance ceded. The approximate amounts deducted for reinsurance ceded are as follows:

(millions)	1990	1989
Outstanding Losses and Loss Expenses	$1,796.7	$1,634.4
Unearned Premiums	$ 304.6	$ 317.2

A critical element of reinsurance is the financial stability of the assuming reinsurer. The company conducts a systematic review of the financial condition of its reinsurers and reevaluates its position with these companies with respect to both existing and future reinsurance. During 1990, the company charged $8.6 million to earnings for uncollectible reinsurance ($8.0 million in 1989; $34.9 million in 1988).

The company has a number of reinsurance treaties to protect against catastrophic losses. Premiums paid for all such treaties in 1990 amounted to $68.7 million (1989—$67.1 million; 1988—$50.2 million). Amounts recoverable at December 31, 1990, under such treaties for paid losses and loss expenses were $131.1 million (1989—$125.2 million; 1988—$22.5 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 DEBT

Short and long-term debt consisted of the following at December 31:

(millions)	1990	1989
SHORT-TERM		
Commercial Paper	$ 635.5	$ 593.1
Notes Payable	321.0	342.3
Current Portion of Long-Term Debt	2.8	34.9
Total Short-Term Debt	$ 959.3	$ 970.3
LONG-TERM		
Secured Debt:		
Mortgage Notes Payable, 11.0%, Final Installment Due 6/2013	$ 354.4	$ 351.4
Capitalized Leases, Rates Ranging from 10.5% to 13.7%, Due through 12/2011	66.5	67.7
Obligations of the Premium Financing Segment, Due through 9/1997	61.5	61.5
Total Secured Debt	482.4	480.6
Unsecured Debt:		
9.375% Notes Due 1993	300.0	300.0
Other	13.9	9.5
Total Unsecured Debt	313.9	309.5
Total Long-Term Debt	$ 796.3	$ 790.1

Borrowings of the Premium Financing segment included in short and long-term debt aggregated $707.5 million and $61.5 million, respectively, at December 31, 1990 (1989—$665.5 million and $61.5 million, respectively). Short-term commercial paper borrowings of the Premium Financing segment are secured by bank lines of credit, with an average interest rate of 8.3%, which are due through January 31, 1991.

Short-term notes payable represent unsecured borrowings of the company, with an average interest rate of 10.9%, which are due through March 4, 1991.

Mortgage notes are payable in monthly installments of $3.1 million through June 1998, $4.4 million from July 1998 to June 2004 and $5.2 million from July 2004 until June 2013, at which time the mortgages will be completely amortized. The effective interest rate for the mortgage notes is 11.0%. The mortgages are secured by buildings and land with a carrying value of $318.8 million at December 31, 1990.

Obligations pursuant to capital leases are payable in installments through the year 2011 at imputed interest rates ranging from 10.5% to 13.7%, and are secured by assets (primarily occupied buildings) with a carrying value of $67.6 million at December 31, 1990 (1989—$71.4 million). The payment schedule is as follows:

(millions)	*Obligations*
1991	$ 9.2
1992	9.2
1993	9.0
1994	8.8
1995	8.8
Thereafter	140.9
Total Payments	185.9
Less: Amount Representing Interest	118.4
Obligations under Capital Leases, Included in Current Portion of Long-Term Debt	1.0
Obligations under Capital Leases	$ 66.5

The 9.375% notes were sold in July 1988, with net proceeds from the sale used to repay short-term bank debt incurred in repurchasing shares of the company's common stock. These notes mature on July 1, 1993.

Maturities of long-term debt for each of the next five years are as follows: 1991—$2.8 million; 1992—$19.5 million; 1993—$323.2 million; 1994—$7.4 million; 1995—$4.0 million.

As of December 31, 1990, the parent company had approximately $323.1 million in available lines of credit to fund short-term borrowings. These lines of credit require no compensation.

In addition, the Premium Financing segment has lines of credit, which are secured by accounts receivable, to support their commercial paper borrowings. Available lines of credit to support additional commercial paper issuance were $581.5 million at December 31, 1990. The terms and amounts of these lines are negotiated annually, and consideration is either compensating balances or annual fees.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 INCOME TAXES

The company files consolidated federal income tax returns with its eligible subsidiaries. Under the tax reform act of 1986 ("Act"), deductibility of unearned premium and loss reserves and exclusions of income that were tax-exempt under prior law have been limited. The adjustment associated with the initial recomputation (discounting) of reserves as of January 1, 1987, will not be taxed. This adjustment ("fresh start") can reduce the financial statement tax expense and is reported as an income tax benefit when utilized. Under the Act, the company must pay the higher of the 34% regular tax on taxable income or an Alternative Minimum Tax (AMT) which, in the event it is applicable, creates a credit which can be carried forward indefinitely.

The company files foreign tax returns in those jurisdictions where it is required. Its foreign income tax expense was $20.0 million in 1990 (1989—$24.1 million; 1988—$12.3 million).

Since the Act, the company has been, for both tax return and financial statement purposes, in an AMT position. Its current federal income tax was $4.5 million in 1990 (1989—$3.5 million; 1988—$3.5 million). For tax return purposes, net operating loss carryforwards available for use in future years amounted to $135.0 million for regular tax and $78.0 million for AMT; such carryforwards expire at various stages through 2004. The company also has foreign tax credit and general business credit carryforwards of $38.6 million available. For financial statement purposes, the 1990 net operating loss carryforwards amounted to $442.0 million for regular tax and $173.0 million for AMT. For financial statement purposes, the company's tax credit carryforwards are $30.6 million; these credits expire at various stages through 1995.

The Omnibus Budget Reconciliation Act of 1990, starting in 1990, requires an accrual for discounted estimates of salvage. The 1990 Act further provides a "fresh start" for 87% of the January 1, 1990, discounted salvage accrual, which will be reported as an income tax benefit when it results in a reduction of financial statement income tax expense.

(millions, except percentages)	1990 Amount	1990 % of Pretax Income	1989 Amount	1989 % of Pretax Income	1988 Amount	1988 % of Pretax Income
Income from Continuing Operations before Income Taxes	$ 170.1		$ 185.2		$ 113.8	
Statutory Federal Corporate Tax	57.8	34%	63.1	34%	38.7	34%
Increases (Deductions) in Taxes Resulting from:						
Tax-Exempt Interest	(25.0)	(15)	(33.0)	(18)	(48.0)	(42)
Dividends Received Deduction	(12.7)	(7)	(19.0)	(10)	(16.0)	(14)
Disposal of Subsidiaries	(39.5)	(23)	12.0	7	—	—
Book Losses Not Usable	1.4	1	—	—	9.0	8
Foreign Income at Higher Rates	41.6	24	6.0	3	3.0	2
Other Items—Net	5.4	3	3.0	1	4.6	4
Total Income Taxes (Benefits)	$ 29.0	17%	$ 32.1	17%	$ (8.7)	(8)%

The sources of timing differences and the related provision for deferred income taxes (benefits) are as follows:

(millions)	1990	1989	1988
Deferred Acquisition Costs	$ (0.8)	$ (3.2)	$ 5.0
Doubtful Reinsurance Recoverable	(3.0)	5.0	3.0
Accruals for Audit and Retrospectively Rated Premiums	4.0	26.1	12.0
Loss Reserve Discounting for Tax Return	(21.3)	(65.4)	(67.0)
Acceleration of Earned Premium for Tax Return	(15.3)	(12.8)	(26.0)
Book Losses Not Usable	15.6	—	9.0
Utilization of Tax NOL Carryforwards	41.2	54.0	41.0
Foreign Income	5.3	—	—
Reversal of Discount on Bonds Sold	(1.8)	(10.0)	(4.0)
Capital Losses	(20.0)	5.0	(3.0)
Salvage and Subrogation	(1.1)	—	—
Other	2.5	4.4	(5.2)
Total Deferred Tax Expense (Benefit)	$ 5.3	$ 3.1	$ (35.2)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The provision for income taxes from continuing operations in different geographical areas is summarized below:

	*United States**			*Foreign*			*Consolidated*		
(millions)	1990	1989	1988	1990	1989	1988	1990	1989	1988
Income before Income Taxes (Benefits)	$324.2	$133.1	$ 83.2	$(154.1)	$ 52.1	$ 30.6	$170.1	$185.2	$113.8
Current Tax Expense*	$ 9.0	$ 8.0	$ 7.0	$ 14.7	$ 21.0	$ 19.5	$ 23.7	$ 29.0	$ 26.5
Deferred Tax Expense (Benefit)	–	–	(28.0)	5.3	3.1	(7.2)	5.3	3.1	(35.2)
Total Tax Expense (Benefit)	$ 9.0	$ 8.0	$ (21.0)	$ 20.0	$ 24.1	$ 12.3	$ 29.0	$ 32.1	$ (8.7)

**Includes state income and franchise taxes of noninsurance subsidiaries.*

NOTE 9 COMMON, PREFERRED AND REDEEMABLE PREFERRED STOCK

The company has authorized a total of 100 million shares of $1 par value common stock. At December 31, 1990, 54,387,687 shares were outstanding. These common shares paid dividends of $2.60 per share in each of the years in the three-year period ended December 31, 1990, and aggregate annual dividends paid on common shares were $141.1 million in 1990 ($140.4 million in 1989; $146.4 million in 1988).

The company has issued four series of preferred stock: Series A, B, C and D. Series A (2,750,000 shares authorized and issued) and Series B (1,094,096 shares authorized and issued) are $4 par value $2.50 cumulative, convertible preferred stock. These preferred shares are convertible into common shares at the rate of 2.2 shares of common stock for each share of preferred stock. In the event of liquidation or redemption by the company, the holders of these preferred shares are entitled to receive $50 per share plus accrued dividends. The aggregate liquidation value of Series A and B preferred shares outstanding at December 31, 1990, amounted to $3.2 million. These preferred shares paid dividends of $2.50 per share in each of the years in the three-year period ended December 31, 1990. Aggregate annual dividends paid on these preferred shares were $0.2 million in 1990, 1989 and 1988, respectively.

The Series C (20,500 shares authorized and issued) is $4 par value redeemable, cumulative, convertible preferred stock. Due to the redemption feature of this issue, it is not classified as Shareholders' Equity in the accompanying consolidated balance sheets. These preferred shares are callable on or after September 30, 1992, and redeemable on or after March 31, 1990, for $1,000 per share plus accrued dividends. These preferred shares are convertible into common shares at the price of $45.435 per common share. Accordingly, 451,194 shares of common stock are reserved for conversion of the Series C preferred stock. These preferred shares paid dividends of $150 per share in each of the years in the three-year period ended December 31, 1990. Aggregate annual dividends paid on these preferred shares were $3.1 million in 1990, 1989 and 1988, respectively.

The Series D (40,000 shares authorized and issued) is $4 par value redeemable, cumulative preferred stock. Due to the redemption feature of this issue, it is not classified as Shareholders' Equity in the accompanying consolidated balance sheets. These preferred shares paid dividends of $70 per share during 1990 ($140 per share in 1989; $132.50 per share in 1988). Aggregate annual dividends paid on these preferred shares were $0.5 million in 1990 ($1.9 million in 1989; $2.8 million in 1988). During 1990, the remaining shares of the Series D preferred stock were redeemed (at a redemption price of $1,000 per share).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of common and preferred share activity is set forth below:

	Common Stock		*Outstanding Preferred Stock, Series*			
	Issued	*In Treasury*	*A*	*B*	*C*	*D*
Balance at December 31, 1987	65,620,923	4,973,715	51,177	49,232	20,500	40,000
Conversion of Shares	48,162		(8,963)	(12,992)		
Treasury Stock Purchased, Net of Sales		6,806,509				
Redemption of Shares						(24,000)
Balance at December 31, 1988	65,669,085	11,780,224	42,214	36,240	20,500	16,000
Conversion of Shares	16,524		(3,780)	(3,752)		
Treasury Stock Sold		(156,988)				
Redemption of Shares						(8,000)
Balance at December 31, 1989	65,685,609	11,623,236	38,434	32,488	20,500	8,000
Conversion of Shares	13,624		(2,685)	(3,521)		
Treasury Stock Sold		(311,690)				
Redemption of Shares						(8,000)
Balance at December 31, 1990	65,699,233	11,311,546	35,749	28,967	20,500	0

NOTE 10 DIVIDEND RESTRICTIONS

The company's insurance subsidiaries are subject to various state statutory and regulatory restrictions, applicable generally to each insurance company in its state of domicile, which limit the amounts of dividends, loans and advances that those subsidiaries may pay to the company. The restrictions are generally based on certain levels of surplus, investment income and operating income, as determined under statutory insurance accounting practices. Some restrictions require that dividends, loans or advances in excess of specified levels be approved by state regulatory authorities. Based upon the foregoing restrictions, the maximum amount available for payment of dividends to the company by its insurance subsidiaries in 1991 without prior approval of regulatory authorities is estimated to be $278.9 million as of December 31, 1990.

The statutory surplus at December 31, 1990, for the insurance subsidiaries was $1,940.9 million (1989—$2,134.9 million; 1988—$1,894.8 million). The insurance subsidiaries' statutory net income, including realized capital gains (losses) for 1990, was $214.7 million (1989—$136.7 million; 1988—$174.0 million).

NOTE 11 FINANCIAL GUARANTEES

The company, through its former participation in the Municipal Bond Insurance Association, issued guarantees of financial obligations. During 1986, this association was reorganized as a corporation named MBIA, Inc. The company's net par value exposure on guarantees issued before the reorganization is $2.3 billion, all of which has been reinsured by MBIA, Inc. In addition, the company has issued financial guarantees of limited partners' obligations, municipal lease obligations, industrial development bonds and other obligations. The company's net par value exposure on these guarantees at December 31, 1990, was $201.1 million. The maturity dates of these obligations range between 1 and 20 years.

NOTE 12 EMPLOYEE BENEFIT PLANS

PENSION PLANS

The company has a defined benefit retirement plan that covers substantially all its United States employees. Benefits are based on an employee's years of service and average compensation for the highest paid 60 consecutive months of the last 120 months of credited service. The company's funding policy is to provide, on a systematic basis, amounts sufficient to provide expected benefits to participants as of their retirement dates. Plan assets consist principally of equity and fixed-income securities, of which $20.7 million (at market value) is invested in the common stock of the company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The company has a separate defined benefit plan covering substantially all Canadian employees. The provisions of the plan are similar to those of the United States plan. In addition, the company's other foreign subsidiaries provide retirement benefits for their employees consistent with local practices.

Pension costs for the United States, Canadian and United Kingdom (1990 and 1989 only) plans include the following:

(millions, except percentages)	1990	1989	1988
Service Cost-Benefits Earned During the Period	$18.2	$16.8	$13.8
Interest Cost on Projected Benefit Obligation	42.3	38.7	34.9
Actual Return on Assets	(18.5)	(59.9)	(22.6)
Net Amortization and Deferral	(25.4)	20.3	(13.5)
Net Pension Cost	$16.6	$15.9	$12.6
Assumptions Used for U.S. Plan:			
Discount Rate for Obligations*	9%	9%	9%
Rate of Compensation Increase	7	7	7
Long-Term Rate of Return on Assets	9	9	9

**Pension costs are determined using the assumption as of the prior year.*

The financial status of the retirement plans for the United States, Canadian and United Kingdom employees at December 31 follows:

	1990		1989	
(millions)	*Underfunded*	*Overfunded*	*Underfunded*	*Overfunded*
Actuarial Present Value of:				
Vested Benefit Obligation	$ (359.8)	$ (39.7)	$ (343.4)	$ (29.8)
Accumulated Benefit Obligation	(370.3)	(40.3)	(354.3)	(30.3)
Projected Benefit Obligation (PBO)	(462.2)	(49.0)	(435.2)	(41.0)
Plan Assets at Fair Value	390.4	72.3	388.5	63.1
PBO (in Excess of) or Less Than Plan Assets	(71.8)	23.3	(46.7)	22.1
Unrecognized Net Loss	36.0	0.2	12.6	0.2
Unrecognized Prior Service Cost	10.5	–	10.2	–
Unrecognized Net Asset at Date of Initial Obligation	(30.4)	(15.2)	(34.3)	(16.1)
Prepaid Pension Asset (Pension Liability)	$ (55.7)	$ 8.3	$ (58.2)	$ 6.2

HEALTH CARE AND POSTRETIREMENT BENEFITS

Comprehensive health care and dental care benefits are provided by the company to enrolled United States employees, their families, retirees and their survivors if they elect such coverage. Benefits are funded through employer and employee contributions to a trust fund. Funding levels are set on the basis of current benefit payments and are so expensed.

Canadian and United Kingdom employees and certain retirees are covered by government-sponsored health care plans that are generally funded through company contributions. The company additionally offers to these employees extended health care coverage and dental care benefits. In Canada, the costs are shared equally between the company and the employees. In the United Kingdom, the costs are principally borne by the company.

Group term life insurance is provided by the company to full-time United States, Canadian and United Kingdom employees. For the United States plan, amounts of insurance are subject to reduction upon retirement. For the United States and Canadian plans, employer and employee contributions are used to pay premiums for such insurance. For the United Kingdom plan, the costs are borne by the company.

Employer costs for the United States, Canadian and United Kingdom health care and dental plans and group life insurance benefit plans as of December 31 follow:

	Health & Dental		*Group Life*	
(millions)	*Active*	*Retired*	*Active*	*Retired*
1988	$33.3	$5.2	$5.0	$0.7
1989	37.9	6.5	4.4	0.6
1990	38.3	8.4	3.4	0.6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The numbers of the United States, Canadian and United Kingdom employees covered by these plans as of December 31 follow:

	Health & Dental		*Group Life*	
	Active	*Retired*	*Active*	*Retired*
1988	13,300	4,600	15,400	3,500
1989	12,600	4,800	14,300	3,700
1990	12,600	5,000	14,100	3,900

LONG-TERM INCENTIVE PLAN

The company has a long-term incentive plan under which it issues stock options and grants performance awards to key employees. The company has granted both incentive stock options and nonqualified stock options under the plan. Seven million shares of common stock, the maximum number of shares that may be issued under the plan, have been reserved for issuance. No employee stock options have been granted below the market price of the company's common stock at the time of grant.

Stock options become exercisable beginning one year after the day of grant. Generally, 50% can be exercised at that time, and the remaining 50% become exercisable the following year. All options expire on the tenth anniversary of the day of grant.

Stock option activity during 1989 and 1990 was as follows:

	Options for Common Shares	*Weighted Average Exercise Price per Share*
1988		
Outstanding at Year-End	2,266,569	$37.90
1989		
Granted	942,600	31.32
Exercised	4,012	28.75
Canceled	166,675	39.49
Outstanding at Year-End	3,038,482	35.78
1990		
Granted	881,000	25.50
Exercised	170	28.75
Canceled	161,100	36.84
Outstanding at Year-End	3,758,212	33.33

Options exercisable at year-end 1990 and 1989 were 2,424,412 ($36.55 per share) and 1,672,982 ($38.98 per share), respectively.

Performance awards are payable in either cash or shares of the company's common stock in amounts determined on the basis of review, by the Compensation Committee of the Board of Directors, of the company's performance for four-year award cycles. As of December 31, 1990, there were 336,379 common shares reserved for possible payment of such awards.

NOTE 13 SEGMENT REPORTING

The company's principal business is property and casualty insurance. This business is divided into three segments: Agency & Brokerage, Specialized Commercial and International & Reinsurance.

The company's other segments are Premium Financing and Corporate & Other, the latter of which includes investment management, claims adjusting and risk management.

The three insurance segments are the primary sources of the company's foreign business, which is conducted in Canada, European Market countries, Latin America and the Pacific Basin. In addition, the Premium Financing segment is engaged in Canadian business.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

IDENTIFIABLE ASSETS BY BUSINESS SEGMENT—DECEMBER 31

(millions)	1990	1989	1988
Insurance Segments*	$12,751.1	$13,135.2	$11,984.4
Premium Financing	930.9	875.5	803.8
Corporate & Other	245.0	248.3	391.0
Total Assets from Continuing Operations	$13,927.0	$14,259.0	$13,179.2

**Distinct investment portfolios are not maintained for each segment, and accordingly, meaningful allocation of assets to each segment is not practicable.*

OPERATIONAL INFORMATION BY BUSINESS SEGMENT FOR THE YEAR ENDED DECEMBER 31

	Revenues		
(millions)	1990	1989	1988
Agency & Brokerage	$2,933.3	$3,093.5	$3,183.2
Specialized Commercial	1,059.9	1,071.5	976.1
International & Reinsurance	594.5	767.6	884.8
Total Premiums Earned	4,587.7	4,932.6	5,044.1
Net Investment Income*	740.0	735.3	616.8
Realized Capital Gains*	129.8	196.7	5.9
Insurance Segments	5,457.5	5,864.6	5,666.8
Premium Financing	126.7	118.7	103.4
Gains on Sales of Subsidiaries	21.8	13.5	2.8
Corporate & Other	99.2	114.7	128.1
Total	$5,705.2	$6,111.5	$5,901.1

	Income before Income Taxes		
(millions)	1990	1989	1988
Agency & Brokerage	$ (353.5)	$ (421.3)	$ (192.1)
Specialized Commercial	(95.6)	(76.4)	(40.6)
International & Reinsurance	(194.8)	(182.3)	(205.3)
GAAP Underwriting (Loss)	(643.9)	(680.0)	(438.0)
Net Investment Income*	740.0	735.3	616.8
Realized Capital Gains*	129.8	196.7	5.9
Insurance Segments	225.9	252.0	184.7
Premium Financing	23.1	19.8	16.6
Gains on Sales of Subsidiaries	21.8	13.5	2.8
Corporate & Other	(100.7)	(100.1)	(90.3)
Total from Continuing Operations†	$ 170.1	$ 185.2	$ 113.8

**Distinct investment portfolios are not maintained for each segment, and accordingly, meaningful allocation of net investment income and realized capital gains to each segment is not practicable.*
†Includes gains (losses) on foreign currency transactions and on certain functional currency translation adjustments: 1990—$4.2 million; 1989—$(12.6) million; 1988—$(7.4) million.

INFORMATION BY GEOGRAPHIC AREAS FROM CONTINUING OPERATIONS

	United States			*Foreign*			*Consolidated*		
(millions)	1990	1989	1988	1990	1989	1988	1990	1989	1988
Revenues	$ 4,586.2	$ 5,015.8	$ 4,838.7	$ 1,119.0	$ 1,095.7	$ 1,062.4	$ 5,705.2	$ 6,111.5	$ 5,901.1
Income (Loss) before Income Taxes	324.2	133.1	83.2	(154.1)	52.1	30.6	170.1	185.2	113.8
Assets at December 31	11,927.2	11,946.2	11,155.7	1,999.8	2,312.8	2,023.5	13,927.0	14,259.0	13,179.2

NOTE 14 OPERATING LEASE COMMITMENTS

The company leases certain office facilities and operating equipment under cancelable and noncancelable agreements. Total rental expense under these agreements amounted to $109.3 million in 1990 ($111.1 million in 1989 and $99.9 million in 1988). At December 31, 1990, the minimum aggregate rental commitment under all noncancelable leases (net of subleases) is as follows:

(millions)	
1991	$ 96.9
1992	91.0
1993	73.9
1994	58.9
1995	46.5
Thereafter	254.2
Total	$621.4

Certain of these leases provide for additional charges based on increases in property taxes or other negotiated items, and certain of these leases require the payment of property taxes directly by the lessee.

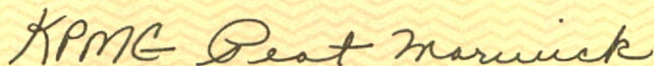
INDEPENDENT AUDITORS' REPORT

THE BOARD OF DIRECTORS AND SHAREHOLDERS
THE CONTINENTAL CORPORATION:

We have audited the accompanying consolidated balance sheets of The Continental Corporation and subsidiaries as of December 31, 1990 and 1989, and the related consolidated income statements, statements of shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 1990. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Continental Corporation and subsidiaries as of December 31, 1990 and 1989, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1990, in conformity with generally accepted accounting principles.



KPMG Peat Marwick
345 Park Avenue
New York, N.Y. 10154
February 13, 1991

SELECTED CONSOLIDATED FINANCIAL DATA OF THE CONTINENTAL CORPORATION

Year Ended December 31 (millions, except per share amounts)	1990	1989	1988	1987	1986
REVENUES:					
Premiums	$ 4,587.7	$ 4,932.6	$ 5,044.1	$ 5,040.5	$ 4,512.2
Net Investment Income	764.5	766.0	652.5	597.9	529.8
Realized Capital Gains (Losses)	106.5	193.4	(0.2)	(159.8)	321.2
Other Revenues	224.7	206.0	201.9	203.2	179.4
Gains (Losses) on Sales of Subsidiaries	21.8	13.5	2.8	(56.5)	—
Total Revenues	5,705.2	6,111.5	5,901.1	5,625.3	5,542.6
EXPENSES:					
Losses and Loss Expenses	3,685.9	3,931.2	3,846.5	3,723.5	3,431.5
Insurance Operating Expenses	1,545.7	1,681.4	1,635.6	1,531.1	1,318.9
Other Expenses	250.0	267.6	276.1	262.3	219.9
Interest on Corporate Borrowings	53.5	46.1	29.1	0.7	—
Total Expenses	5,535.1	5,926.3	5,787.3	5,517.6	4,970.3
Income before Income Taxes	170.1	185.2	113.8	107.7	572.3
Income Taxes (Benefits):					
Current	23.7	29.0	26.5	30.5	(7.6)
Deferred	5.3	3.1	(35.2)	(144.2)	155.8
Total Income Taxes (Benefits)	29.0	32.1	(8.7)	(113.7)	148.2
Income from Continuing Operations	141.1	153.1	122.5	221.4	424.1
Income (Loss) from Discontinued Operations	—	—	(121.6)	12.3	25.5
Net Income	$ 141.1	$ 153.1	$ 0.9	$ 233.7	$ 449.6
PER COMMON SHARE:					
Income from Continuing Operations	$ 2.53	$ 2.74	$ 2.06	$ 3.49	$ 6.99
Income (Loss) from Discontinued Operations	—	—	(2.15)	0.20	0.43
Net Income (Loss)	$ 2.53	$ 2.74	$ (0.09)	$ 3.69	$ 7.42
Dividends per Common Share	$ 2.60	$ 2.60	$ 2.60	$ 2.60	$ 2.60
Total Assets	$ 13,927.0	$ 14,259.0	$ 13,302.0	$ 12,309.3	$ 11,591.6
Long-Term Debt	796.3	790.1	818.4	554.4	485.2
Redeemable Preferred Stocks at Redemption Value	20.5	28.5	36.5	60.5	60.5
Shareholders' Equity	2,060.9	2,287.1	2,228.6	2,558.0	2,550.9
Book Value per Share	37.83	42.24	41.28	42.10	41.62
Book Value per Share (Securities at Market)	38.29	43.22	40.95	42.16	43.68
Market Price per Common Share at Year-End	24.88	31.13	32.38	38.75	44.75

See Notes to Consolidated Financial Statements.

COMPARATIVE FINANCIAL DATA — INSURANCE OPERATIONS

Year Ended December 31 (millions)	1990	1989	1988	1987	1986
Statutory Basis:					
Premiums Written	$ 4,522.9	$ 4,775.2	$ 5,052.2	$ 5,145.6	$ 4,652.8
Premiums Earned	$ 4,575.2	$ 4,855.9	$ 5,003.7	$ 4,981.4	$ 4,482.5
Losses	3,220.1	3,441.9	3,292.0	3,248.5	3,024.7
Loss Expenses	460.4	479.8	499.4	447.1	405.9
Commissions	672.0	757.8	825.0	821.8	728.2
Other Underwriting Expenses	815.1	850.5	788.4	723.4	612.0
	5,167.6	5,530.0	5,404.8	5,240.8	4,770.8
Statutory Underwriting Income (Loss)	(592.4)	(674.1)	(401.1)	(259.4)	(288.3)
Dividends to Policyholders	43.6	29.0	22.0	19.0	22.0
	(636.0)	(703.1)	(423.1)	(278.4)	(310.3)
(Increase) Decrease to Conform to Generally Accepted Accounting Principles Basis:					
Deferred Acquisition Costs	1.6	10.4	(18.3)	(46.7)	(47.5)
Audit and Retrospectively Rated Premiums	(12.5)	(76.7)	(40.4)	(59.1)	(27.5)
Other	18.8	43.2	73.6	41.5	2.9
	7.9	(23.1)	14.9	(64.3)	(72.1)
GAAP Underwriting Income (Loss)	(643.9)	(680.0)	(438.0)	(214.1)	(238.2)
Net Investment Income	740.0	735.3	616.8	565.0	487.0
Realized Capital Gains (Losses)	129.8	196.7	5.9	(153.2)	318.6
Income before Income Taxes*	$ 225.9	$ 252.0	$ 184.7	$ 197.7	$ 567.4
STATUTORY RATIOS:					
Loss and Loss Expense	80.4%	80.8%	75.8%	74.1%	76.5%
Underwriting Expense	32.9	33.7	31.9	30.0	28.8
Combined	113.3%	114.5%	107.7%	104.1%	105.3%
Combined after Policyholders' Dividends	114.3%	115.0%	108.1%	104.5%	105.8%
AT YEAR-END (STATUTORY BASIS):					
Bonds and Stocks	$ 8,918.7	$ 9,221.6	$ 8,649.8	$ 7,453.6	$ 6,771.2
Unearned Premiums	1,898.5	1,972.3	1,993.8	1,945.3	1,825.6
Outstanding Losses and Loss Expenses	7,367.8	7,305.7	6,654.3	5,794.4	5,258.4
Surplus	1,940.9	2,134.9	1,894.8	1,523.7	1,672.5
Premiums Written/Surplus	2.3/1	2.2/1	2.7/1	3.4/1	2.8/1

**From continuing operations.*

OPERATING DATA BY LINE — INSURANCE OPERATIONS*

Analysis and Summary of Business by Line	*Written Premiums (millions)*	*Written Premiums (% of total)*	*Earned Premiums (millions)*	*Loss and Loss Expense Ratio to Earned Premiums*	*Expense Ratio to Written Premiums*	Combined Ratio 1990	Combined Ratio 1989	Combined Ratio 1988
COMMERCIAL INSURANCE:								
Multi-Peril	$1,106.8	24.5%	$1,087.3	66.4%	39.3%	**105.7%**	103.1%	94.1%
Workers' Compensation	886.6	19.6	871.5	99.9	13.1	**113.0**	119.7	111.4
General Liability	384.6	8.5	406.5	92.1	32.1	**124.2**	126.9	128.0
Automobile	349.1	7.7	373.3	76.9	37.0	**113.9**	110.4	114.4
Inland/Ocean Marine	319.7	7.1	323.5	77.9	37.8	**115.7**	106.2	95.9
Fidelity/Surety	125.9	2.8	115.4	31.2	55.0	**86.2**	87.4	86.5
Fire & Allied Lines	114.8	2.5	117.1	82.2	46.1	**128.3**	152.4	94.2
Other	167.5	3.7	197.2	82.5	42.9	**125.4**	126.1	111.3
Total Commercial	3,455.0	76.4	3,491.8	80.2	32.4	**112.6**	114.1	105.6
PERSONAL INSURANCE:								
Automobile	529.1	11.7	535.7	77.8	33.1	**110.9**	113.3	115.9
Homeowners	235.9	5.2	237.5	57.7	40.9	**98.6**	111.6	97.0
Other	40.3	0.9	42.1	59.6	39.7	**99.3**	121.7	88.1
Total Personal	805.3	17.8	815.3	71.0	35.8	**106.8**	113.1	109.3
Reinsurance	262.6	5.8	268.1	112.0	30.9	**142.9**	121.2	119.3
TOTAL ALL LINES	$4,522.9	100.0%	$4,575.2	80.4%	32.9%	**113.3%**	114.5%	107.7%

**Statutory basis.*

SUMMARIZED CONSOLIDATED QUARTERLY FINANCIAL DATA

	First Quarter		*Second Quarter*		*Third Quarter*		*Fourth Quarter*	
(millions, except per share amounts)	1990	1989	1990	1989	1990	1989	1990	1989
REVENUES:								
Premiums	$1,148.7	$1,256.2	$1,130.4	$1,241.3	$1,172.6	$1,240.3	$1,136.0	$1,194.8
Net Investment Income	190.7	179.5	187.9	188.9	194.1	189.0	191.8	208.6
Realized Capital Gains (Losses)	26.6	6.6	(11.8)	37.4	41.9	46.8	49.8	102.6
Other Revenues	50.7	48.2	53.3	52.3	53.7	52.1	67.0	53.4
Gains on Sales of Subsidiaries	15.5	—	—	—	—	—	6.3	13.5
Total Revenues	1,432.2	1,490.5	1,359.8	1,519.9	1,462.3	1,528.2	1,450.9	1,572.9
EXPENSES:								
Losses and Loss Expenses	925.4	943.4	883.3	936.9	942.7	1,056.1	934.5	994.8
Insurance Operating Expenses	392.4	424.7	390.3	433.4	382.8	403.2	380.2	420.1
Other Expenses	61.4	60.6	65.2	67.3	62.6	74.3	60.8	65.4
Interest on Corporate Borrowings	12.9	10.6	13.6	9.0	14.3	13.8	12.7	12.7
Total Expenses	1,392.1	1,439.3	1,352.4	1,446.6	1,402.4	1,547.4	1,388.2	1,493.0
Income (Loss) before Income Taxes	40.1	51.2	7.4	73.3	59.9	(19.2)	62.7	79.9
Total Income Taxes	7.9	7.0	4.9	8.1	6.6	8.5	9.6	8.5
Net Income (Loss)	32.2	44.2	2.5	65.2	53.3	(27.7)	53.1	71.4
Net Income (Loss) Available to Common Shareholders	$ 31.1	$ 42.8	$ 1.4	$ 63.8	$ 52.5	$ (29.0)	$ 52.3	$ 70.3
Net Income (Loss) per Common Share	$ 0.58	$ 0.80	$ 0.02	$ 1.18	$ 0.97	$ (0.54)	$ 0.96	$ 1.30
DIVIDENDS PER SHARE:								
Common	$ 0.650	$ 0.650	$ 0.650	$ 0.650	$ 0.650	$ 0.650	$ 0.650	$ 0.650
Preferred Series A	0.625	0.625	0.625	0.625	0.625	0.625	0.625	0.625
Preferred Series B	0.625	0.625	0.625	0.625	0.625	0.625	0.625	0.625
Preferred Series C	37.500	37.500	37.500	37.500	37.500	37.500	37.500	37.500
Preferred Series D	35.000	35.000	35.000	35.000	—	35.000	—	35.000

SUMMARY OF INVESTMENT PORTFOLIO

CONSOLIDATED FIXED MATURITIES SCHEDULE (AT PAR VALUE)

(millions)	*U.S. Treasuries*	*Canadian Gov't*	*Other Int'l*	*U.S. Agency*	*Tax-Exempt*	*Corporate*	*Redeemable Preferred**	*Total*	*% Due in Period*
1991	$ —	$ 84.8	$ 77.7	$ 29.7	$ 23.8	$ 20.8	$ 107.0	$ 343.8	4.4%
1992	21.0	27.1	89.9	6.5	8.2	174.3	36.8	363.8	4.7
1993	20.5	67.7	172.9	27.9	12.4	127.8	—	429.2	5.6
1994	1.5	17.5	92.7	0.1	15.8	105.5	—	233.1	3.0
1995	5.9	93.4	140.4	66.6	34.8	244.9	1.9	587.9	7.6
1991–1995	48.9	290.5	573.6	130.8	95.0	673.3	145.7	1,957.8	25.3
1996–2000	50.6	208.7	605.2	86.8	133.7	348.0	33.1	1,466.1	19.0
2001–2005	—	42.7	57.5	75.2	176.8	119.0	3.0	474.2	6.1
2006–2010	—	25.6	31.5	52.4	292.7	45.5	0.1	447.8	5.8
Post-2010	18.3	9.0	56.3	172.4	285.0	84.0	—	625.0	8.1
Subtotal	117.8	576.5	1,324.1	517.6	983.2	1,269.8	181.9	4,970.9	64.3
Mortgage-Backed	—	—	—	919.2	—	208.3	—	1,127.5	14.6
Fixed Maturities Investment Portfolio	117.8	576.5	1,324.1	1,436.8	983.2	1,478.1	181.9	6,098.4	78.9
Fixed Maturities Trading Portfolio	1,575.6	3.9	33.5	—	—	20.0	—	1,633.0	21.1
Total Fixed Maturities	$ 1,693.4	$ 580.4	$ 1,357.6	$ 1,436.8	$ 983.2	$ 1,498.1	$ 181.9	$ 7,731.4	100.0%
Average Quality Rating	AAA	AAA	AA+	AAA	AA	A+	A	AA+	

**Redeemable preferred stocks are shown at amortized cost.*

(millions)	*December 31, 1990* Carrying Value	*December 31, 1990* % of Total	*December 31, 1989* Carrying Value	*December 31, 1989* % of Total
FIXED MATURITIES INVESTMENT PORTFOLIO				
U.S. Treasury Securities	$ 103.5	1.1%	$ 74.0	0.8%
U.S. Agency Securities	356.4	3.8	194.3	2.0
Tax-Exempt Securities	941.2	10.1	1,480.2	15.3
Canadian Government, Provincial and Municipal Securities	572.5	6.1	427.7	4.4
Other International Securities	1,307.2	14.0	1,426.7	14.7
Corporate and Convertible Securities	1,237.8	13.3	1,197.0	12.3
Mortgage-Backed Securities	1,079.9	11.6	945.3	9.8
Redeemable Preferred Stock	181.9	2.0	66.9	0.7
Total Fixed Maturities Investment Portfolio	5,780.4	62.0	5,812.1	60.0
FIXED MATURITIES TRADING PORTFOLIO	1,376.4	14.8	1,024.5	10.6
Total Fixed Maturities	7,156.8	76.8	6,836.6	70.6
EQUITY PORTFOLIO				
Nonredeemable Preferred Stocks	223.3	2.4	437.6	4.5
COMMON STOCKS				
Aerospace	21.0	0.2	—	—
Apparel and Textile	7.0	0.1	6.4	0.1
Banks	39.2	0.4	48.2	0.5
Chemicals	5.4	0.1	10.5	0.1
Diversified	45.5	0.5	30.0	0.3
Drugs	59.8	0.6	42.3	0.4
Electric and Electronics	7.7	0.1	6.5	0.1
Environmental Control	8.3	0.1	30.8	0.3
Financial Services	92.8	1.0	124.4	1.3
Food	80.0	0.9	4.5	0.0
Insurance	30.6	0.3	83.6	0.9
Leisure Related	21.5	0.2	19.7	0.2
Machinery	22.6	0.2	8.8	0.1
Metal and Mining	5.8	0.1	15.9	0.2
Office Equipment	54.1	0.6	43.4	0.5
Oil	57.6	0.6	50.4	0.5
Retail General	31.1	0.3	55.3	0.6
Soaps	34.8	0.4	11.4	0.1
Utilities—Electric	23.9	0.3	31.7	0.3
Utilities—Telephone	19.8	0.2	210.1	2.2
Miscellaneous	41.5	0.4	78.4	0.7
Total Common Stocks	710.0	7.6	912.3	9.4
Total Equity Portfolio	933.3	10.0	1,349.9	13.9
OTHER INVESTMENTS				
Money Market Instruments	660.9	7.1	838.9	8.6
Invested Cash	280.2	3.0	365.5	3.8
Mortgages Receivable	157.4	1.7	181.4	1.9
Venture Capital Investments	61.8	0.6	47.6	0.5
Investment in Minority Affiliates	34.2	0.4	27.6	0.3
Other Notes and Participations	37.6	0.4	41.7	0.4
Total Other Investments	1,232.1	13.2	1,502.7	15.5
TOTAL INVESTMENTS	$ 9,322.2	100.0%	$ 9,689.2	100.0%

BOARD OF DIRECTORS AND SENIOR OFFICERS

BOARD OF DIRECTORS

Ivan A. Burns
Former Executive Vice President, CPC International Inc., food processing 1983 (2,3)

Alec Flamm
Former Vice Chairman, Union Carbide Corporation, chemicals, plastics, gases, carbon, metals and consumer products 1983 (1,2,3)

Rowland C. Frazee
Former Chairman, Royal Bank of Canada 1981 (2,4)

Irvine O. Hockaday, Jr.
President and Chief Executive Officer, Hallmark Cards, Inc. 1989 (3,5)

John E. Jacob
President and Chief Executive Officer, National Urban League 1985 (1,2,6)

Henry E. Kates
President and Chief Executive Officer, The Mutual Benefit Life Insurance Company 1990 (4,6)

John P. Mascotte
Chairman and Chief Executive Officer, The Continental Corporation 1981 (1)

John F. McGillicuddy
Chairman and Chief Executive Officer, Manufacturers Hanover Corporation 1975 (4,5)

Charles A. Parker
Executive Vice President, The Continental Corporation 1989

L. Edwin Smart
Counsel to the law firm of Hughes Hubbard & Reed 1978 (1,4,5,6)

Harold W. Sonn
Former Chairman, Public Service Electric and Gas Company, investor-owned New Jersey utility 1983 (2,4)

Patricia Carry Stewart
Vice President, The Edna McConnell Clark Foundation 1976 (1,3,5)

William E. Thiele
President and Chief Operating Officer, The Continental Corporation 1988

Michael Weintraub
Private investor 1976 (3,6)

Anne Wexler
Chairman, The Wexler Group, government relations consulting firm 1990 (2,6)

George G. Zipf
Former Vice Chairman, McDermott Inc., and former President, The Babcock & Wilcox Company, energy services, industrial equipment and materials 1971 (3,5)

Board Committees
(1) Member of Executive Committee
(2) Member of Audit Committee
(3) Member of Investment Committee
(4) Member of Compensation Committee
(5) Member of Nominating Committee
(6) Member of Public Affairs Committee
(Date denotes year director was elected to board.)

SENIOR OFFICERS

John P. Mascotte
Chairman of the Board and Chief Executive Officer

William E. Thiele
President and Chief Operating Officer

Wayne H. Fisher
Executive Vice President and President, Special Operations

John H. Loynes
Executive Vice President, Office of the Chairman

Fredric G. Marziano
Executive Vice President and President, Agency and Brokerage

Charles A. Parker
Executive Vice President, Investments

Steven J. Smith
Executive Vice President, Office of the Chairman

Phillip N. Ben-Zvi
Senior Vice President, Actuarial, Planning and Analysis

Kenneth J. Burk
Senior Vice President, Systems

Robert E. Cassidy
Senior Vice President, Human Resources

J. Heath Fitzsimmons
Senior Vice President and Chief Financial Officer

William F. Gleason, Jr.
Senior Vice President, General Counsel and Secretary

John F. Kirby
Senior Vice President, Office of the President

Adrian M. Tocklin
Senior Vice President, Corporate Claims

Kenneth B. Zeigler
Senior Vice President and President, Marine and International

Arthur J. O'Connor
Vice President, Corporate Communications and Investor Relations

CORPORATE DATA

HEADQUARTERS
180 Maiden Lane, New York, N.Y. 10038
Telephone: (212) 440-3000
Telex: 426785

TREASURER
Edward J. Harvey, Vice President

FORM 10-K REPORT
The annual report on Form 10-K for the fiscal year ended December 31, 1990, is available to shareholders without charge upon written request to Investor Relations, The Continental Corporation, 180 Maiden Lane, New York, N.Y. 10038.

ANNUAL MEETING
The annual meeting of shareholders will be held Thursday, May 16, 1991, at 10:30 a.m., in the Ricker Auditorium (second floor), The Continental Corporation, 180 Maiden Lane, New York, N.Y.

HIGH AND LOW MARKET PRICE FOR COMMON STOCK OF THE CONTINENTAL CORPORATION

	1990	1989
1st Quarter	31¾-26	36-31½
2nd Quarter	31-28⅛	35⅝-32
3rd Quarter	31⅜-17⅞	38⅝-33⅝
4th Quarter	28-15¾	36⅜-30

SHAREHOLDERS
Approximate number of holders of record as of January 2, 1991:
Common Stock 18,956
Preferred Stock 1,630

TRANSFER AGENT AND REGISTRAR
Manufacturers Hanover Trust Company, 450 W. 33rd Street, New York, N.Y. 10001

STOCK EXCHANGE LISTINGS FOR COMMON STOCK
(Symbol: CIC) New York, Midwest and Pacific Exchanges

INQUIRIES
Please contact Corporate Communications/Investor Relations for more information, including:
- Proxy Statement
- Investment Supplement
- 10-Q Reports
- Quarterly Shareholder Reports
- Community Relations
- Philanthropic Grants
- Equal Employment Policy

THE CONTINENTAL CORPORATION

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