Alexander & Alexander
1988 Annual Report

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FINANCIAL HIGHLIGHTS

Alexander & Alexander Services Inc. *(in millions, except per share amounts)*	1988	1987
Operating revenues	$1,227.7	$1,183.3
Operating income	122.2	113.6
Income from continuing operations	71.0	74.9
Net income	67.5	68.4
Per share of common stock:		
Income from continuing operations	$ 1.71	$ 1.77
Net income	1.63	1.62
Cash dividends	1.00	1.00
Total assets	$2,635.2	$2,661.8
Cash provided by operations	65.4	95.2
Stockholders' equity	371.6	389.4
Book value per share	9.20	9.27
Return on equity	17.7%	19.2%
Average shares outstanding	41.4	42.3
Number of employees (thousands)	16.3	17.0

ALEXANDER & ALEXANDER SERVICES INC. is the international insurance brokerage, risk management and human resource management consulting company serving the needs of clients in over 70 countries.

More than 16,000 A&A employees plan, place and service all types of insurance and risk management programs on behalf of businesses and other organizations as well as governmental entities and individuals. We place reinsurance and provide risk analysis and self-insurance services.

Our human resource management consulting operations provide actuarial and administrative services for compensation and benefit plans as well as employee communications and management consulting services.

Worldwide operations of Alexander & Alexander Services Inc. produced record revenues in 1988 of $1.23 billion and net income of $67.5 million. Our operating income grew more than 7.5% as margins improved throughout the year.

Insurance markets, like equity markets, are subject to pricing volatility. Throughout 1988, commercial insurance premiums were declining at double-digit rates as underwriters competed fiercely for market share.

In my letter to you a year ago, I noted that soft markets bring short-term benefits to many of our clients but create long-term financial risks and possible insolvencies among underwriters. A&A management has carried this message to audiences worldwide as we address our clients' diverse risk management interests.

A&A's strategy for enhancing shareholder value is straightforward. During all phases of the insurance cycle, we focus on providing exceptional client service, improving our operating margins, and attracting the best available talent to execute our strategy. We performed well in 1988 against these objectives.

Over a year ago, we announced our commitment to concentrate on the Company's core businesses. A&A's divestiture of underwriting units was followed in 1988 by the sale of our insurance premium financing subsidiary, TIFCO Inc.

In addition, we will sell or phase out several small, nonstrategic operations during 1989. The estimated costs or expenses have been charged in 1988 and should have no impact on 1989 financial results.

Our exposure to the cyclical swings in the insurance markets is offset to some degree by the success of our global human resource management operation, the Alexander Consulting Group. Frequent tax law and legislative changes relating to employee benefits help fuel ACG's growth.

A&A's international strategy was reflected in further enhancement of our service network in key geographical regions. We have focused special attention on North America, Europe and the Pacific Rim to respond to growing business opportunities.

A&A benefited throughout the year from increased synergy among our insurance broking, risk management and human resource management consulting operations.

In all of these activities, A&A people "think global and act local." Just as our own service business has become more complex, so have the needs of our clients. We are determined that each client receives the same commitment to excellence from the A&A team anywhere in the world. As shareholders, we recognize superior client service is the key to outperforming the competition and improving shareholder value.

Client retention and new business production during 1988 were solid. We continued to emphasize cost containment and expense controls. As a result, we expect improvement in our operating margins when the insurance market stabilizes.

At last year's Annual Meeting, shareholders voted to change the composition of the board of directors from 17 to 10 and to create a majority of non-management or "outside" directors.

Two new outside directors, Dr. Robert E. Boni and Peter C. Godsoe, have joined the board. After four years of service, W. Douglas H. Gardiner retired in February 1989.

We made a number of management changes during 1988 that will serve us well in the 1990s. New responsibilities were assigned to Michael K. White and William M. Wilson, our exec-

utive vice presidents and directors.

Mr. White was named chairman of A&A Inc., our U.S. retail broking unit. In November, his duties were expanded to include Reed Stenhouse operations in Canada, Latin American retail operations, and A&A's worldwide risk management services. The Alexander Consulting Group also reports to him.

Mr. Wilson was named chairman of Alexander & Alexander Europe plc, with responsibility for worldwide reinsurance and wholesale broking as well as retail broking operations in the United Kingdom and Ireland, Europe, Asia/Middle East, Japan, Australia and New Zealand.

These moves prepare A&A to serve changing client needs flowing from the elimination of trade barriers by the European Community and other regions. To further take advantage of these opportunities, Ron W. Forrest was named to the newly created position of managing director, Global Business Development, for retail broking operations.

Last summer, the board of directors authorized the purchase of up to two million additional shares of A&A

common stock. This reflects their belief that A&A shares are undervalued based on future earnings potential.

We are also pleased to note A&A's selection for Standard & Poor's 500-stock index, additional recognition of A&A's stature in the business community.

The Company continues to have a sound balance sheet and good credit ratings. This provides flexibility and enables us to manage A&A's growth in a financially prudent manner.

The current year is our 90th. As we prepare to enter the 1990s, I look forward to reporting to you on the continuing success of our company.

Tinsley H. Irvin

T.H. IRVIN
Chairman
& Chief Executive Officer

Alexander & Alexander's worldwide resources typically support transactions between an A&A professional and a client. Our employees bring to each business relationship:

☐ The training and skills to understand the clients' business and their insurance, risk management and human resource management consulting needs.

☐ The highest level of professional counsel with an emphasis on creative solutions.

☐ An ability to anticipate clients' needs and respond from their point of view.

☐ Effective communication.

During 1988, thousands of A&A executives and support staff completed professional development programs.

The Alexander Consulting Group's Achieving Professional Excellence (APEX) program enhanced the client-service capabilities of nearly 150 consultants and brokers.

Other ACG ptograms offer specialized training to our employees. This enables them to better assist clients facing complex human resource management issues such as new discrimination rules for health and other welfare benefit plans.

Alexander & Alexander Inc. expanded its regional training system to further strengthen the professional skills of U.S. brokers, account executives and support staff.

Training seminars at Alexander Howden Limited, A&A's U.K.-based wholesale broking subsidiary, are regularly attended by London underwriters. Client service capabilities also have been strengthened among many of the Company's retail brokers by Howden's London exchange program. This gives our brokers hands-on experience in the London market.

Executives are increasingly cautious when selecting brokers and consultants. They seek out experts who fully understand their organizations as well as their risk exposures and human resource management needs.

While mastering the details of individual specialties, our professionals know where to turn when clients need additional support. A&A business units coordinate worldwide expertise and resources to match individual client needs.

The Company's emphasis on quality service also encompasses technical resources. Expanded computerization and other technical enhancements continue to speed claims and service and to minimize paperwork.

Recruitment, development and retention of skillful, committed employees are among A&A's principal objectives. Despite difficult market conditions, the Company continues to meet its long-term commitment to nurture our people and to provide them with appropriate resources for obtaining and serving clients worldwide.

"A RECORD NUMBER OF A&A PROFESSIONALS COMPLETED TRAINING PROGRAMS IN 1988. OUR FLEXIBLE, HIGHLY SKILLED EMPLOYEES PROVIDE QUALITY SERVICE TO OUR CLIENTS AROUND THE WORLD. BECAUSE OF THE TALENT BASE OF A&A PEOPLE, WE CAN MEET CLIENTS' NEEDS EVEN IN A VOLATILE INSURANCE MARKET."

MICHAEL K. WHITE
EXECUTIVE VICE PRESIDENT

A coordinated network of services extends from A&A's more than 16,000 employees in over 300 offices worldwide.

Through our account executives and other professionals, clients have access to diverse insurance and reinsurance brokerage and risk management services, including innovative alternatives to traditional coverage.

Our sophisticated human resource management services are also available through local offices worldwide.

This global network has grown steadily since we became a publicly held company in 1969. Twenty years ago, more than 95% of our business was centered in the United States. In 1988, non-U.S. operations produced about one-third of the Company's operating revenues. We expect this pattern to accelerate.

A&A's teams of professionals support local offices with specialized expertise. In North America, this is reflected in our national marketing groups. For example, the Financial Products Group is recognized for their experience with directors and officers liability, fidelity bonds, computer crime and other financial products.

They assist A&A offices in designing and marketing accounts to underwriters as well as keeping our executives up to date on industry trends and practices in the financial services field.

Our marketing groups also focus on aviation, health care, energy, utilities and construction as well as U.S.-Japanese investment business and other international activity. As resources for local offices, they provide relevant technical service for specialized needs.

The breadth of our services also enables us to perform as risk management consultants when our clients' interests are not fully covered by traditional insurance.

A&A has continued its tradition of developing alternative funding mechanisms to meet specific business and professional needs. Among the products launched in 1988 was EPIC, a risk retention group for environmental impairment insurance. We also established alternative funding mechanisms for physicians and other medical professionals.

Various legal and public policy developments keep the insurance industry in a state of turmoil.

In the United States, we track public policy developments through various research efforts that include our Government & Industry Affairs Office in Washington, D.C. GIA's annual risk management survey and related activities offer added value to clients whose financial exposures are affected by various federal laws and regulations.

Around the globe, A&A has few rivals in its ability to help businesses understand and manage their exposures to risk.

> "With our international network in place, A&A has unparalleled capabilities for serving clients from country to country. The advantages of a worldwide team approach are becoming increasingly important to our clients. In the 1990s, few companies, large or small, will escape the changes that are sweeping the global business environment."
>
> William M. Wilson
> *Executive Vice President*

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香港

For 90 years, Alexander & Alexander Services Inc. has provided creative, professional service to clients.

Since our founding in 1899, the company launched by Charles and William Alexander has grown from a small West Virginia insurance firm into one of the world's leading insurance brokerage, risk management and human resource management consulting organizations.

Leadership and prosperity in the future will be earned by companies that combine worldwide expertise with specific local know-how. It is what we mean when we say, "Think global, act local."

Two important free trade developments received international headlines in 1988.

The United States and Canada signed a landmark free trade agreement. Meanwhile, the European Community continues to move toward economic integration and free trade in the 1990s.

For all the talk of "EC 1992" and the Canadian-U.S. agreement, the ultimate business consequences cannot be predicted with certainty. A&A has created a flexible sales and service strategy that will position us to work effectively whatever the prevailing business conditions.

This is illustrated by the fact that, outside of their home country, our major competitors rely primarily on correspondents to represent their clients. In contrast, A&A owns controlling interest in most of our major affiliated operations.

> "A&A's mission ties directly into the interests of clients, employees and shareholders. Our mission is to solve client problems by providing innovative service through highly motivated, expert employees. By achieving this, we will offer a secure and growing financial return to shareholders and employees."
>
> T.H. Irvin
>
> *Chairman & Chief Executive Officer*

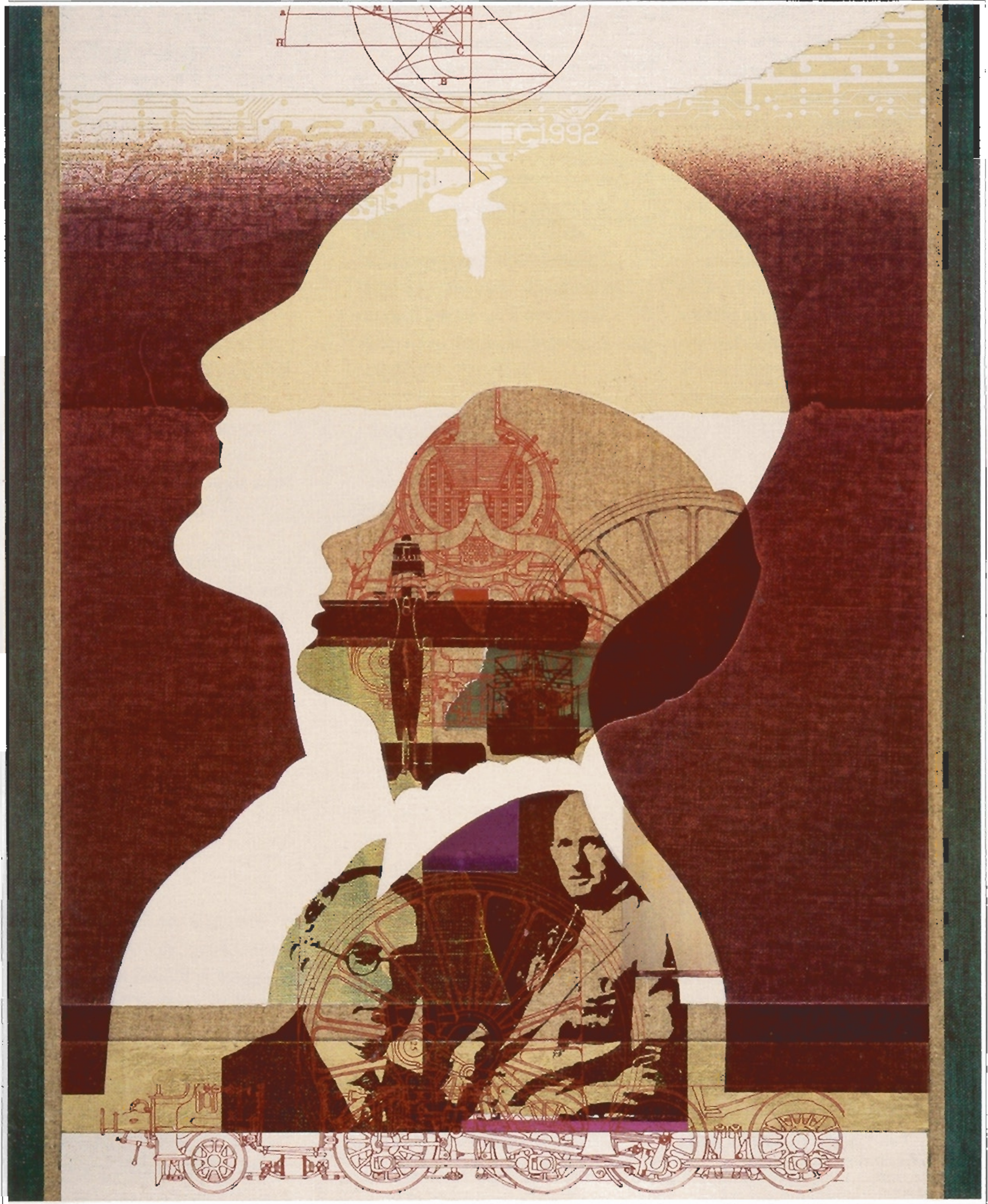
In Europe, where some companies are just beginning to prepare for 1992, we have a mature network in place. We own or control broking, risk management and human resource management consulting operations in the United Kingdom and Ireland, the Netherlands, France, Italy, Belgium, Sweden, Spain, Portugal and Switzerland. We also have substantial equity in a West German insurance broker.

These relationships enable us to provide consistent, integrated quality service. It gives our people "global passports" to cross international boundaries to develop the best insurance programs for clients.

Ownership also helps us better understand economic conditions and insurance practices. We can collect reliable local information and put it to use in the most complex, centrally controlled master program.

Flexibility is our key to growth. The 1990s will be a period of major change in traditional insurance markets. There will be difficult regulatory and legal challenges as well as a continuing expansion in client consulting needs.

In this environment, we are committed to offering professional, innovative services while providing a good financial return for our shareholders. A&A has the people and resources to achieve this in the midst of challenging global business conditions.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The clients of Alexander & Alexander depend on our diversity and depth of services in insurance brokerage, risk management and human resource management consulting. They rely on the proven capabilities and service network that support our recommendations.

In commercial centers throughout the world, we customize and deliver prompt, cost-effective services. In many countries, A&A is the foremost broker and consultant with operations that grew out of indigenous businesses.

Retail Broking

As a leading international retail broker, we arrange risk management and insurance programs for businesses and other organizations as well as governmental entities and individuals.

Internationally, client service is provided through an insurance broking network coordinated by A&A's Global Retail Board. Specialized regional marketing groups support the expertise and service available through local offices in more than 70 countries.

We have a particularly strong position in the United States, United Kingdom and Europe, Canada, Australia and New Zealand.

A&A's primary retail brokerage companies include Alexander & Alexander Inc., Reed Stenhouse and Alexander Stenhouse.

Wholesale Broking

For specialty lines and complex, hard-to-place risks, we offer an essential link between retail brokers and underwriters.

Alexander Howden Limited operates in London at the center of the wholesale insurance business. Howden experts in various disciplines handle all general lines of insurance as well as unusual coverage that requires access to Lloyd's, London companies or other markets.

Alexander Howden North America specializes in excess/surplus and specialty lines placements. AHNA places large and medium-sized commercial accounts from retail agents and brokers throughout North America.

Reinsurance Broking

Reinsurance broking has become increasingly prominent as our brokers place reinsurance on behalf of insurance and reinsurance companies worldwide.

Alexander Howden Reinsurance Brokers Limited, based in London, operates in all major reinsurance markets. It acts as a broker to insurance and reinsurance companies and Lloyd's syndicates through a network of divisions and subsidiaries.

Thomas A. Greene & Company Inc., based in New York, primarily handles property, casualty and marine treaty reinsurance of U.S. insurance companies.

Risk Management

A&A's risk management consulting services help clients analyze and control their risk exposure. When appropriate, we help companies develop alternatives to traditional insurance programs through self-insurance, captives, risk retention groups and other alternative funding vehicles.

Anistics is a leading financial and information systems consulting company. They pioneered development of loss forecasting, financial models, statistical analysis and related consulting services.

Alexsis offers risk analysis services as well as claims administration and claims information reporting.

Alexander Insurance Managers Limited manages client captive insurance companies worldwide.

Alexander Trade Services provides intermediary services in political risk/export credit risk insurance and trade finance packages.

Human Resource Management Consulting

The Alexander Consulting Group is an innovator in health care strategies and other areas of human resource management.

They offer actuarial and administrative services for compensation and benefit plans as well as employee communications.

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Selected Financial Data (a)

Alexander & Alexander Services Inc. *(in millions, except per share amounts)*	1988	1987	1986	1985	1984
Summary of operations					
Operating revenues	**$1,227.7**	$1,183.3	$1,134.6	$ 976.8	$ 859.1
Operating income	**122.2**	113.6	163.4	123.2	78.0
Income from continuing operations	**71.0**	74.9	66.6	44.7	28.3
Loss from discontinued operations	**(6.0)**	(10.0)	(24.0)	(52.0)	(77.1)
Extraordinary credits	**2.5**	3.5	0.6	—	1.6
Net income (loss)	**67.5**	68.4	43.2	(7.3)	(47.2)
Per share of common stock:					
Income from continuing operations	**$ 1.71**	$ 1.77	$ 1.62	$ 1.17	$ .78
Loss from discontinued operations	**(.14)**	(.24)	(.58)	(1.36)	(2.12)
Extraordinary credits	**.06**	.09	.01	—	.04
Net income (loss)	**$ 1.63**	$ 1.62	$ 1.05	$ (.19)	$ (1.30)
Cash dividends	**$ 1.00**	$ 1.00	$ 1.00	$ 1.00	$ 1.00
Weighted average number of shares	**41.4**	42.3	41.2	38.2	36.3
Financial position					
Current assets	**$1,918.4**	$1,962.1	$1,899.7	$1,685.0	$1,361.4
Working capital	**147.3**	99.3	86.0	87.1	52.7
Total assets	**2,635.2**	2,661.8	2,481.6	2,183.0	1,895.6
Long-term debt	**214.6**	170.2	118.2	146.3	176.5
Stockholders' equity	**371.6**	389.4	324.4	284.0	263.6

(a) In 1988, the Company has restated prior years' amounts under the provisions of Statement of Financial Accounting Standards No. 94, "Consolidation of All Majority-Owned Subsidiaries" and has made certain reclassifications to conform with the current years' presentation. These changes had no effect to previously reported consolidated net income or stockholders' equity.

General

The insurance brokerage industry's operating results are directly affected by the cyclical pattern of premium rates charged by the property and casualty insurance companies. The intensely competitive pricing environment, which began in late 1986, is expected to continue through 1989. Analysts and industry officials have indicated that premium rates declined 30% in 1987 and again at double-digit rates in 1988. Rate cutting is expected to continue throughout 1989, thus lowering commissions for the insurance brokers.

Commission revenue growth in this environment is largely a function of new business production, retention of existing business, new product development, foreign exchange rates and acquisitions. Operating income growth is dependent, for the most part, on prudent expense control.

Net income for 1988 was $67.5 million or $1.63 per share, including a $6.0 million charge for the Company's discontinued operations and an extraordinary credit of $2.5 million from the utilization of net operating loss carryforwards. This compares to net income of $68.4 million or $1.62 per share in 1987, which included a loss from discontinued operations of $10.0 million and an extraordinary credit of $3.5 million. The Company's consolidated operating revenues increased by $44.4 million to a record $1.2 billion in 1988. Income from continuing operations was $71.0 million in 1988 and included an after-tax gain of $18.2 million from the sale of TIFCO Inc. (TIFCO), the Company's premium financing subsidiary. The gain was offset, in part, by $12.1 million in provisions for costs relating to adverse development for indemnities given on the sale of Shand, Morahan & Company, Inc. (Shand) as well as estimated losses on the pending sales of two small operations. Income from continuing operations was $74.9 million in 1987 and included after-tax gains of $19.9 million on the sales of real estate and other operations. Excluding non-recurring gains and losses, income from continuing operations would have increased by approximately 25% in 1988.

The Company's consolidated financial statements have been restated for all prior years presented to reflect the provisions of Statement of Financial Standards (SFAS) No. 94, "Consolidation of all Majority-Owned Subsidiaries," and No. 95, "Statement of Cash Flows." In addition, fiduciary investment income and amortization of intangible assets have been reclassified as components of operating revenue and operating expenses, respectively. These changes had no effect on previously reported net income or stockholders' equity.

Results of Operations

Revenues

Consolidated operating revenues increased by 3.8% in 1988 and 4.3% in 1987; however, excluding the impact from higher foreign exchange rates and the net effect from acquisitions and sold operations, revenues were up by approximately 1% and 2%, respectively.

Insurance services revenues, which includes retail, wholesale, reinsurance, and risk management commissions and fees, as well as investment income on fiduciary funds, comprise approximately 87% of total revenues. Worldwide insurance services commissions and fees were up 2.5% and 3.4% in 1988 and 1987, respectively, as strong new business production, higher foreign exchange rates and acquisitions more than offset reduced revenues from sold operations. For both comparable periods, the increase in operating revenues due to higher foreign exchange rates was approximately 2.0%. Solid new business production mitigated the effect from reduced premium rates. Investment income on fiduciary funds increased by 2.8% in 1988 principally as the effect of reduced investment levels was more than offset by higher average short-term interest rates. In 1987, fiduciary investment income was flat primarily due to higher levels of funds available for investment offset by lower short-term interest rates.

Worldwide human resource management consulting revenues of the Alexander Consulting Group increased by 16.0% and 14.9% in 1988 and 1987, respectively. Significant legislative and regulatory changes, as well as new and proposed accounting standards, have resulted in increased demand for services in the areas of employee benefits, compensation and incentive programs.

Operating Expenses

Total operating expenses increased by 3.3% in 1988 compared to a 10.1% increase in 1987. After adjusting for the effects of higher foreign exchange rates, total operating expenses increased by 0.9% in 1988 and 7.0% in 1987. Beginning in early 1987, the Company initiated salary and expense controls designed to significantly reduce the rate of expense growth. As a result of the expense control program, the overall rate of growth was reduced by approximately one-third in 1987 and two-thirds in 1988.

Salaries and related benefits were up 1.5% in 1988 compared to a 10.2% increase in 1987. Effective January 1, 1988, the Company adopted SFAS No. 87 for its international pension plans, the result of which was a reduction in pension expense of approximately $12.6 million over the 1987 amount. Total staff costs reflect a 4.1% and 5.6% decline in number of employees in 1988 and 1987, respectively, primarily due to divestitures and cost control measures.

Other operating expenses increased by 6.5% in 1988 compared to a 10.0% increase in 1987. The 1988 amount includes $7.3 million of costs associated with the fourth quarter decision to phase out the mainframe computer service operations of Anistics Inc., the Company's U.S. risk management consulting unit. Occupancy and depreciation costs were up 11.9% and 19.2% in 1988 and 1987, respectively, primarily reflecting facilities and systems costs connected with strategic expansion.

The Company's insurance and self-insurance costs decreased by 3.8% in 1988 compared to a 6.9% increase in 1987. While lower premiums and increased levels of selected coverage became available in 1988, the trend over the last several years has been an increase in costs due to higher policy deductibles and reduced overall insurance coverage available in the markets. The Company continues its emphasis on quality control programs, particularly as it relates to prevention of errors and omissions claims.

Equity Earnings

As described in Note 4, the Company sold TIFCO in 1988 and Evanston Services Inc. in 1987. As these subsidiaries have been sold, their results continue to be presented in the consolidated financial statements as equity earnings through dates of sale.

Effective December 31, 1988, the Company adopted SFAS No. 94. With the sale of TIFCO and Evanston, the impact of SFAS No. 94 was not significant to the consolidated financial statements and had no effect on previously reported net income or stockholders' equity.

Other Income and Expenses

Investment income increased by $3.5 million in 1988 primarily due to higher interest rates and interest on the note receivable in connection with the sale of TIFCO. In 1987, investment income declined by $2.7 million resulting principally from lower interest rates.

Interest expense increased by $6.8 million in 1988 after a $3.3 million decline in 1987. Higher interest rates and an increase in average debt outstanding along with the interest associated with a capital lease accounted for the increase in 1988. Interest rates and average debt outstanding declined in 1987 from 1986 levels.

The pre-tax gain on the sale of TIFCO in 1988 was $26.3 million. Offsetting this gain, in part, was a provision of $10.9 million in connection with adverse development for indemnities given on the sale of Shand, Morahan & Company, Inc. and a $4.5 million provision for estimated losses on the pending divestiture of two small operations.

In 1987, the Company recorded $24.1 million of gains, before minority interest, relating to sales of real estate in the United Kingdom and France and a $7.5 million gain on the sale of a Canadian insurance broking subsidiary.

In November 1986, the Company settled its lawsuit against certain former auditors of Alexander Howden Group, plc. As a result, legal and accounting costs associated with this suit and related matters declined to $1.8 million in 1987 from $9.1 million in 1986.

Income Taxes

The Company's effective tax rates from continuing operations were 43.5% in 1988 and 1987 and 54.0% in 1986 compared to the U.S. Statutory rates of 34%, 40% and 46% for 1988, 1987, and 1986, respectively.

State and local income taxes, amortization of goodwill, certain expenses disallowed by statute and losses of certain subsidiaries for which no tax benefit can currently be recognized account for the higher effective rates. The Tax Reform Act of 1986 had the effect of lowering the U.S. tax provisions in 1988 and 1987 due to the reduced statutory rates. In 1987, the effective tax rate was favorably impacted due to the effect of capital gain rates on the sales of real estate and businesses.

In December 1987, SFAS No. 96, "Accounting for Income Taxes," was issued by the Financial Accounting Standards Board. The more significant elements of the Statement are the shift to the liability method of accounting for income taxes whereby deferred taxes are adjusted currently for tax rate changes, as well as limitations on recognition of deferred tax assets. Assuming no change to the current tax rate, the application of the provisions of the Statement is expected to have a positive impact on the Company in the year of adoption. The Company anticipates adopting SFAS No. 96 for the year ending December 31, 1990.

Discontinued Operations

The Company has completed the divestitures of the discontinued entities which were held for sale and is continuing with the runoff of the claim liabilities for the remaining Atlanta and Bermuda insurance companies.

The $6.0 million provision recorded in the fourth quarter of 1988 reflects primarily the estimated net cost of a reinsurance agreement regarding the Atlanta and Bermuda insurance companies. The agreement, which is subject to regulatory and other approvals, would provide $50.0 million of coverage against the possibility of future losses in excess of current reserves.

The additional provision in 1987 of $10.0 million related primarily to the sale of Sphere Drake as described in Note 2.

The 1986 provision resulted primarily from the requirement to strengthen underwriting reserves and increase the allowance for doubtful reinsurance recoverables in the Atlanta and Bermuda insurance companies.

The Company believes the reserve for estimated loss on disposal is sufficient to adequately provide for the estimated losses through the period of runoff or indemnification; however, there is no assurance that adverse deviation may not occur due to the variables inherent in the estimation process.

Extraordinary Credits

The extraordinary credits of $2.5 million in 1988, $3.5 million in 1987 and $0.6 million in 1986 represent the tax benefits resulting from the utilization of net operating loss carryforwards relating to the U.S. operations of Reed Stenhouse Companies Limited.

Liquidity and Capital Resources

The Company has generated sufficient cash flow from operations, supplemented by proceeds from asset dispositions and commercial paper borrowings, to finance its operating and capital expenditures as well as to pay dividends, repurchase common stock and fund the discontinued operations. Premiums held as fiduciary assets are restricted for use by state and certain foreign jurisdictions and are not available for the operating needs of the Company.

In October 1988, the Company completed the sale of TIFCO Inc. for total proceeds of $73.8 million, of which $7.0 million was received at closing. The remaining proceeds include a payment of $58.5 million, plus interest, which was received in January 1989 and was used to reduce commercial paper borrowings. The balance of $8.3 million, plus interest, is payable in three installments from 1990 through 1992. As part of the transaction, two real estate subsidiaries of TIFCO were transferred to the Company at book value. Included in the net assets of these subsidiaries was a $22.8 million direct financing lease receivable and related mortgage debt of $20.5 million.

In August 1988, the Company instituted a commercial paper program for the private placement of up to $100 million of commercial paper notes, of which $64.9 million was outstanding at December 31, 1988. The Company can use the commercial paper for general corporate purposes, including working capital needs, repurchases or redemptions of securities, acquisitions and other capital expenditures. The increase in average commercial paper in 1988 was due primarily to the repurchase of the Company's common stock and additions to property and equipment.

Effective June 30, 1988, the Company amended its long-term credit agreement with a bank. The amendment, which expires June 30, 1993, increased the Company's credit facility from $50 million to $100 million under terms which are generally more favorable to the Company. In addition, a Canadian subsidiary entered into a three-year credit agreement providing for a credit facility of up to Canadian $15.0 million. Supplementing the credit agreements, the Company has committed unsecured lines of credit of $102.9 million as support for future cash needs.

In 1988 and 1987, the board of directors authorized the purchase of up to 5.0 million shares of the Company's common stock. As of December 31, 1988, a total of 3.4 million shares had been repurchased at a cost of $74.9 million. In 1988, the State of Maryland enacted legislation requiring Maryland corporations to treat shares acquired of its own stock as authorized but unissued shares. Previously, such shares were treated as treasury stock by the Company. For 1988, the cost of the Company's treasury shares has been allocated as a reduction of common stock and paid-in capital, respectively. This allocation had no effect on total stockholders' equity.

In 1988, the Company remitted $4.3 million to its Atlanta discontinued insurance company to fund the runoff of claim liabilities. Of the total estimated premium for the reinsurance agreement discussed above, it is anticipated that approximately $10 million will be funded by the Company in the first half of 1989 and the remaining amount will be funded from the liquid assets of the Atlanta and Bermuda companies.

The Company's dividend policy is to pay dividends out of current sustainable earnings. While under Maryland law, dividends may be paid from unrestricted paid-in capital, the Company's board of directors has no present intention of doing so.

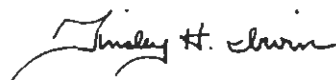
The Company anticipates that cash flow from operations, supplemented by use of short-term borrowings, will be sufficient to meet 1989's working capital needs.

Management of the Company is responsible for all the information and representations contained in the consolidated financial statements and other sections of the annual report. Management believes that the consolidated financial statements and related information have been prepared in accordance with generally accepted accounting principles appropriate in the circumstances. These financial statements necessarily include amounts that are based on management's judgment and best estimates.

The Company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that accounting records provide a reliable basis for the preparation of financial statements. The internal accounting control system is augmented by an internal auditing program, other written policies and guidelines, including the Company's policy on General Business Ethics, and careful selection and training of qualified personnel.

Deloitte Haskins + Sells has been engaged, with the approval of the Company's stockholders, as the independent auditors to audit the financial statements of the Company and to express an opinion thereon. Their opinion is based on procedures believed by them to be sufficient to provide reasonable assurance that the financial statements present fairly, in all material respects, the Company's financial position, cash flows and results of operations. Their report is set forth on Page 19.

The Audit Committee of the board of directors is composed of four directors, none of whom is an employee of the Company or any of its subsidiaries. It assists the board in exercising its fiduciary responsibilities for oversight of audit and related matters, including corporate accounting, reporting and control practices. It is responsible for recommending to the board the independent auditors to be employed for the coming year, subject to stockholder approval. The Audit Committee meets periodically with management, internal auditors and the independent auditors to review internal accounting controls, auditing and financial reporting matters. The independent auditors and the internal auditors have free access to the Audit Committee.



T. H. Irvin
Chairman of the Board
President &
Chief Executive Officer

Paul E. Rohner
Senior Vice President
& Chief Financial Officer

To The Shareholders of Alexander & Alexander Services Inc.

We have audited the accompanying consolidated balance sheets of Alexander & Alexander Services Inc. and its subsidiaries as of December 31, 1988 and 1987, and the related consolidated statements of income, cash flows and stockholders' equity for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the companies at December 31, 1988 and 1987, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1988, in conformity with generally accepted accounting principles.

As discussed under Accounting Changes and Restatements in Note 1 to the financial statements, effective January 1, 1988, the Company changed the method of accounting for its international pension plans to conform with Statement of Financial Accounting Standards (SFAS) No. 87, and in 1988 restated the financial statements for prior years to conform its basis of consolidation with SFAS No. 94.

Deloitte Haskins + Sells

DELOITTE HASKINS + SELLS
Baltimore, Maryland
March 6, 1989

Consolidated Statements of Income

Alexander & Alexander Services Inc.
For the three years ended December 31, (in millions, except per share amounts)

	1988	1987	1986
Operating revenues:			
Insurance services	**$1,063.4**	$1,037.6	$1,003.9
Human resource management consulting	**140.3**	121.0	105.3
Other	**24.0**	24.7	25.4
	1,227.7	1,183.3	1,134.6
Operating expenses:			
Salaries and benefits	**681.7**	671.7	609.5
Other	**423.8**	398.0	361.7
	1,105.5	1,069.7	971.2
Operating income	**122.2**	113.6	163.4
Equity in unconsolidated operations (Note 4)	**5.1**	11.6	17.0
Other income (expenses):			
Investment income	**11.1**	7.6	10.3
Interest expense	**(23.5)**	(16.7)	(20.0)
Other (Note 4)	**14.0**	26.2	(22.5)
	1.6	17.1	(32.2)
Income from continuing operations before income taxes and minority interest	**128.9**	142.3	148.2
Income taxes (Note 5)	**56.1**	62.0	80.1
Income from continuing operations before minority interest	**72.8**	80.3	68.1
Minority interest	**(1.8)**	(5.4)	(1.5)
Income from continuing operations	**71.0**	74.9	66.6
Loss from discontinued operations (Note 2)	**(6.0)**	(10.0)	(24.0)
Income before extraordinary credits	**65.0**	64.9	42.6
Extraordinary credits (Note 5)	**2.5**	3.5	0.6
Net income	**$ 67.5**	$ 68.4	$ 43.2
Per share of common stock (Note 1):			
Income from continuing operations	**$ 1.71**	$ 1.77	$ 1.62
Loss from discontinued operations	**(.14)**	(.24)	(.58)
Income before extraordinary credits	**1.57**	1.53	1.04
Extraordinary credits	**.06**	.09	.01
Net income	**$ 1.63**	$ 1.62	$ 1.05
Cash dividends	**$ 1.00**	$ 1.00	$ 1.00
Weighted average number of shares	**41.4**	42.3	41.2

See Notes to Financial Statements.

Consolidated Balance Sheets

Alexander & Alexander Services Inc. *As of December 31, (in millions)*	1988	1987
ASSETS		
Current assets:		
Cash and cash equivalents	$ 382.7	$ 356.9
Short-term investments	192.4	308.3
Accounts receivable (net of allowance for doubtful accounts of $24.5 in 1988 and $26.3 in 1987)		
Customer accounts	1,213.8	1,212.9
Other	129.5	84.0
Total current assets	1,918.4	1,962.1
Property and equipment—at cost:		
Land and buildings (Note 7)	36.7	35.8
Furniture and equipment	314.3	274.7
Leasehold improvements	105.3	95.3
	456.3	405.8
Less accumulated depreciation and amortization	(195.0)	(160.4)
Property and equipment—net	261.3	245.4
Other assets:		
Equity in unconsolidated operations (Note 4)	—	39.6
Long-term notes and other receivables (Notes 2 and 4)	77.9	72.1
Intangible assets (net of accumulated amortization of $87.4 in 1988 and $70.7 in 1987)	254.5	246.4
Other (Note 7)	123.1	96.2
	$2,635.2	$2,661.8
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,590.5	$1,633.1
Short-term debt (Note 6)	5.0	16.2
Accrued compensation	57.4	61.5
Other payables and accrued expenses	118.2	152.0
Total current liabilities	1,771.1	1,862.8
Long-term liabilities:		
Long-term debt (Note 7)	214.6	170.2
Deferred income taxes (Note 5)	107.5	102.7
Other (Notes 2, 10 and 13)	170.4	136.7
Total long-term liabilities	492.5	409.6
Commitments and contingent liabilities (Notes 2, 4, 11 and 12)		
Stockholders' equity (Notes 7, 8 and 9):		
Preferred stock, authorized 9.5 shares, $1 par value; issued and outstanding, none	—	—
Series A Junior Participating Preferred Stock, authorized 0.5 shares; issued and outstanding, none	—	—
Common stock, authorized 60.0 shares $1 par value; issued and outstanding 36.6 and 38.7 shares, respectively	36.6	38.7
Class A common stock, authorized 13.0 shares $.00001 par value; issued and outstanding 3.1 and 3.4 shares, respectively	—	—
Class C common stock, authorized 5.5 shares $1 par value; issued and outstanding 0.7 and 0.8 shares, respectively	0.7	0.8
Paid-in capital	284.7	334.7
Retained earnings	66.9	40.8
Accumulated translation adjustments	(17.3)	(8.1)
	371.6	406.9
Less—Treasury stock, at cost, 0.9 shares (Note 8)	—	(17.5)
Total stockholders' equity	371.6	389.4
	$2,635.2	$2,661.8

See Notes to Financial Statements.

Consolidated Statements of Cash Flows

Alexander & Alexander Services Inc.
For the three years ended December 31, (in millions)

	1988	1987	1986
Cash provided (used) by:			
Operating activities:			
Income from continuing operations	$ 71.0	$ 74.9	$ 66.6
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and amortization	62.6	51.1	43.8
Deferred income taxes	6.6	16.7	4.1
Gains on disposition of subsidiaries and other assets	(18.3)	(29.5)	(0.6)
Other	11.1	10.3	3.8
Changes in assets and liabilities, net of effects from acquisitions and dispositions:			
Accounts receivable	5.3	17.8	(119.6)
Other assets	(4.5)	(5.1)	(3.4)
Accounts payable	(34.7)	(2.4)	196.1
Other current liabilities	(52.7)	(51.8)	36.2
Other liabilities	13.4	4.5	37.5
Net cash provided by operating activities before discontinued operations and extraordinary items	59.8	86.5	264.5
Discontinued operations	3.1	5.2	(45.9)
Extraordinary items	2.5	3.5	0.6
Net cash provided by operating activities	65.4	95.2	219.2
Investing activities:			
Purchases of property and equipment	(72.2)	(101.4)	(59.6)
Purchases of businesses (net of cash acquired)	(6.7)	(16.6)	(6.9)
Proceeds from sales of subsidiaries and other assets (net of cash sold)	19.3	57.6	12.7
Purchases of investments	(1,571.4)	(1,078.7)	(861.5)
Sales/maturities of investments	1,655.5	1,149.5	781.3
Net cash provided (used) by investing activities	24.5	10.4	(134.0)
Financing activities:			
Cash dividends	(41.4)	(42.3)	(41.0)
Additions to debt	468.9	354.7	421.3
Repayments of debt	(439.4)	(327.6)	(462.0)
Repurchase of common stock	(56.1)	(18.8)	—
Issuance of common stock	0.4	0.9	3.0
Net cash used by financing activities	(67.6)	(33.1)	(78.7)
Effect of exchange rate changes on cash	3.5	21.2	5.0
Cash and cash equivalents at beginning of year	356.9	263.2	251.7
Cash and cash equivalents at end of year	$ 382.7	$ 356.9	$ 263.2
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$ 23.7	$ 18.4	$ 16.8
Income taxes (Notes 2 and 5)	46.4	66.8	18.5
Non-cash investing and financing activities:			
Capital lease	—	25.4	—
Notes received on dispositions of subsidiaries	66.8	67.1	—
Common stock issued for business acquisitions and employee benefit plans	18.4	8.3	10.7

See Notes to Financial Statements.

Consolidated Statements of Stockholders' Equity

Alexander & Alexander Services Inc. *For the three years ended December 31, (in millions)*	1988	1987	1986
Common stock:			
Balance, beginning of year	$ 38.7	$ 35.4	$ 32.5
Contributed to an employee benefit plan, none, 0.2 and 0.2 shares, respectively	—	0.2	0.2
Issued for acquisitions, 0.2, 0.7 and 1.6 shares, respectively	0.2	0.7	1.6
Conversions of Class A and Class C shares into common stock, 0.3, 2.3 and 0.9 shares, respectively	0.3	2.3	0.9
Common stock purchased and retired, 0.6 shares	(0.6)	—	—
Treasury stock retired	(2.0)	—	—
Other	—	0.1	0.2
Balance, end of year	$ 36.6	$ 38.7	$ 35.4
Class A common stock:			
Balance, beginning of year	$ 0.0	$ 0.0	$ 0.0
Conversions into common stock, 0.2, 1.6 and 0.6 shares, respectively	—	—	—
Balance, end of year	$ 0.0	$ 0.0	$ 0.0
Class C common stock:			
Balance, beginning of year	$ 0.8	$ 1.5	$ 1.8
Conversions into common stock, 0.1, 0.7 and 0.3 shares, respectively	(0.1)	(0.7)	(0.3)
Balance, end of year	$ 0.7	$ 0.8	$ 1.5
Paid-in capital:			
Balance, beginning of year	$334.7	$327.7	$308.8
Contributed to an employee benefit plan	—	4.8	6.0
Issued for acquisitions	4.6	0.6	9.1
Conversions into common stock	(0.2)	(1.6)	(0.6)
Common stock purchased and retired	(15.0)	—	—
Treasury stock retired	(41.3)	—	—
Other	1.9	3.2	4.4
Balance, end of year	$284.7	$334.7	$327.7
Retained earnings:			
Balance, beginning of year	$ 40.8	$ 14.7	$ 13.0
Net income	67.5	68.4	43.2
Dividends	(41.4)	(42.3)	(41.0)
Other	—	—	(0.5)
Balance, end of year	$ 66.9	$ 40.8	$ 14.7
Accumulated translation adjustments:			
Balance, beginning of year	$ (8.1)	$ (54.9)	$ (72.1)
Foreign currency translation adjustments	(9.2)	46.8	17.2
Balance, end of year	$ (17.3)	$ (8.1)	$ (54.9)
Treasury stock (Note 8):			
Balance, beginning of year	$ (17.5)	$ —	$ —
Purchase of 1.8 and 1.0 shares, respectively	(40.5)	(18.8)	—
Issued to an employee benefit plan, 0.1 and 0.1 shares, respectively	1.4	1.3	—
Issued for acquisitions, 0.7 shares	13.1	—	—
Other	0.2	—	—
Treasury stock retired	43.3	—	—
Balance, end of year	$ —	$ (17.5)	$ —

See Notes to Financial Statements.

1. Significant Accounting Policies

Consolidation The accompanying consolidated financial statements include the accounts of Alexander & Alexander Services Inc. and its majority-owned subsidiaries. All significant intercompany transactions and balances between consolidated subsidiaries have been eliminated.

Accounting Changes and Restatement Effective January 1, 1988, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 87, "Employers Accounting for Pensions" for its international pension plans, the result of which was a reduction of pension expense of $12.6 million for the year ended December 31, 1988. The Company adopted SFAS No. 87 for its domestic pension plans effective January 1, 1985.

Effective December 31, 1988, the Company adopted the provisions of SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries." In prior years, the Company had consolidated only its majority-owned subsidiaries which were engaged primarily in insurance services and human resource management consulting services. The effect of including these previously unconsolidated subsidiaries in the accompanying consolidated financial statements was not significant and had no effect on previously reported consolidated net income or stockholders' equity. As described in Note 4, the Company sold TIFCO Inc., its wholly-owned premium finance subsidiary, in 1988 and Evanston Services Inc., a 52%-owned insurance underwriting subsidiary, in 1987, both of which are presented on the equity basis in the accompanying consolidated financial statements as a result of their divestiture by the Company.

Effective December 31, 1988, the Company adopted SFAS No. 95, "Statement of Cash Flows." Under the provisions of SFAS No. 95, the Company considers all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents.

The accompanying consolidated financial statements and related footnote information have been restated for all years presented relating to the adoption of SFAS Nos. 94 and 95. Additionally, certain prior year amounts have been reclassified to conform with the current year presentation. These include reporting fiduciary investment income and amortization of intangible assets as components of operating revenues and expenses, respectively. The Company believes this presentation more appropriately reflects operating results by matching revenue with related expenses.

Foreign Currency Translation Assets and liabilities denominated in foreign currencies are translated at current exchange rates. Operating results are translated at average rates of exchange prevailing during the year. Unrealized gains or losses resulting from translation, including transactions which hedge a foreign currency investment or long-term intercompany investment, are included as a separate component of stockholders' equity.

Forward exchange contracts are purchased by the Company to hedge the impact of currency fluctuations affecting operations of certain foreign subsidiaries. Gains and losses on these contracts are generally recognized in the period in which the applicable exchange rates change. Net foreign currency transaction gains (losses), amounting to $0.7 million, $1.2 million and $(1.0) million for the years ended December 31, 1988, 1987 and 1986, respectively, are included in the determination of income from continuing operations.

Property and Depreciation The cost of property and equipment is depreciated generally on the straight-line method over the estimated useful lives of the related assets which range up to 40 years for buildings and 10 years for equipment. Leasehold improvements are capitalized and amortized over the shorter of the life of the asset or the lease term. Maintenance and repair costs are charged to operations when incurred.

Intangible Assets Intangible assets resulting from acquisitions, principally expiration lists and goodwill, are amortized on the straight-line method over periods not exceeding 17 and 40 years, respectively. The costs of non-compete agreements are amortized on the straight-line method over the terms of the agreements. Amortization of intangi-

ble assets included in operating expenses amounted to $15.6 million, $12.3 million and $11.8 million for the years ended December 31, 1988, 1987 and 1986, respectively.

Income Taxes Deferred income taxes are provided on revenue and expense items recognized for financial accounting purposes in different periods than for income tax purposes. Income taxes are generally not provided on undistributed earnings of foreign subsidiaries because they are considered to be permanently invested.

Fiduciary Funds Premiums which are due from insureds are reported as assets of the Company and as corresponding liabilities, net of commissions, to the insurance carriers. Premiums received from insureds but not yet remitted to the carriers are held as cash or investments in a fiduciary capacity where required by regulation. Investment income earned on fiduciary funds included in operating revenues amounted to $63.0 million, $61.3 million and $61.9 million for the years ended December 31, 1988, 1987 and 1986, respectively.

Revenue Recognition Commissions are recognized generally on the effective date of the policies or the billing date, whichever is later. Any subsequent premium adjustments, including policy cancellations, are recognized upon notification from the insurance carriers. Contingent commissions, commissions on policies billed and collected directly by insurance carriers are recognized when received. Fees for services rendered are generally recognized when earned.

Per Share Data Earnings per share are based on the weighted average number of common shares and their economic equivalents outstanding during each period and, if dilutive, shares issuable under stock option plans or debenture conversion rights. Dividends per share are based on the Company's common and economic equivalent shares outstanding at each record date.

2. Discontinued Operations

In March 1985, the Company discontinued the insurance underwriting subsidiaries acquired in 1982 as part of the Alexander Howden Group plc (Alexander Howden) acquisition. Accordingly, the estimated loss on disposal, which includes estimated operating results through disposal or runoff and estimated realizable values, is presented separately from continuing operations in the Consolidated Statements of Income.

The Company has completed the divestitures of the entities held for sale. Effective January 1, 1987, the Company sold Sphere Drake Insurance Group (Sphere Drake) for approximately $55.5 million, including the settlement of an intercompany balance of $24.3 million. To provide security to the buyer in connection with certain indemnities, on December 30, 1987, the Company purchased a pounds sterling 13.0 million zero coupon senior note bearing interest at 10% and a pounds sterling 12.7 million zero coupon subordinated note bearing interest at 12%, both due in 1995. Payment by the buyer of the notes is subject, effectively, to offset based upon the adequacy of the loss reserves and reinsurance recoverables recorded on the books of Sphere Drake at December 31, 1986. These notes are included in the Company's Consolidated Balance Sheets at a discounted value (pounds sterling 19.3 million) of $34.6 million and $36.4 million at December 31, 1988 and 1987, respectively.

The sale agreement provides indemnities from the Company for various potential liabilities of Sphere Drake. Certain indemnities, which relate to operations of Sphere Drake prior to the sale, are not limited in time and amount. Other indemnities, which relate to Sphere Drake's loss reserves and reinsurance recoverables attributable to 1986 and prior underwriting years, are limited in time (expiring June 30, 1995) and amount, up to the value of the notes and related interest thereon. The Company may be obligated, under certain circumstances, to provide a credit facility to the buyer with respect to these latter indemnities. The Company will defer recognizing the related interest income on these notes in the Consolidated Statements of Income until realization is assured.

The remaining Atlanta and Bermuda discontinued insurance companies continue in a runoff mode of operation. The Company is proceeding with its plans to liquidate or otherwise dispose of these operations.

Loss on Disposal The components of the estimated loss on disposal and related income tax provisions (benefits) are as follows:

For the years ended December 31,	1988	1987	1986
United States	$(14.7)	$ (6.6)	$(23.4)
International	(2.0)	(12.3)	(14.0)
	$(16.7)	$(18.9)	$(37.4)
Less: Income Tax Provision (Benefit)			
Federal			
Current	$ 0.5	$ (2.8)	$ (8.9)
Deferred	(5.5)	1.7	(1.4)
International			
Current	(5.7)	(5.6)	(2.3)
Deferred	—	(2.2)	(0.8)
	$ (6.0)	$(10.0)	$(24.0)

The Company is in the process of finalizing a reinsurance agreement, subject to regulatory and other approvals, to indemnify the Atlanta and Bermuda companies for $50.0 million of coverage against the possibility of future losses in excess of current reserves. The agreement also contains a profit sharing provision which is anticipated to cover future operating expenses of the Atlanta and Bermuda operations. The $6.0 million provision recorded in the fourth quarter of 1988 relates primarily to the net estimated cost of this agreement.

In 1988, the Company received tax refunds from the Inland Revenue in the United Kingdom amounting to $9.3 million, including interest. The settlement relates principally to the agreement of prior years' losses and the tax deductibility of certain items relating to Alexander Howden's underwriting operations. These refunds have been recorded as additions to the Company's reserve for estimated loss on disposal.

The 1987 additional provision relates primarily to the recorded loss on the disposal of Sphere Drake. The additional provision in 1986 relates primarily to the Atlanta and Bermuda companies and resulted from the need to strengthen insurance underwriting reserves by approximately $21.0 million and to increase the allowance for doubtful reinsurance recoverables by approximately $10.0 million.

Net Liabilities of Discontinued Operations A summary of the net liabilities of the Company's discontinued operations as of December 31, 1988 and 1987, is as follows:

	1988	1987
Assets		
Cash and investments	$ 73.3	$ 69.2
Accounts receivable	43.3	44.8
Income taxes receivable from parent	0.9	7.6
Other assets	3.1	9.1
Total	120.6	130.7
Liabilities		
Claim liabilities	109.2	102.8
Other liabilities	10.1	22.7
Total	119.3	125.5
Net assets	1.3	5.2
Reserve for estimated loss on disposal (see below)	22.7	15.3
Net liabilities of discontinued operations	$ 21.4	$ 10.1

During 1988 and 1987, respectively, the Company remitted approximately $6.3 million and $34.4 million to the Atlanta insurance companies representing principally tax benefits from prior years' losses. In addition, in 1988 and 1987, the Company contributed $4.3 million and $7.8 million, respectively, of additional capital to the Atlanta insurance companies and to a Bermuda insurance company to fund the runoff of claim liabilities. The net liabilities of the Company's discontinued operations are included in other long-term liabilities in the Consolidated Balance Sheets.

An analysis of the Company's reserve for estimated loss on disposal of its discontinued operations is as follows:

	1988	1987	1986
Balance, beginning of year	$15.3	$23.1	$ 20.3
Provision recorded for estimated loss on disposal	6.0	10.0	24.0
Operating income (loss) of:			
Companies held for sale	—	—	3.0
Companies being runoff	(7.6)	(4.4)	(22.2)
Gain (loss) on divestitures	—	(7.8)	1.2
U.K. tax refunds	9.3	—	—
Other	(0.3)	(5.6)	(3.2)
Balance, end of year	$22.7	$15.3	$ 23.1

While the reserve is based upon management's best judgment, there is no assurance that further adverse developments may not occur due to the variables inherent in the estimation process.

3. Acquisitions

Poolings of Interests The total number of shares issued in transactions accounted for as poolings of interests aggregated 0.6 million and 1.5 million during 1987 and 1986, respectively. There were no poolings of interest in 1988.

Purchases The cost of businesses acquired by the Company in transactions accounted for as purchases aggregated $25.4 million in 1988, including 0.9 million shares of common stock; $24.8 million in 1987, including 0.1 million shares of common stock; and $4.5 million in 1986, including 0.1 million shares of common stock. The excess of the purchase price over the fair value of net assets acquired was approximately $25.1 million, $18.6 million and $5.1 million, respectively, and is being amortized over periods not exceeding 40 years.

The effect of these acquisitions was not significant to the Company's consolidated financial statements.

4. Dispositions

TIFCO Inc. In 1988, the Company sold its wholly-owned premium finance subsidary, TIFCO Inc., for proceeds of $73.8 million. Of the total proceeds, $7.0 million was received at closing and $58.5 million, plus interest, was received in January 1989. The remaining balance of $8.3 million, plus interest, is due in three installments from 1990 to 1992 and is contingent upon future premium financing volume placed at TIFCO. A pre-tax gain of $26.3 million has been recognized on the sale and is included in Other Income (Expenses) in the Consolidated Statements of Income.

Summarized financial information relating to TIFCO through the date of sale is as follows:

For the years ended December 31,	1988	1987	1986
Revenues	$21.8	$31.8	$37.0
Expenses	16.7	22.2	23.4
Income before taxes	5.1	9.6	13.6
Income taxes	1.7	4.2	6.4
Net income	$ 3.4	$ 5.4	$ 7.2

As of December 31,	1987
Assets:	
Cash and investments	$ (0.5)
Receivables	213.3
Other assets	4.4
	$217.2
Liabilities and Equity:	
Accounts payable	$ 17.5
Notes payable and long-term debt	152.1
Other liabilities	8.0
Equity	39.6
	$217.2

Shand, Morahan & Company, Inc. In 1987, the Company sold its domestic underwriting management subsidiary, Shand Morahan & Company, Inc. (Shand) for approximate book value of $62.8 million. The proceeds included $11.0 million cash, net of an intercompany balance of $19.5 million, and a deferred payment of $32.3 million plus interest due in 1992. Of the total deferred payment, $29.3 million is subject to offset based upon the adequacy of the loss reserves and reinsurance recoverables recorded, as of December 31, 1986, on the books of Evanston Services Inc., a 52%-owned insurance underwriting subsidiary of Shand at date of sale. In addition, the Company has agreed to indemnify the purchasers of Shand against certain contingencies, including the Mutual Fire, Marine and Inland Insurance Company contingency described in Note 12.

Based upon audited year-end 1988 financial information received from the purchasers of Shand, and other information, the Company recorded a $10.9 million provision in the fourth quarter relating to

the indemnities given by the Company. The provision resulted from deterioration in loss reserves and additional uncollectible reinsurance balances as well as legal costs associated with defending the Company against other indemnified loss contingencies. As a result of the adverse development relating to the indemnities, the Company does not anticipate realizing any interest income on the contingent deferred paymenr balance.

Summarized financial information relating to Shand through the date of sale is as follows:

For the years ended December 31,	1987	1986
Revenues	$23.1	$40.8
Expenses	26.0	34.4
Income (loss) before equity earnings and income taxes	(2.9)	6.4
Equity earnings (Evanston)	2.0	3.4
Income (loss) before income taxes	(0.9)	9.8
Income taxes	(1.2)	3.3
Net income	$ 0.3	$ 6.5

Other Assets During 1987 a wholly-owned United Kingdom subsidiary and a 50%-owned French subsidiary sold their respective office buildings for cash of approximately $35.3 million. The pre-tax gains, included in Other Income (Expenses), and the after-tax gains on these transactions were approximately $21.5 million and $16.9 million, respectively.

5. Income Taxes

The components of income from continuing operations before income taxes are as follows:

For the years ended December 31,	1988	1987	1986
United States	**$ 74.8**	$ 66.9	$ 86.4
International	**54.1**	75.4	61.8
	$128.9	$142.3	$148.2

The components of the provision for income taxes on continuing operations are as follows:

For the years ended December 31,	1988	1987	1986
Current:			
Federal	**$21.8**	$12.2	$41.4
State and local	**7.9**	5.7	8.6
International	**19.8**	27.4	26.0
	49.5	45.3	76.0
Deferred:			
Federal	**3.9**	14.4	1.7
State and local	**0.2**	(0.2)	(1.8)
International	**2.5**	2.5	4.2
	6.6	16.7	4.1
Total tax provision	**$56.1**	$62.0	$80.1

The Company files a U.S. Federal consolidated tax return which includes the losses of its U.S. discontinued operations. The current federal provision recognizes the amounts payable to the discontinued operations for the tax benefits relating to such losses.

The components of the deferred income tax provision on continuing operations are as follows:

For the years ended December 31,	1988	1987	1986
Excess of tax over book depreciation	**$ 1.8**	$ 2.2	$ 3.1
Tax leases	**(2.8)**	(3.2)	1.6
Financial accounting accruals, net	**(0.1)**	0.4	(17.4)
Net deferred gains on subsidiary dispositions	**2.8**	—	—
Alexander Howden loss deduction (See below)	—	—	41.6
Net operating loss and other tax credit carryforwards	**4.2**	17.4	(25.1)
Other	**0.7**	(0.1)	0.3
	$ 6.6	$16.7	$ 4.1

A reconciliation of the tax provision and the amount computed by applying the U.S. Federal income tax rate of 34% in 1988, 40% in 1987 and

46% in 1986 to income from continuing operations before income taxes is as follows:

For the years ended December 31,	1988	1987	1986
Computed "expected" tax expense	$43.8	$56.9	$68.2
State and local income taxes net of federal income tax	5.4	3.4	3.7
Foreign statutory rates over (under) U.S. Federal statutory rate	2.8	(0.6)	(1.4)
Benefit of income taxed at capital gains or other rates	—	(3.8)	(0.2)
Subsidiaries' losses receiving no current tax benefit	0.4	1.7	2.0
Tax credits	—	(0.5)	(0.5)
Amortization of intangible assets	2.8	2.1	2.5
Other non-deductible expenses	3.8	2.7	4.2
Adjustment to prior year estimated tax provisions	—	1.5	4.4
Other, net	(2.9)	(1.4)	(2.8)
Total tax provision	$56.1	$62.0	$80.1

For the years 1982, 1986 and 1987, tax deductions totaling $132.8 million, net of estimated recoveries, were claimed by the Company for a loss sustained in connection with the acquisition of Alexander Howden. The $61.1 million in tax benefits associated with these tax deductions are reflected in the deferred income tax balances in the Consolidated Balance Sheets and will not be recognized for income statement purposes until realization is reasonably assured. During 1988, the Internal Revenue Service (IRS) issued its final Revenue Agent's Report in connection with the completion of the audit of the Company's 1982 U.S. consolidated tax return. As anticipated, the IRS disallowed the $43.1 million tax deduction which was claimed in 1982. In addition, the IRS disallowed a tax deduction for certain costs which the Company incurred in its post-acquisition investigation into Alexander Howden. The Company filed its protest against these two issues with the Appellate Division of the IRS on December 30, 1988. It is the Company's opinion that the amounts not yet recognized for income statement purposes are sufficient to cover any potential liability arising out of these issues.

In 1983 and 1984, $23.9 million in tax deductions were claimed by the Company in connection with payments, to an unrelated third party, for an indemnification policy against the potential adverse effects on the Company from losses arising out of certain underwriting exposures. The related tax benefit of $11.4 million was recognized in 1983. In connection with the current examination of the Company's 1983 through 1985 income tax returns, these tax deductions are under review by the IRS; however, the Company believes it will be successful in sustaining these deductions.

The extraordinary credits of $2.5 million in 1988, $3.5 million in 1987 and $0.6 million in 1986 represent the realization of tax benefits resulting from the utilization of approximately $6.3 million, $8.7 million and $1.2 million, respectively, of net operating loss carryforwards attributable to the U.S. operations of Reed Stenhouse Companies Limited prior to the merger in 1985. At December 31, 1988, the Company had, for financial reporting purposes, a net operating loss carryforward relating to these operations of approximately $4.4 million which will expire in the years 1996 to 1998.

At December 31, 1988, the net undistributed earnings of foreign subsidiaries aggregated approximately $193.8 million. Since these earnings are considered permanently invested, there is no provision for additional U.S. income taxes which might result upon distribution of such earnings; however, foreign tax credits could be available to offset part or all of the U.S. income taxes which would be incurred.

In December 1987, SFAS No. 96, "Accounting for Income Taxes," was issued which will require the Company to adjust its balance sheet liabilities to the liability method of reporting instead of the deferred method. Under this newly prescribed method, future tax liabilities will be adjusted in a current period to reflect changes in income tax rates. As a result of the complex implementation issues in applying the provisions of SFAS No. 96, the effective date has been deferred to 1990. The Company is continuing to refine its analyses of the impact of the new Statement; however, it is anticipated that its adoption will have a positive impact on the Company's financial position in the year of adoption.

6. Short-Term Debt

Consolidated short-term debt consists of the following:

As of December 31,	1988	1987
Commercial paper	$64.9	$34.8
Notes payable to banks	21.0	20.2
Current portion of long-term debt (Note 7)	5.0	11.2
	90.9	66.2
Less short-term debt reclassified as long-term (Note 7)	85.9	50.0
	$ 5.0	$16.2

Information with respect to short-term borrowing activity is as follows:

As of December 31,	1988	1987	1986
Commercial paper:			
Balance at year end	$64.9	$34.8	$ 9.9
Weighted average interest rate	9.3%	8.3%	6.4%
Maximum outstanding	$64.9	$50.0	$75.1
Average outstanding	$51.2	$29.7	$45.9
Weighted average interest rate during the year	7.9%	7.0%	7.3%
Notes payable to banks:			
Balance at year end	$21.0	$20.2	$ —
Weighted average interest rate	10.9%	8.2%	
Maximum outstanding	$34.0	$21.1	$ 1.6
Average outstanding	$27.6	$ 4.3	$ 0.3
Weighted average interest rate during the year	9.6%	8.8%	12.0%

The maximum outstanding balance above reflects the maximum amount of each category outstanding at any month end. The maximum aggregate short-term debt outstanding at any month end was $89.8 million, $56.1 million, and $75.1 million in 1988, 1987 and 1986, respectively.

In August 1988 the Company instituted a commercial paper program for the private placement of up to $100 million of commercial paper notes. The notes are unsecured obligations of the Company and will be sold only to institutional investors that qualify as accredited investors as defined in Regulation D of the Securities Act of 1933.

Including the $100 million credit facility described in Note 7(B), the Company has committed unsecured lines of credit totaling $202.9 million of which $163.5 million was unused as of December 31, 1988. The lines may be drawn as needed with interest at market rates and carry an annual commitment fee of no greater than 1/4% of the line. In addition, the Company has approximately $80.5 million of uncommitted bank lines of credit which are available for general corporate purposes, of which $37.0 million was unused at December 31, 1988.

7. Long-Term Debt

Consolidated long-term debt outstanding is as follows:

As of December 31,	1988	1987
11% Convertible subordinated debentures (A)	$ 67.6	$ 67.6
Reclassified short-term debt (B)	85.9	50.0
Long-term credit agreement (B)	12.6	—
Obligation under capital lease (C)	20.7	25.4
Non-recourse mortgage notes (D)	20.5	20.6
Other	12.3	17.8
	219.6	181.4
Less current portion (Note 6)	5.0	11.2
	$214.6	$170.2

The principal portion of payments required during the next five years is $5.0 million in 1989, $3.5 million in 1990, $16.8 million in 1991, $5.8 million in 1992, and $5.5 million in 1993.

A. 11% Convertible Subordinated Debentures The debentures are unsecured subordinated obligations maturing April 15, 2007. The debentures were issued in connection with the acquisition of Alexander Howden under an Indenture agreement dated February 1, 1982, and are convertible into common shares at $39 per share, subject to adjustment under certain conditions and to prior redemption. The remaining debentures are redeemable any time, at the Company's option, at 106.6% of par value prior to April 15, 1989, and at declining prices thereafter until April 15, 1997. Commencing April 15, 1992, 5% of the aggregate principal amount outstanding as of October 15, 1991, must be redeemed at the principal amount through the operation of a mandatory sinking fund.

B. Long-Term Credit Agreements
The Company has a long-term credit agreement with a bank which expires in June 1993. The agreement, as amended effective June 30, 1988, increased the Company's credit facility from $50 to $100 million and contains various restrictions including limits on minimum net worth, maximum consolidated debt, minimum interest coverage and minimum consolidated cash flow from continuing operations. The Company has the option to select domestic or Eurocurrency borrowings priced at a spread over the appropriate index. The Company has not borrowed under this agreement.

In the event short-term borrowings cannot be made advantageously, the Company intends to use this facility to refinance a portion of its short-term borrowings on a long-term basis. Accordingly, $85.9 million and $50.0 million of short-term debt has been reclassified as long-term debt at December 31, 1988 and 1987, respectively.

In addition, in 1988 a Canadian subsidiary entered into a three-year credit agreement with a Canadian financial institution which expires in May 1991. The agreement provides for a credit facility of up to Canadian $15.0 million under various borrowing options with interest rates of either 1/2% below the Canadian prime rate (12 1/4% at December 31, 1988) or at bankers' acceptance rates.

C. Obligation Under Capital Lease
Effective December 31, 1987, a 50%-owned French subsidiary entered into a lease agreement for office facilities which is classified as a capital lease. Future minimum lease payment obligations are approximately $2.0 million for each of the next five years and an aggregate of $34.7 million thereafter.

D. Non-Recourse Mortgage Notes
Under terms of the sale agreement of TIFCO (see Note 4), two wholly-owned real estate subsidiaries of TIFCO were transferred to the Company at net book value prior to closing. The net assets of these subsidiaries, which are now included in the consolidated financial statements, include principally an investment in a direct financing lease of an office building and related non-recourse mortgage notes. The mortgage notes bear interest at rates between 12.1% and 13.0% and are payable in semi-annual installments of $1.4 million (including principal and interest) through September, 2010.

The components of the net investment in the direct financing lease, included in Other Assets in the Consolidated Balance Sheet as of December 31, 1988, are as follows:

Future minimum lease payments to be received	$ 79.0
Unguaranteed residual value accruing to the benefit of the Company	7.9
Less unearned income	(64.3)
Net investment in lease	$ 22.6

Future minimum lease payments to be received are approximately $2.5 million for each of the next five years and an aggregate of $66.5 million thereafter.

8. Common and Preferred Stock

Common Stock In connection with the Reed Stenhouse Companies Limited (RSC) merger in 1985, the Company issued 2 new classes of voting equity securities, Class A and Class C shares, with voting rights equal to the Company's common stock. Associated with each such share is a dividend paying share issued by a Canadian (RSC Class 1 Share) or a United Kingdom (AAE Dividend Share) subsidiary which pays dividends in Canadian dollars and Sterling, respectively, equivalent to the dividends paid on shares of common stock. Holders of these securities, therefore, hold the economic equivalent of shares of common stock. Each Class A Share (together with an RSC Class 1 Share) and Class C Share (together with an AAE Dividend Share) may be exchanged at any time for a share of common stock.

At December 31, 1988, the Company had 5.8 million shares of common stock reserved for issuance under employee stock option plans, 0.3 million shares reserved for contingent issuance under business purchase agreements, 1.7 million shares reserved for issuance in the event of conversion of the 11% convertible subordinated debentures and 3.8 million shares reserved for issuance upon redemption or conversion of the Class A and Class C common shares.

Dividend Restrictions No dividends may be declared and paid on the Company's common stock unless an equivalent amount per share is declared and paid on the economic equivalent shares. Accordingly, the Company's ability to pay dividends is limited by the amounts available to the Canadian and U.K. subsidiaries for such purposes. These amounts approximate Canadian $40.9 million or $34.3 million, assuming certain solvency tests are met under Canadian law, and pounds sterling 46.5 million or $83.3 million, respectively, at December 31, 1988. In the event sufficient earnings are not available in Canada or the United Kingdom to declare dividends, the Company's legal structure allows it to make earnings or capital available in those countries to pay dividends.

Preferred Stock and Related Rights The Company's preferred stock can be issued in one or more series with full or limited voting rights, with the rights of each series to be determined by the board of directors before each issuance.

On June 11, 1987, the board of directors adopted a resolution authorizing a series of preferred stock, Series A Junior Participating Preferred Stock (Preferred Shares), $1.00 par value per share. At the same time, a dividend of 1 preferred share purchase right (Right) was declared for each outstanding share of common stock and each common stock equivalent. Each subsequently issued share will also carry such a Right. Each Right entitles the holder thereof to buy one one-hundreth of a Preferred Share at a price of $85. The Rights will become exercisable only if a person or group acquires 20% or more of the Company's voting shares or announces a tender or exchange offer for 30% or more of such voting shares. If the Company is subsequently acquired each Right will entitle its holder to purchase, at the then-current exercise price, stock of the surviving company having a market value of twice the exercise price of each Right. The Rights, which expire on July 6, 1997, are redeemable by action of the board of directors prior to becoming exercisable at a redemption price of $.01 per Right.

Treasury Stock The board of directors has authorized, subject to certain business and market conditions, the purchase of up to 5 million shares of the Company's common stock. As of December 31, 1988, the total number of shares purchased was 3.4 million at an average price of $21.62 per share.

In 1988, the State of Maryland enacted legislation requiring Maryland corporations to treat shares acquired of its own stock as authorized but unissued shares. Previously, the cost of such shares were treated and classified as treasury stock by the Company. For 1988, the cost of the Company's treasury stock has been allocated as a reduction of common stock and paid-in capital, respectively. This allocation had no effect to total stockholders' equity.

9. Stock Option and Incentive Plans

In 1988, the shareholders approved the 1988 Long-Term Incentive Compensation Plan (1988 Plan) which provides for the granting of up to 3 million shares of the Company's common stock to officers and key employees as stock options, including incentive stock options and non-qualified options, stock appreciation rights, restricted stock awards, performance share/unit awards and other stock based awards.

Stock options may be granted under the 1988 Plan at a price not less than the fair market value of the common stock on the date the option is granted and, with respect to incentive stock options, must be exercised not later than 10 years from date of grant and, with respect to non-qualified options, must be exercised not later than 10 years and 1 day from date of grant.

Stock appreciation rights may be granted alone or in conjunction with a stock option at a price not less than the fair market value of the common stock at date of grant. Upon exercise of a stock appreciation right, the participant will receive cash, common stock or a combination thereof equal to the excess of the market value over the price of the stock appreciation right. Exercise of either the right or the stock option will result in the surrender of the other.

Restricted stock awards may be granted which limit the sale or transfer of the shares until the expiration of a specified time period. Such awards are subject to forfeiture if the participant does not remain in the employ of the Company throughout the restricted time period. A maximum of 750,000 shares may be issued under the 1988 Plan. There were 2,000 shares issued in 1988.

Performance share/unit awards may be granted based upon certain performance criteria as determined by the Compensation Committee of the board of directors. Upon achievement of the performance share/unit criteria, the participant will receive cash, common stock or a combination thereof equal to the award. There were 121,600 performance share/unit awards made in 1988.

The Company's Long-Term Compensation Program (1982 Program), adopted in 1982, was superceded by the 1988 Plan described above. The 1982 Program consisted of three independent plans providing for stock options, performance bonus awards and restricted stock awards. No stock options were granted after December 31, 1988, and no awards were made after May 19, 1988, under either the performance bonus or restricted stock plans.

Option transactions under all programs were as follows:

	Number of Shares	Option Price Per Share Range
Outstanding, January 1, 1986	1,175,956	$17.06–$32.88
Granted	553,257	38.63
Exercised	(134,779)	17.06 - 31.13
Cancelled	(47,848)	
Outstanding, December 31, 1986	1,546.586	$17.75–$38.63
Granted	956.600	17.75– 25.38
Exercised	(48,344)	17.75– 24.50
Cancelled	(513,240)	
Outstanding, December 31, 1987	1,941.602	$17.75–$38.63
Granted	512,477	23.63– 24.75
Exercised	(20,317)	17.75– 23.19
Cancelled	(278,989)	
Outstanding, December 31, 1988	2,154.773	$17.75–$38.63

The number of options exercisable at December 31 were as follows:

1988	994,235
1987	865,463
1986	759,811

10. Employees' Retirement Plans and Benefits

Pension Plans The Company has contributory and non-contributory defined benefit pension plans covering substantially all domestic and international employees. The plans generally provide pension benefits that are based on the employee's years of service and compensation prior to retirement. In general, it is the Company's policy to fund these plans consistent with laws and regulations of the respective taxing jurisdictions in which the Company operates. An overfunding exists in the United States' largest plan. As a result, the Company will not make any contributions to this plan until the overfunding is substantially reduced.

Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 87, "Employers Accounting for Pension" for its significant international pension plans. The Company had adopted SFAS No. 87 for its domestic plans in 1985. Total pension costs for these plans for the years ended December 31, 1988, 1987 and 1986 is summarized as follows:

	1988	1987	1986
Service cost	$ 25.2	$ 15.3	$ 10.4
Interest cost	28.9	13.4	10.8
Actual return on plan assets	(54.3)	(10.9)	(26.4)
Net amortization and deferral	3.3	(13.8)	5.6
Net pension costs	$ 3.1	$ 4.0	$ 0.4

International pension expense totaled $16.1 million in 1987 and $13.2 million in 1986.

The following table sets forth the funded status and amounts recognized in the Company's Consolidated Balance Sheets as of December 31, 1988 and 1987:

	1988		1987
	U.S.	International	U.S.
Vested benefit obligation	$ 118.6	$ 122.3	$ 103.4
Accumulated benefit obligation	$ 130.8	$ 124.4	$ 115.3
Projected benefit obligation	$(172.2)	$(203.5)	$(153.4)
Plan assets at fair market value	217.0	259.0	200.1
Excess of plan assets over projected benefit obligation	44.8	55.5	46.7
Unrecognized net (gain) loss	(19.3)	4.1	(13.6)
Unrecognized prior service cost	4.7	—	3.1
Unrecognized net assets being amortized over 16 years	(36.9)	(52.6)	(40.3)
(Accrued) prepaid pension cost	$ (6.7)	$ 7.0	$ (4.1)
Assumed discount rate	9.5%	9.0–10.25%	9.5%
Assumed rate of compensation increase	6.0%	6.0– 9.0 %	6.0%
Expected rate of return on plan assets	10.75%	10.5–11.0%	10.75%

At December 31, 1988 and 1987, approximately 63% and 56%, respectively, of plan assets are invested in equity securities and 37% and 44%, respectively, in cash equivalents or debt securities.

Thrift Plans The Company maintains thrift plans for most U.S. and Canadian employees. Under the thrift plans, eligible employees may contribute amounts through payroll deduction, supplemented by Company contributions, for investments in various funds established by the plans. The cost of these plans was $6.5 million, (including 0.1 million shares of common stock valued at $1.4 million) in 1988, $6.7 million, (including 0.2 million shares of common stock valued at $6.0 million) in 1987, and $7.3 million (including 0.2 million shares valued at $6.2 million) in 1986.

Post-Retirement Benefits Substantially all of the Company's U.S. employees may become eligible for certain health care benefits up to age 65 and life insurance benefits if they reach normal retirement age while working for the Company. The cost of providing these benefits for retirees is not separable

from the cost for active employees in the United States. The total cost, which is recognized as expense when premiums or claims are paid, and number of employees were as follows:

	1988	1987	1986
Total cost	$28.2	$24.2	$20.8
Number of employees (thousands):			
Active	9.6	9.8	10.2
Retired	1.3	1.4	1.3

Certain of the Company's international subsidiaries have similar plans for their employees; however, most retirees are covered primarily by governmental sponsored programs. As a result, the cost to the Company for retired employees is not significant for these programs.

Deferred Compensation Plan In 1985, the Company established a deferred compensation plan which permitted certain of its key officers and employees to defer a portion of their incentive compensation in each of the succeeding four years. In 1986, the plan was amended to permit a single election to defer, in 1987, all remaining amounts deferrable under the plan. The deferred compensation is being accrued over the period of active employment on a present value basis. To fund these plans, the Company has purchased whole-life insurance on each participant's life. The Company's obligation under the plan, $10.7 million and $8.6 million at December 31, 1988 and 1987, respectively, is included in Other Long-term Liabilities in the Consolidated Balance Sheet.

11. Commitments

Lease Commitments The Company leases property and equipment under non-cancellable operating lease agreements which expire at various dates through 2013.

Future minimum annual rentals under non-cancellable leases are as follows:

	Operating Leases
1989	$ 75.0
1990	69.3
1991	62.1
1992	58.2
1993	53.9
Thereafter	280.5
Total minimum lease payments	$599.0

Rent expense for office space, which includes property taxes and certain other costs, amounted to $87.3 million, $82.8 million and $69.0 million for the years ended December 31, 1988, 1987 and 1986, respectively.

Other Commitments The Company has guaranteed certain borrowings and letters of credit and has otherwise agreed to reimburse the payment of certain other asserted or unasserted liabilities of subsidiaries. While these assurances and guarantees may expose the Company to financial consequences, it is management's opinion that any adverse effects will not be material to the Company's financial condition.

12. Contingent Liabilities

Following the acquisition of Alexander Howden in January 1982, certain claims, relating primarily to the placement of reinsurance by Alexander Howden subsidiaries and questionable broking and underwriting practices of former Alexander Howden officials and others, were asserted. In particular, claims have been asserted against the Company and certain of its subsidiaries alleging, among other things, that certain of the Company's subsidiaries accepted, on behalf of certain insurance companies, insurance or reinsurance at premium levels not commensurate with the level of underwriting risks assumed and retroceded or reinsured those risks with financially unsound reinsurance companies. In two pending actions, plaintiffs seek compensatory and punitive damages totaling $69.0 million based on treble damage claims under the Racketeer Influenced and Corrupt Organizations Act (RICO). Related actions contain a variety of allegations and seek treble damages. Management of the Company believes that there are valid defenses to all claims that have been made with respect to these activities. The Company is vigorously defending the pending actions.

The Company and its subsidiaries are also subject to various claims and lawsuits from both private and governmental parties in the ordinary course of business, consisting principally of alleged errors and omissions in connection with the placement of insurance and in rendering consulting services. In some of these cases, the remedies that may be sought or damages claimed are substantial. Additionally, the Company and its subsidiaries are subject to the risk of losses resulting from the potential uncollectibility of insurance and reinsurance balances and claims advances made on behalf of clients.

Shand and its subsidiaries, prior to the 1987 sale, placed insurance and reinsurance with and on behalf of the Mutual Fire, Marine and Inland Insurance Company (Mutual Fire). Mutual Fire was placed in rehabilitation in December 1986. A number of proposed plans of rehabilitation have been determined to be unworkable; the most recent proposal was submitted to the rehabilitator for review on January 31, 1989. It is not possible to predict with certainty whether Mutual Fire will be successfully rehabilitated or will eventually be placed in liquidation. In the event of a liquidation of Mutual Fire, a liquidator may assert claims against Shand and its subsidiaries based upon, among other matters, the amount of reinsurance owed to or paid by Mutual Fire and the reimbursement by Mutual Fire of claims payments advanced on its behalf. Other claims have been or may be asserted by other affected parties, including insureds of Mutual Fire. The sales contract between the Company and Shand's purchasers provides an indemnification to the purchasers with respect to this contingency.

These contingent liabilities involve significant amounts, and while it is not possible to predict with certainty the outcome of such contingent liabilities, their coverage under the Company's professional liability insurance policies, or their financial impact on the Company, management presently believes that such impact will not be material to the Company's financial condition.

13. Litigation Settlement

In November 1986, the Company settled its lawsuit, which commenced in 1983, against certain former auditors of Alexander Howden. The terms of the settlement included the payment of $24.0 million to the Company. Recognition of this recovery in the Consolidated Statements of Income has been deferred pending final resolution of specific loss contingencies arising out of the Alexander Howden acquisition which were known at the date of the settlement. The amount of the recovery is included in Other Long-term Liabilities in the Company's Consolidated Balance Sheet.

In 1987, the Company's after-tax contribution to the settlement offered to members of Lloyd's syndicates formerly managed by PCW Underwriting Agencies Ltd. was charged against this recovery and, accordingly, the amount deferred was reduced to approximately $22.3 million.

14. Business Segments

Segment information is provided for the Company's two reportable segments, Insurance Services and Human Resource Management Consulting.

Insurance Services includes a broad range of insurance brokerage services such as negotiating and placing casualty, property and marine insurance, reinsurance brokerage, risk analysis and management, and self-insurance services.

Human Resource Management Consulting includes a variety of human resource management services such as actuarial and administrative services for pension, compensation and benefit plans, employee communications consulting and management consulting.

The following tables present information about the Company's operations by business segment and geographical areas for each of the three years in the period ended December 31, 1988:

	Operating Revenue	Operating Income	Identifiable Assets	Depreciation & Amortization	Capital Expenditures
1988					
Insurance services	$1,063.4	$131.3	$2,442.9	$55.4	$ 65.9
Human resource management consulting	140.3	14.1	115.4	4.7	6.4
Other business	24.0	2.4	62.6	1.6	0.8
General corporate	—	(25.6)	14.3	0.9	0.5
	$1,227.7	$122.2	$2,635.2	$62.6	$ 73.6
1987					
Insurance services	$1,037.6	$132.5	$2,415.5	$45.6	$119.7
Human resource management consulting	121.0	5.5	129.9	3.4	11.5
Other business	24.7	1.7	64.8	1.4	2.2
Equity in unconsolidated operations	—	—	39.6	—	—
General corporate	—	(26.1)	12.0	0.7	1.1
	$1,183.3	$113.6	$2,661.8	$51.1	$134.5
1986					
Insurance services	$1,003.9	$176.5	$2,241.4	$36.3	$ 48.8
Human resource management consulting	105.3	5.1	100.5	2.6	4.3
Other business	25.4	5.5	50.9	4.9	5.9
Equity in unconsolidated operations	—	—	55.1	—	—
General corporate	—	(23.7)	4.8	—	—
Assets held for disposal	—	—	28.9	—	—
	$1,134.6	$163.4	$2,481.6	$43.8	$ 59.0

	Operating Revenue	Income Before Taxes	Identifiable Assets
Geographical areas:			
1988			
United States	$ 776.8	$108.5	$1,271.9
United Kingdom	202.7	32.0	773.6
Canada, principally RSC	116.8	8.9	177.7
Other countries	131.4	11.3	397.7
Equity in unconsolidated operations	—	5.1	—
General corporate	—	(36.9)	14.3
	$1,227.7	$128.9	$2,635.2
1987			
United States	$ 780.6	$ 99.6	$1,267.9
United Kingdom	180.5	28.1	735.3
Canada, principally RSC	121.4	18.3	190.6
Other countries	100.8	22.8	416.4
Equity in unconsolidated operations	—	11.6	39.6
General corporate	—	(38.1)	12.0
	$1,183.3	$142.3	$2,661.8
1986			
United States	$ 763.0	$112.1	$1,368.3
United Kingdom	162.9	22.9	558.1
Canada, principally RSC	119.7	20.6	195.3
Other countries	89.0	12.5	271.1
Equity in unconsolidated operations	—	17.0	55.1
General corporate	—	(36.9)	4.8
Assets held for disposal	—	—	28.9
	$1,134.6	$148.2	$2,481.6

15. Quarterly Financial Data (Unaudited)

Quarterly operating results for 1988 and 1987 are summarized below (in millions, except per share data). The first three quarters of 1988 and all quarters of 1987 have been restated from amounts previously reported to reflect the adoption of SFAS No. 94 and the reclassification of fiduciary investment income and amortization of intangible assets as described in Note 1.

Quarters	Operating Revenue	Operating Income	Income from Continuing Operations	Net Income
1988				
1st	$ 300.0	$ 29.6	$16.5	$16.5
2nd	312.9	36.3	20.1	20.1
3rd	296.9	28.3	14.0	16.5
4th	317.9	28.0	20.4(a)	14.4(b)
Year	$1,227.7	$122.2	$71.0	$67.5
1987				
1st	$ 284.3	$ 27.3	$14.4	$14.4
2nd	309.7	35.9	27.9	27.9
3rd	290.3	28.2	21.9	15.4
4th	299.0	22.2	10.7	10.7
Year	$1,183.3	$113.6	$74.9	$68.4

Per Share of Common Stock

Quarters	Income from Continuing Operations	Net Income	Dividends	High	Low
1988					
1st	$ .39	$ .39	$ .25	$24 1/2	$17 3/8
2nd	.48	.48	.25	24 1/4	21 1/2
3rd	.34	.40	.25	25 7/8	21 5/8
4th	.50	.35	.25	28 1/8	23 1/4
Year	$1.71	$1.63(c)	$1.00		
1987					
1st	$ .34	$ .34	$ .25	$32	$24 1/4
2nd	.66	.66	.25	30 5/8	22 3/8
3rd	.52	.36	.25	27 3/4	22 3/4
4th	.25	.25	.25	28 1/4	15 7/8
Year	$1.77	$1.62(c)	$1.00		

(a) Includes an $18.2 million gain on the sale of TIFCO, offset in part, by $12.1 million in provisions relating to the sale of Shand (see Note 4) and two small operations.

(b) Includes a $6.0 million provision for discontinued operations relating to a reinsurance agreement regarding the Atlanta and Bermuda insurance companies (see Note 2).

(c) Not equal to the sum of the quarters.

Board of Directors, Corporate Officers and Major Operating Units

Alexander & Alexander Services Inc.

Tinsley H. Irvin* [1]
Chairman of the Board, President & Chief Executive Officer
Chairman, Executive Committee

James D. Berry* [2][3]

Dr. Kenneth Black, Jr.* [2][3]
Regents' Professor of Insurance
Georgia State University

John A. Bogardus, Jr.* [3]
Former Chairman of the Board

Robert E. Boni* [1][4]
Chairman & Chief Executive Officer
Armco Inc.
(A diversified steel company.)

Peter C. Godsoe*
Vice Chairman
The Bank of Nova Scotia

Angus M. M. Grossart* [2][4]
Partner/Managing Director
Noble Grossart Limited
(A U.K. merchant bank.)

Vincent R. McLean* [1][2][3][4]

Michael K. White* [1]
Executive Vice President

William M. Wilson* [1]
Executive Vice President

Peter M. Densen
Senior Vice President & Chief of Staff

Ron W. Forrest
Senior Vice President & Managing Director
Global Business Development

Ronald A. Iles
Senior Vice President

James B. Lockhart III
Vice President & Treasurer

Jayne D. Maas
Vice President & Director of Taxes

Dr. Robert H. Moore
Senior Vice President
Corporate Relations

Mark E. Oleksik
Vice President & Assistant to the Chief Financial Officer

Dan R. Osterhout
Senior Vice President
Underwriting Operations

James Y. Paulding
Senior Vice President

John C. Reece
Vice President & Chief Information Officer

Ronald J. Roessler
Senior Vice President & General Counsel

Paul E. Rohner
Senior Vice President & Chief Financial Officer

Edward P. Schade
Vice President & Controller
Chief Accounting Officer

Donald L. Seeley
Vice President
Financial Management

Thomas Soper III
Vice President
Human Resources

Kenneth J. Tesi
Vice President
Corporate Audit Operations

Frank R. Wieczynski
Secretary

*Director
(1) Member, Executive Committee
(2) Member, Audit Committee
(3) Member, Compensation Committee
(4) Member, Finance-Investment Committee

Alexander & Alexander Services Inc. Operations Board

Tinsley H. Irvin
Chairman
Chairman, President & Chief Executive Officer
Alexander & Alexander Services Inc.

Michael K. White
Deputy Chairman
Executive Vice President
Alexander & Alexander Services Inc.

William M. Wilson
Deputy Chairman
Executive Vice President
Alexander & Alexander Services Inc.

Bobby J. Cline
Director, Client & Industry Relations
Alexander & Alexander Inc.

Angelo M. D'Alessandro
President & Chief Executive Officer
Alexander Consulting Group Inc.

Peter M. Densen
Senior Vice President & Chief of Staff
Alexander & Alexander Services Inc.

Ron W. Forrest
Senior Vice President & Managing Director
Global Business Development
Alexander & Alexander Services Inc.

Thomas A. Greene
Chairman, President & Chief Executive Officer
Thomas A. Greene & Company, Inc.

Luther T. Griffith
Chief Executive Officer
Risk Management Services Group
Alexander & Alexander Services Inc.

James S. Horrick
President & Chief Executive Officer
Reed Stenhouse Limited

Ronald A. Iles
Chairman
Alexander Howden Reinsurance Brokers Limited

Dennis L. Mahoney
Chairman
Alexander Howden Limited

James A. McCormick
President & Chief Operating Officer
Alexander & Alexander Inc.

Lloyd E. Mills
Regional Chief Executive Officer
Alexander Stenhouse Limited, Australia & New Zealand

Paul E. Rohner
Senior Vice President & Chief Financial Officer
Alexander & Alexander Services Inc.

Alexander & Alexander Services Inc. Principal Worldwide Operating Units:

Retail Broking

Alexander & Alexander Inc.

Alexander Stenhouse Limited

Reed Stenhouse Limited

Wholesale Broking

Alexander Howden Limited

Alexander Howden North America, Inc.

Reinsurance

Alexander Howden Reinsurance Brokers Limited

Thomas A. Greene & Company, Inc.

Risk Management Services

Alexander Insurance Managers Limited

Alexander Trade Services

Alexsis Inc.

Anistics Inc.

Human Resource Management Consulting Services

Alexander Consulting Group Inc.

Approximate Number of Equity Security Holders
As of March 3, 1989, there were approximately 3,364 record holders of the Company's common stock, 1,053 beneficial holders of Class A common stock and 1,829 record holders of Class C common stock.

Stock Listings
Alexander & Alexander's stock is listed on the New York, London and Toronto stock exchanges.
NYSE Symbol .... AAL
London .... (Common and Class C)
Toronto ...... (RSC Special Class 1)

Anticipated 1989 Dividend Payment Dates
March 31 (paid), June 30, September 29, December 29.

Notice of Form 10K
A copy of the Company's 1988 Annual Report on Form 10K may be secured by writing to:
Alexander & Alexander Services Inc.
Corporate Secretary
10461 Mill Run Circle
Owings Mills, Md. 21117

Investors, bankers, security analysts and others desiring financial information should contact:
Frank R. Wieczynski
(301) 363-5000

Transfer Agents and Registrars
Morgan Shareholder Services Trust Company
30 West Broadway
New York, N.Y. 10007-2192

The Equitable Trust Company
100 South Charles St.
Baltimore, Md. 21201

The Royal Trust Company
48/50 Cannon St.
London EC4N 6LD
England

Montreal Trust Company of Canada
66 Temperance St.
Toronto, Ontario M5H 1Y7
Canada

Auditors
Deloitte Haskins + Sells

Annual Meeting of Shareholders
Date: Thursday, May 18, 1989
Time: 9:30 a.m.
Place: The Equitable Center Auditorium
787 Seventh Avenue
between West 51st and West 52nd Sts.
New York, N.Y. 10019

Corporate Headquarters
Alexander & Alexander Services Inc.
1211 Avenue of the Americas
New York, N.Y. 10036
(212) 840-8500

The Worldwide Network of A&A

Argentina
Australia
Austria
Bahamas
Barbados
Belgium
Bermuda
Bolivia
Brazil
Cameroon
Canada
Cayman Islands
Channel Islands
Chile
China
Colombia
Costa Rica
Curacao
Denmark
Dominican Republic
Ecuador
Finland
Fiji
France
Greece
Guadeloupe
Guatemala
Hong Kong
India
Indonesia
Ireland
Isle of Man
Italy
Jamaica
Japan
Kenya
Kuwait
Luxembourg
Malaysia
Mexico
Netherlands
New Zealand
Nigeria
Norway
Pakistan
Panama
Papua New Guinea
Peru
Philippines
Portugal
Puerto Rico
Saudi Arabia
Singapore
South Korea
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Taiwan
Thailand
Trinidad & Tobago
Turkey
United Arab Emirates
United Kingdom
United States
Venezuela
Virgin Islands
West Germany
Zaire

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