C

Alexander & Alexander

SERVICE IN TIMES OF RISK

1989 Annual Report

CONTENTS

On the cover: A&A's 1922 incorporation papers as reconstructed from Maryland archives. This Annual Report reviews major historical highlights of Alexander & Alexander Services Inc.

FINANCIAL HIGHLIGHTS

Alexander & Alexander Services Inc. (in millions, except per share amounts)	1989	1988
Operating revenues	$1,248.9	$1,227.7
Operating income	107.6	122.2
Income from continuing operations	59.0	71.0
Net income	60.1	67.5
Per share of common stock:		
Income from continuing operations	$ 1.45	$ 1.71
Net income	1.48	1.63
Cash dividends	1.00	1.00
Total assets	$2,604.7	$2,635.2
Stockholders' equity	375.1	371.6
Book value per share	9.28	9.20
Return on equity	16.1%	17.7%
Average shares outstanding	40.6	41.4
Number of employees (thousands)	16.0	16.3

Founded in 1899, Alexander & Alexander Services Inc. is a global 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 also place reinsurance and provide risk analysis and self-insurance services.

Our worldwide human resource management consulting operations provide actuarial and benefit plan consulting services, flexible compensation consulting, communication and management consulting services as well as human resource organizational analysis and planning.

TO OUR FELLOW SHAREHOLDERS

Alexander & Alexander Services Inc. performed well during 1989 in a difficult market. It was a market characterized by a continued decline in property and casualty rates. Our collective efforts produced revenues of $1.25 billion and net profits of $60.1 million.

New business production was strong in A&A's London reinsurance operations and among many of our retail broking units. Rising costs for health care and other human resource needs spurred client demand for Alexander Consulting Group services. Revenues grew as ACG responded creatively and effectively.

Through increased productivity and other measures, 1989 expense growth was held to 3.2 percent without reducing the quality of client service. In addition, investments were made in selected operating units.

While we made progress in key areas, 1989 net income was lower than the previous year. The industrywide reductions in premium rates more than offset new business production and savings generated by our cost-containment efforts. In addition, 1988 income included a substantial, one-time gain from the sale of our premium finance company.

A&A ended the year with a sound balance sheet and solid debt ratings. We continued to focus on controlling day-to-day operating costs. In addition, we are improving management of semi-fixed costs such as office space and business information systems.

The year cannot be discussed without noting the historic developments in Europe and the potential opening of additional markets for insurance as well as other financial services.

A&A's operations in Western Europe are now firmly established. Our equity investments in indigenous retail brokers will enable us to provide consistent, quality service as the European Community removes internal trade barriers. This presence was further consolidated in 1989 with additional investments in West Germany, the Netherlands and Scandinavia.

In West Germany, we maintained a 20 percent equity interest in a company formed when our partner, Industrie-Assekuranz GmbH & Co., merged with Carl Jaspers Sohn. The new company, Jaspers Industrie Assekuranz GmbH, is the third largest German broker. This and other investments have positioned us to support clients who have business operations and joint ventures in the Soviet Union and Eastern Europe.

Earlier this year, a McDonald's restaurant opened in the heart of Moscow. We took pride in knowing that our Canadian retail company, Reed Stenhouse Limited, provides risk management and insurance broking services for this new enterprise.

Our experience in Moscow with McDonald's and other clients builds on decades of success in Eastern Europe and the Soviet Union by Alexander Howden Reinsurance Brokers Limited. We are working to expand stable, long-term relationships that can benefit our clients during times of dramatic change. This reflects a management philosophy that A&A applies worldwide.

In this spirit of partnership, A&A also followed a coordinated strategy in responding to a series of natural disasters around the world. Our people did an especially outstanding job after Hurricane Hugo and earthquakes in California and New South Wales.

Insurance claims from these and other events prompted speculation that insurance prices would increase. Although prices are beginning to stabilize, projections of major increases have not materialized. We do not expect that our clients will face abrupt pricing changes such as those experienced in 1985 and 1986.

Your company marks its 90th anniversary with historical highlights elsewhere in this report. The corporate values that have sustained A&A since 1899 continue to be the foundation for our future. As an employee since 1953, I can report that today's employees follow the tradition of quality service that was established by our founders.

As we work toward our centennial, A&A has a well-defined corporate vision that will make effective use of our talent and energy. We are committed to expanding our proud heritage of creative, value-added client service.

Tinsley H. Irvin

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

T.H. Irvin

A&A's formative years, like those of my father's brokerage, spanned two world wars and the Great Depression. Most value-added services centered around developing new insurance capacity to cover our clients' growth.

Much of this capacity was developed here and in London with a focus on energy, heavy industry, mining and transportation. As a result of spreading and layering the risk, we were also able to enhance market stability and improve pricing.

To control the growing loss exposures of our clients, we organized innovative loss control services and specialized claims support facilities.

This was the foundation of the science of risk management, although the phrase itself wouldn't enter the lexicon for decades.

Horace H. Holcomb III is director of IMPACT, A&A Inc.'s liaison with the insurance marketplace. As a value-added service, IMPACT monitors financial developments, identifies appropriate insurance markets for our clients and helps to design new products. Horace joined A&A in 1969 through a merger with H.H. Holcomb & Sons, a Chicago insurance brokerage founded by his father.

When Alexander & Alexander was founded in 1899, America was charged with energy and optimism. Industrialization and immigration spurred the growth of cities. The country was emerging as an international military and economic power. Expanding businesses needed insurance services to respond to their risks and opportunities.

Cousins William F. and Herbert L. Alexander formed their insurance partnership in Clarksburg, West Virginia, where they served thé nearby growth industries of the day—coal, oil and railroads. A&A began its remarkable growth when William's brother, Charles B., replaced Herbert in 1902.

Innovation and service were their hallmarks. When fires created by internal combustion wreaked havoc in the natural gas business, A&A pioneered the inherent explosion clause of fire policies. With the transportation business—and associated risks—growing, the brothers designed excess public liability and employer liability covers for railroads.

Shortly after Charles Lindbergh made his historic trans-Atlantic flight in 1927, A&A developed an airline insurance program. It was soon standard for the industry.

During the Depression, Americans clamored for additional government benefits. Congress passed the Social Security Act and other legislation to put America back on its feet. Attuned to the human resource needs of its clients, A&A entered the life, accident, health and hospitalization fields in 1934.

A&A also expanded to serve clients wherever they did business. After winning its first major transportation account in 1914, the B&O Railroad, A&A opened an office across from B&O headquarters in Baltimore. In 1919, William Alexander moved to New York City to be closer to clients and major insurance markets. When the oil rush flourished in the West, offices were opened in Tulsa and other oil patch cities.

World War II marked yet another transition for America and for the insurance industry. During this period, A&A entered its "second generation" as leadership began shifting from the founders—a stage reached by fewer than one in 100 companies. By 1945, it was one of the nation's top three insurance brokers with revenues of more than $1 million.

Major technological breakthroughs in the 1920s—the Golden Age of Aviation—led to America's emergence as a leader in the passenger airline industry.

Financial security and employee benefits became a priority for American workers during the Depression-plagued 1930s.

Early in the century, popular entertainment took hold and flourished. Today, A&A subsidiary Albert G. Ruben & Company, Inc. is a leading broker for the multi-billion dollar film industry.

The company developed by Charles B. and William F. Alexander was founded in the foothills of Clarksburg, West Virginia. A&A's incorporation in 1922 extended management beyond the Alexander family for the first time. Ownership would thereafter remain with active management.

1901	McKinley assassinated; Theodore Roosevelt becomes president
1903	First airplane flies on own power
1904	Roosevelt wins full term
1906	San Francisco earthquake
1907	U.S. Financial Panic
1908	Taft elected president
1911	Triangle Shirtwaist Factory fire
1912	Titanic sinks
1912	Wilson elected president
1914	World War I begins
1914	Panama Canal opens
1914	Clayton Antitrust Act
1920	Commercial radio broadcasts begin
1920	Harding elected president
1921	Einstein receives Nobel Prize
1922	Mussolini marches on Rome
1924	Coolidge wins presidency
1925	Scopes "Monkey Trial"
1927	First talking picture publicly shown
1928	Penicillin discovered by Sir Alexander Fleming
1928	Herbert Hoover becomes president
1929	Wall Street crash
1932	Franklin Roosevelt defeats Hoover
1937	Golden Gate bridge completed
1939	World War II begins
1939	"Gone With the Wind" named best picture
1941	U.S. enters World War II
1943	Income tax withholding introduced
1945	FDR dies; Truman becomes president
1945	McCarran-Ferguson Act passed
1945	WW II ends; United Nations founded

If you have an opportunity to get an education, you have an opportunity to change the world. I believe this applies to me as well as to the people that I work with.

Training gives employees an extra measure of self-esteem, an extra measure of knowledge. It helps us feel more creative and confident about problem-solving.

1990 is going to be a difficult year, but we're not cutting back on developing our people. It has been very gratifying to say to staff: A&A is committed to increasing your value—both for your own self-esteem as well as for the company and our clients.

Karen G. Foley is U.S. director of Anistics, an A&A risk management consulting operation. She is chairperson of the 1990 Technical Excellence Conference for outstanding support personnel. A 1974 graduate of Hamilton College, Karen is participating in the Executive M.B.A. Program at the Wharton School of Business.

With the end of World War II, America reached a new level of prosperity. U.S. companies entered a golden age as they worked overtime to meet the demands of domestic consumers. Globally, American industry frequently dominated competitors, many of whom were struggling to overcome the devastation of war.

During this period, employee benefits became increasingly important. The first major medical group insurance contract was developed, as were the first noncancelable and guaranteed renewable, lifetime hospital-surgical-medical policies. Vision and dental care benefits were written into group policies.

A&A stayed abreast of technological, political and social developments. For example, the company worked closely with nuclear agencies as nuclear power became a promising energy source in the '50s. Special coverages were pioneered for oil exploration and drilling in the Gulf of Mexico. "All Risk" policies were developed for diesel locomotives and other rolling stock, as was coverage of railroad liability for loss or damage to property being moved under bills of lading.

In 1946, Roy Jenkins, one of A&A's first employees, became president. With the belief that "hard work gets the job done," he reinforced the company's commitment to client service. Under his leadership, A&A developed a strong national production and service organization. Sales, product and technical training were applied systematically throughout the company.

Recognizing that people were a company's most important asset, A&A established its human resource management division. It became a leader in health and welfare employee benefit programs, actuarial consulting and communications. By 1962, the foundation was completed for what later became the Alexander Consulting Group.

Service capabilities were also developed through acquisition of local and regional firms. Beginning in 1952, mergers resulted in offices in Atlanta, Pittsburgh, San Francisco, Miami, Philadelphia and elsewhere.

Nearly four decades and a cross-country trip after that 1952 championship season, the Dodgers and A&A are still on the same team.

Mass production of the computer in the early '50s resulted in its wide-spread use in business nationwide.

The economic boom of the post-war years created unprecedented opportunities—and risks—for the nation's industry. To meet our clients' accelerating needs, A&A President Roy Jenkins oversaw an aggressive recruiting and training program.

The space age, launched in the late 1950s, created a new frontier of large-scale catastrophic risks.

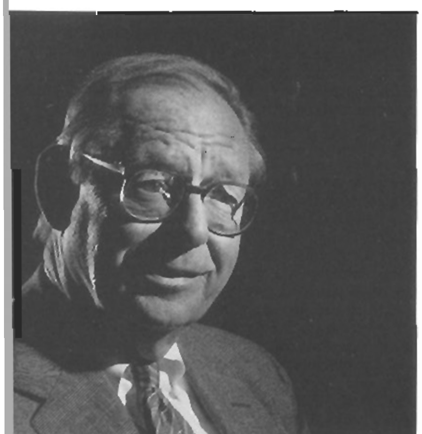
America's love affair with the automobile paved the way for a 40,000 mile interstate highway system and a massive exodus from the cities to the suburbs.

1946 Nuremberg trial verdict
1946 Churchill gives "Iron Curtain" speech
1947 Marshall Plan for Europe proposed
1948 State of Israel formed
1949 NATO established
1949 German Federal Republic established
1949 People's Republic of China proclaimed
1950 Korean War begins
1950 Nuclear propulsion developed
1951 Color television introduced
1952 George VI dies; Elizabeth II assumes throne
1952 Eisenhower defeats Stevenson for presidency
1953 Stalin dies
1953 Hillary climbs Mt. Everest
1953 Korean armistice signed
1954 Atomic submarine Nautilus launched
1954 Jonas Salk develops injective polio vaccine
1955 Labor groups AFL and CIO merge
1955 Warsaw Pact signed
1956 Egypt takes control of Suez Canal
1956 Interstate highway program launched
1957 U.S. passes Civil Rights Act
1957 Sputnik circles globe
1958 European Economic Community established
1958 Khrushchev becomes Soviet premier
1958 De Gaulle becomes French president
1958 Trans-Atlantic jet passenger service begins
1959 Castro takes power in Cuba
1960 John F. Kennedy becomes youngest U.S. president
1961 Berlin Wall erected
1961 Peace Corps established

Before my company merged with A&A, we were faced with a problem common to local brokers: how to keep pace with our clients' growing national and international requirements.

People were our main consideration in selecting a merger partner. It may sound trite, but A&A's senior management and our senior management had the same chemistry. The cultures were comparable. A&A was people-oriented.

I had been familiar with some of A&A's acquisitions for years. The Murphy Agency in Green Bay, S. Hammond Story in Atlanta, Clifton & Co. in San Francisco—these were all friends I had known through trade associations. All of a sudden, we were members of A&A. It was like being in the same club.



John A. Stough is managing vice president of A&A Inc.'s Louisville office and director of the National Construction Division. He was senior vice president and director of Nahm, Turner, Vaughan & Landrum, Inc., Kentucky's largest insurance broker, when it merged with A&A in 1982.

From the early '60s to the early '80s, the United States was transformed by the effects of the civil rights movement, growing ecological concerns and social upheaval fueled by the Vietnam War. Foreign companies began making inroads into key U.S. markets. "Stagflation"—a combination of inflation and recession—turned the economy upside down. Industry faced what architect Philip Johnson called "the challenge of chaos."

As urban problems grew, new classifications for property insurance in high risk areas were developed. High interest rates and double-digit inflation in the '70s led to life insurance policies that became investment vehicles such as universal and variable life policies. Jumbo jets, supertankers and offshore drilling platforms created large-scale risks. Health maintenance organizations and employee wellness programs reflected new trends in the health care system.

Health concerns prompted a greater interest in the environment. The Environmental Protection Agency was established. DDT was banned. Love Canal opened America's eyes to the potential dangers of toxic waste. Three Mile Island evoked similar concern over nuclear power.

Many U.S. industries—including insurance broking—entered a period of consolidation. Regional brokers and agents often faced a Hobson's choice of being a consolidator or of being consolidated. By merging with selected regional and local firms, A&A strengthened its position as a leading U.S. broker.

After A&A went public in 1969, growth accelerated under the leadership of chief executives Kenneth W. S. Soubry, William L. Carter, Jr. and John A. Bogardus, Jr. Over the next 20 years, A&A acquired more than 225 insurance brokers, agencies and consulting concerns.

Management sought out compatible firms that would provide high quality and innovative client services. Among its 1972 acquisitions was Anistics, part of A&A's risk management consulting operations.

By 1981, A&A had nearly 100 U.S. offices as well as numerous offices and joint ventures overseas. The stage was set for globalization.

By the 1970s, public policy was transforming the relationship between government and business. A&A established a Government and Industry Affairs office, which is unique among brokers. It monitors and analyzes policy developments affecting the insurance industry and various financial exposures of our clients.

Traditional risk management and public policy issues converged in the aftermath of the nuclear accident at Three Mile Island in 1979.

On April 22, 1969, A&A stock was publicly traded for the first time. Public ownership fueled the growth of A&A's services, enabling the company to meet growing national and international needs of clients. Photo shows John A. Bogardus, Jr., (center) and Kenneth W.S. Soubry (right) touring the New York Stock Exchange with a NYSE official.

Multi-billion dollar cargo risks required new coverages beyond the traditional boundaries of cargo insurance and reinsurance.

1963	France, West Germany sign treaty of cooperation
1963	Kennedy assassinated; Johnson sworn in
1964	Johnson re-elected
1965	Power blackout in New York region
1967	First human heart transplant
1968	Dr. King and Sen. Kennedy assassinated
1968	Lloyd's opens membership outside the U.K.
1968	Tet Offensive
1968	Nixon elected president
1969	First Concorde flight
1969	Woodstock
1969	Man walks on the moon
1970	First "jumbo" jet flies
1970	Occupational Safety & Health Act passes
1972	Watergate break-in
1973	Great Britain, Ireland and Denmark enter Common Market
1973	Israel and Egypt sign ceasefire
1974	Hank Aaron breaks Babe Ruth's record
1974	Nixon resigns; Ford sworn in
1975	Saigon falls
1976	Chairman Mao dies
1976	Resource Conservation and Recovery Act (RCRA) passed
1976	Carter elected president
1977	Alaska pipeline begins operation
1979	Shah leaves Iran
1979	Accident at Three Mile Island nuclear plant
1979	Carter and Brezhnev sign SALT II agreement
1980	Mount St. Helens erupts
1980	Congress establishe Superfund
1980	Reagan elected president
1981	Product Liability Risk Retention Act passes
1981	Sandra Day O'Conne appointed to Supreme Court

I started with Stenhouse in Manchester, England, more than 30 years ago. To be part of something so small and watch it grow into something so large, is thrilling.

Many brokers provide quality and professionalism. Only a handful can coordinate client service in far-flung parts of the world.

In Europe and Asia, we're seen as one of the few brokers who can give a broad range of engineering, risk management and loss control services. And our London operations have long-standing contacts with the reinsurance and specialty markets.

The breadth and depth of our resources are exceptional. Our clients recognize it, the insurance companies recognize it, the world recognizes it.

Ron W. Forrest is senior vice president and managing director, Global Business Development, based in New York. He was previously chief executive officer of Alexander Stenhouse Ltd., A&A's retail insurance broking subsidiary in Great Britain.

Foreign affairs dominated the headlines of this period as global issues touched almost every aspect of our lives. At the same time, the U.S. lost its unchallenged post-World War II economic leadership.

The rise of competing economic centers has been underscored by economist Lester Thurow. As he told A&A's U.S. managers in 1989, "We have gone from three-quarters to one-quarter of the world's GNP. This means that three-quarters of the economic opportunities are located outside of the United States."

One practical effect was an increasingly interrelated global economic structure. The European Community took unprecedented steps to create a single economic entity. The success of Japan, South Korea and other Pacific Rim powerhouses was even more evident. Free-market policies also began emerging in parts of Eastern Europe.

Anticipating this environment, A&A embarked on a globalization strategy to support the worldwide needs of its clients. The effects were dramatic. When A&A went public in 1969, 95 percent of its business was centered in the United States. Twenty years later, non-U.S. operations produced more than one-third of its operating revenues.

The 1982 acquisition of Alexander Howden expanded A&A's capabilities in wholesale and reinsurance broking. Howden also provided A&A with direct access to the London markets.

In 1985, A&A merged with Toronto-based Reed Stenhouse Companies, Ltd., the world's sixth largest broker. A&A's global service capabilities increased by more than 50 percent. Reed Stenhouse was particularly strong in the United Kingdom and Europe, Canada, Australia and New Zealand.

With a global organization in place, the company began refining its service network with strategic acquisitions. Additionally, management focused on the core A&A businesses of insurance broking, risk management and human resource management consulting. Professional and technical training was enhanced for A&A's 16,000 employees.

For 90 years, value-added, professional service has distinguished A&A as it responds to client needs in times of risk.

The Brandenburg Gate and the removal of the Berlin Wall symbolized the Eastern Bloc's move toward democracy and freer markets. A&A's service in Eastern Europe and the Soviet Union builds on long-standing ties of Alexander Howden Reinsurance Brokers Limited.

Flanking A&A Services Chairman and CEO T.H. Irvin are Executive Vice Presidents Michael K. White (left) and William M. Wilson. Mr. White directs retail operations in the U.S., Canada and Latin America, and global risk management and human resource management consulting. Mr. Wilson is responsible for retail operations in the U.K., Europe, Asia/Middle East and Australia/New Zealand as well as reinsurance and wholesale operations worldwide.

From ground-breaking in 1983 through the extinguishing of the torch, the 1988 Winter Olympic Games in Calgary, Canada, was financially protected by multi-million dollar coverages arranged through A&A's Reed Stenhouse Limited.

The globalization of business, politics and culture was accelerated by telecommunications technology, which allowed information to bypass national boundaries.

1982	First artificial heart implant
1982	Kohl becomes West German chancellor
1983	Hawke becomes Australian prime minister
1983	Lech Walesa wins Nobel Peace Prize
1984	Andropov dies; Chernenko named Soviet leader
1984	Olympics held in Los Angeles
1984	Brian Mulroney, Conservatives win Canadian election
1984	Indira Gandhi assassinated; Rajiv succeeds her
1984	Britain and China reach Hong Kong agreement
1984	Toxic gas leak in Bhopal, India
1985	Mikhail Gorbachev becomes Soviet leader
1985	Reagan and Gorbachev meet at summit
1985	Thousands die in Mexico earthquake
1985	Spain, Britain reopen Gibraltar borders
1986	Chernobyl nuclear accident
1986	Spain and Portugal join Common Market
1986	Britain and France agree to Channel tunnel
1986	Challenger disaster
1987	Hurricane-force storms hit U.K. and Europe
1987	Black Monday on Wall Street
1987	Gorbachev demands Communist Party reforms
1987	Thatcher wins third term
1987	French re-elect Mitterrand
1988	Benazir Bhutto chosen to lead Pakistan
1988	Earthquake in Soviet Armenia
1988	Yellowstone Park devastated by fires
1988	U.S. and Canada reach Free Trade Agreement
1988	Bush succeeds Reagan
1988	Australia celebrates bicentennial
1989	Hurricane Hugo
1989	Earthquakes in San Francisco, New South Wales
1989	Berlin Wall is dismantled

FINANCIAL CONTENTS

SELECTED FINANCIAL DATA

Alexander & Alexander Services Inc. (in millions, except per share amounts)	1989	1988	1987	1986	1985
Summary of Operations					
Operating revenues	$1,248.9	$1,227.7	$1,183.3	$1,134.6	$ 976.8
Operating income	107.6	122.2	113.6	163.4	123.2
Income from continuing operations	59.0	71.0	74.9	66.6	44.7
Loss from discontinued operations	—	(6.0)	(10.0)	(24.0)	(52.0)
Extraordinary credits	1.1	2.5	3.5	0.6	—
Net income (loss)	60.1	67.5	68.4	43.2	(7.3)
Per share of common stock:					
Income from continuing operations	$ 1.45	$ 1.71	$ 1.77	$ 1.62	$ 1.17
Loss from discontinued operations	—	(.14)	(.24)	(.58)	(1.36)
Extraordinary credits	.03	.06	.09	.01	—
Net income (loss)	$ 1.48	$ 1.63	$ 1.62	$ 1.05	$ (.19)
Cash dividends	$ 1.00	$ 1.00	$ 1.00	$ 1.00	$ 1.00
Weighted average number of shares	40.6	41.4	42.3	41.2	38.2
Financial Position					
Current assets	$1,892.7	$1,918.4	$1,962.1	$1,899.7	$1,685.0
Working capital	149.1	147.3	99.3	86.0	87.1
Total assets	2,604.7	2,635.2	2,661.8	2,481.6	2,183.0
Long-term debt	215.5	214.6	170.2	118.2	146.3
Stockholders' equity	375.1	371.6	389.4	324.4	284.0

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

General

Insurance services operations, which includes the Company's retail, wholesale, reinsurance broking and risk management operations, account for over 85% of total operating revenues. Overall revenue growth is influenced by many factors. Those factors include new business production, retention of existing business and new product development as well as interest and foreign exchange rates. However, the most significant factor affecting commissions and fees is premium rates charged by property and casualty insurance and reinsurance companies.

Beginning in late 1986 and continuing throughout most of 1989, intense competition among the insurance carriers for market share was reflected in double-digit declines in premium rates. In late 1989, following several significant natural disasters around the world, pricing on some lines of insurance began to stabilize. While it is too early to accurately predict the magnitude of premium rate changes in the near term, the Company anticipates premium rate fluctuations will not be as great as those experienced in the mid-1980s.

Operating revenues of the Alexander Consulting Group have reflected solid growth since the human resource management consulting operations were organized into a global unit during the latter part of 1986. Worldwide demand for consulting services for employee benefit programs and human resource management services continues at a strong pace. This demand is primarily due to constantly changing legislative and accounting regulations. In addition, escalating health care costs have created demand for alternative programs. The growth in this segment of the Company's operations has been primarily from internal sources and is expected to remain strong in the future.

Despite the continuing decline in property and casualty premium rates, consolidated operating revenues increased $21.2 million to $1,248.9 million in 1989. However, this revenue growth was not adequate to offset a modest increase of 3.2% in operating expenses. The result was an 11.9% decline in operating income for 1989.

Net income in 1989 declined by $7.4 million to $60.1 million with net income per share at $1.48, a 9.2% decrease. Income from continuing operations was $59.0 million compared to $71.0 million in 1988. In 1988, income from continuing operations included a non-recurring gain of $18.2 million on the sale of TIFCO Inc., offset in part by an $8.5 million provision relating to the 1987 sale of Shand, Morahan & Co., Inc.

The following discussion and analysis of significant factors affecting the Company's results of operations and liquidity and capital resources should be read in conjunction with the accompanying financial statements and related notes.

Results of Operations

Operating Revenues

Total operating revenues increased by 1.7% in 1989 compared to a 3.8% increase in 1988. Excluding the effects of foreign exchange rates, consolidated revenues increased by 2.9% and 1.7% for 1989 and 1988, respectively.

Insurance services revenues, which include interest income on fiduciary funds, increased by 1.1% in 1989 compared to 2.5% in 1988. Excluding investment income as well as the effects from changes in foreign exchange rates, worldwide insurance services commissions and fees declined by 5.2% in 1989 and 5.9% in 1988. In both periods, strong new business production was more than offset by reductions in premium rates and lost business.

In 1989, investment income on fiduciary funds increased by 28.9% due to higher short-term interest rates and slightly higher investment levels. Investment income on fiduciary funds increased by 2.8% in 1988 as reduced investment levels were more than offset by higher average short-term interest rates.

Human resource management consulting revenues increased by 9.3% and 16.0% in 1989 and 1988, respectively. This growth reflects the increased demand for consulting services in the areas of employee benefits, compensation programs and communications consulting. The demand for these and other human resource management consulting services is anticipated to remain strong throughout 1990.

Operating Expenses

Total operating expenses increased by 3.2% and 3.3% in 1989 and 1988, respectively. Excluding the effects of foreign exchange rates in both periods, operating expenses increased by 4.8% in 1989 and 0.9% in 1988. The Company's cost containment efforts should continue to favorably impact the rate of growth of normal operating costs.

Salaries and benefit costs increased by 1.0% in 1989 and 1.5% in 1988, reflecting reductions in the number of employees as well as the Company's efforts to control salary growth and employee benefit costs. In 1989, the Company recognized gains of $15.7 million from the settlement of pension obligations to certain retired employees in the U.S. In 1988, the Company adopted SFAS No. 87 for its international pension plans, the result of which was a reduction in pension expense of $12.6 million over the 1987 amount. After adjusting for these one-time items and the effects of changes in foreign exchange rates, worldwide salaries and related benefits increased by 4.7% in 1989 and 1.1% in 1988. Total staff costs reflect a decline in the number of employees of 1.2% in 1989 and 4.1% in 1988 primarily due to cost control measures and sold operations.

Other operating expenses increased by 6.8% in 1989 compared to a 6.5% increase in 1988. The 1989 increase included charges of $15.2 million reflecting a $7.5 million increase to the Company's professional self-insurance reserves arising from settlements connected with litigation in Puerto Rico and California as well as a $7.7 million write-off of certain system development costs. The 1988 increase included $7.3 million of costs associated with the decision to phase out the mainframe computer service operations of Anistics. After adjusting for these items and the effects of changes in exchange rates, other operating expenses increased by 5.0% and 2.0% in 1989 and 1988, respectively.

Premises and depreciation costs increased in both periods reflecting generally higher rents on leases and system costs associated with enhanced business information systems. Insurance costs for errors and omissions claims made against the Company includes both insurance coverage with third-party insurance companies and self-insured programs. The Company believes its reserves for the self-insured retention are adequate to cover all potential claims. There is no assurance, however, that rising litigation and claims costs will not adversely impact the costs of the Company's self-insurance programs and related insurance coverage.

Equity Earnings

As described in Note 4, the Company sold TIFCO Inc. in 1988 and Evanston Services Inc. in 1987. The results of these previously unconsolidated subsidiaries are presented on the equity basis through their respective dates of sales.

Other Income and Expenses

Investment income on non-fiduciary funds increased by $6.0 million in 1989 primarily due to an increase in interest rates. In 1988, investment income increased by $3.5 million due to higher interest rates and interest on the note receivable from the sale of TIFCO Inc.

Interest expense increased by $2.2 million in 1989 due to higher interest rates partially offset by a decline in average debt outstanding. Higher interest rates and an increase in average debt levels were the primary reasons for an increase of $6.8 million in 1988.

In 1989, other income (expenses) includes gains on sales of assets of $8.3 million, including a $5.3 million gain on the sale of an office building in the United Kingdom. These gains were partially offset by costs associated with certain of the Company's contingent liabilities referred to in Note 12.

Other income (expenses) in 1988 reflected a $26.3 million gain on the sale of TIFCO Inc., offset in part by a $10.9 million provision relating to indemnities given on the 1987 sale of Shand, Morahan & Company, Inc.

In 1987, the Company recorded gains of $24.1 million, 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.

Income Taxes

The Company's effective tax rate from continuing operations was 39.4% in 1989 and 43.5% in both 1988 and 1987 compared to statutory rates of 34% in 1989 and 1988 and 40% in 1987. State and local taxes, amortization of goodwill and certain expenses disallowed as deductions for tax purposes account for rates higher than the U.S. statutory rate. In 1989 and 1987, the effective rates were favorably impacted by the sales of real estate and businesses.

In December 1987, the Financial Accounting Standards Board (FASB) issued SFAS No. 96, "Accounting for Income Taxes." The Statement requires deferred income taxes to be calculated using the liability method whereby deferred taxes are adjusted currently for tax rate changes, as well as places limitations on recognition of deferred tax assets. As a result of the complex implementation issues associated with SFAS No. 96, the FASB has deferred the effective date to 1992. The Company does not plan to adopt the provisions of SFAS No. 96 until the required effective date. Based upon current tax rates, foreign exchange rates and the overall tax position of the Company, the adoption of the Statement is not expected to have a material impact on the Company's financial position.

Discontinued Operations

During 1989, the Company finalized reinsurance agreements providing the Atlanta and Bermuda insurance companies with coverage for their reserves as of December 31, 1988 and up to $50.0 million of additional insurance coverage for potential losses in excess of those reserves. The agreements also provide for a reinsurance premium adjustment. Based upon current loss projections, the estimated reinsurance premium adjustment is sufficient to cover the projected runoff expenses of these operations. As a result of this transaction and the adequacy of reserves covering the remaining contingent exposures, no additional provision was required to the Company's estimated loss on disposal of its discontinued operations in 1989.

In 1988, the $6.0 million provision recorded in the fourth quarter primarily represented the cost of the reinsurance agreement described above. In 1987, the $10.0 million provision primarily related to the estimated loss on the disposal of Sphere Drake Insurance Group.

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, including estimating insurance reserves and reinsurance recoverability.

Extraordinary Credits
The extraordinary credits of $1.1 million in 1989, $2.5 million in 1988 and $3.5 million in 1987 represent the tax benefit resulting from the utilization of net operating loss carryforwards.

Liquidity and Capital Resources
In 1989, cash flow generated from operations, supplemented by short-term borrowings and the proceeds from the sales of assets financed the operating and capital expenditure requirements of the Company, as well as dividend payments and the repurchase of common stock. The increase in cash and cash equivalents and short-term investments primarily represents fiduciary funds which are generally not available for the operating needs of the Company. The Company's cash equivalents and short-term investments primarily consist of government securities and bank time deposits and are of investment grade quality.

The Company's capital expenditures in 1989 primarily represent computer and other office automation equipment and technology, premises refurbishments and various acquisitions. Capital expenditures in 1990 are anticipated to approximate 1989's level.

In 1988 and 1987, the board of directors authorized the purchase of up to 5.0 million shares of the Company's stock. During 1989, the Company purchased and retired 0.2 million shares at a cost of $5.4 million, bringing the total number of shares purchased and retired to 3.7 million at a cost of $80.3 million. Future repurchases will be dependent upon the market price of the Company's common stock and other considerations.

The Company maintains long-term credit agreements, the primary one being a $100.0 million agreement which expires in 1993. Supplementing the credit agreements, the Company has committed unsecured lines of credit totaling $139.0 million as support for possible future cash needs.

In addition to $59.4 million from the sale of TIFCO Inc., the Company received $21.2 million in 1989 from the sales of assets, including $8.5 million from the sale of an office building. These proceeds were used to reduce bank borrowings.

In 1989, approximately $10 million of the total premiums for the reinsurance agreements discussed previously was funded by the Company. The remaining premiums were 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 believes that cash flow from operations, supplemented by the use of short-term borrowings, will be sufficient to satisfy working capital and other requirements in the future.

REPORT OF MANAGEMENT

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, written policies and guidelines, including the Company's policy on General Business Ethics, and careful selection and training of qualified personnel.

Deloitte & Touche 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 five 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

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

INDEPENDENT AUDITORS' REPORT

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, 1989 and 1988, and the related consolidated statements of income, cash flows and stockholders' equity for each of the three years in the period ended December 31, 1989. 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, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1989, in conformity with generally accepted accounting principles.

As discussed under Pension Plans in Note 10 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 No. 87.

Deloitte & Touche

DELOITTE & TOUCHE
Baltimore, Maryland
March 5, 1990

CONSOLIDATED STATEMENTS OF INCOME

Alexander & Alexander Services Inc.

For the three years ended December 31, (in millions, except per share amounts)	*1989*	*1988*	*1987*
Operating revenues:			
Insurance services	$1,075.3	$1,063.4	$1,037.6
Human resource management consulting	153.4	140.3	121.0
Other	20.2	24.0	24.7
	1,248.9	1,227.7	1,183.3
Operating expenses:			
Salaries and benefits	688.5	681.7	671.7
Other	452.8	423.8	398.0
	1,141.3	1,105.5	1,069.7
Operating income	107.6	122.2	113.6
Equity in unconsolidated operations (Note 4)	—	5.1	11.6
Other income (expenses):			
Investment income	17.1	11.1	7.6
Interest expense	(25.7)	(23.5)	(16.7)
Other (Note 4)	3.4	14.0	26.2
	(5.2)	1.6	17.1
Income from continuing operations before income taxes and minority interest	102.4	128.9	142.3
Income taxes (Note 5)	40.3	56.1	62.0
Income from continuing operations before minority interest	62.1	72.8	80.3
Minority interest	(3.1)	(1.8)	(5.4)
Income from continuing operations	59.0	71.0	74.9
Loss from discontinued operations (Note 2)	—	(6.0)	(10.0)
Income before extraordinary credits	59.0	65.0	64.9
Extraordinary credits (Note 5)	1.1	2.5	3.5
Net income	$ 60.1	$ 67.5	$ 68.4
Per share of common stock (Note 1):			
Income from continuing operations	$ 1.45	$ 1.71	$ 1.77
Loss from discontinued operations	—	(.14)	(.24)
Income before extraordinary credits	1.45	1.57	1.53
Extraordinary credits	.03	.06	.09
Net income	$ 1.48	$ 1.63	$ 1.62
Cash dividends	$ 1.00	$ 1.00	$ 1.00
Weighted average number of shares	40.6	41.4	42.3

See Notes to Financial Statements.

CONSOLIDATED BALANCE SHEETS

Alexander & Alexander Services Inc.
As of December 31, (in millions)

	1989	1988
Assets		
Current assets:		
Cash and cash equivalents	$ 357.5	$ 382.7
Short-term investments	327.7	192.4
Accounts receivable (net of allowance for doubtful accounts of $22.5 in 1989 and $24.5 in 1988)		
Customer accounts	1,136.8	1,213.8
Other	70.7	129.5
Total current assets	1,892.7	1,918.4
Property and equipment—at cost:		
Land and buildings (Note 7)	34.8	36.7
Furniture and equipment	315.2	314.3
Leasehold improvements	104.3	105.3
	454.3	456.3
Less accumulated depreciation and amortization	(214.6)	(195.0)
Property and equipment—net	239.7	261.3
Other assets:		
Long-term notes and other receivables (Notes 2 and 4)	69.0	77.9
Intangible assets (net of accumulated amortization of $97.3 in 1989 and $87.4 in 1988)	246.6	254.5
Other (Note 7)	156.7	123.1
	$2,604.7	$2,635.2
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$1,559.9	$1,590.5
Short-term debt (Note 6)	5.3	5.0
Other payables and accrued expenses	178.4	175.6
Total current liabilities	1,743.6	1,771.1
Long-term liabilities:		
Long-term debt (Note 7)	215.5	214.6
Deferred income taxes (Note 5)	103.2	107.5
Other (Notes 2, 10 and 13)	167.3	170.4
Total long-term liabilities	486.0	492.5
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 36.7 and 36.6 shares, respectively	36.7	36.6
Class A common stock, authorized 13.0 shares $.00001 par value; issued and outstanding 3.1 shares	—	—
Class C common stock, authorized 5.5 shares $1 par value; issued and outstanding 0.6 and 0.7 shares, respectively	0.6	0.7
Paid-in capital	287.6	284.7
Retained earnings	86.8	66.9
Accumulated translation adjustments	(36.6)	(17.3)
Total stockholders' equity	375.1	371.6
	$2,604.7	$2,635.2

See Notes to Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	1989	1988	1987
Cash provided (used) by:			
Operating activities:			
Income from continuing operations	$ 59.0	$ 71.0	$ 74.9
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and amortization	76.4	62.6	51.1
Deferred income taxes	2.2	6.6	16.7
Gains on disposition of subsidiaries and other assets	(7.8)	(18.3)	(29.5)
Gain on pension plan settlements	(15.7)	—	—
Other	5.8	11.1	10.3
Changes in assets and liabilities, net of effects from acquisitions and dispositions:			
Accounts receivable	34.8	5.3	17.8
Other assets	(6.5)	(4.5)	(5.1)
Accounts payable	26.3	(34.7)	(2.4)
Other current liabilities	4.4	(52.7)	(51.8)
Other liabilities	7.4	13.4	4.5
Net cash provided by operating activities before discontinued operations and extraordinary items	186.3	59.8	86.5
Discontinued operations	(10.5)	3.1	5.2
Extraordinary items	1.1	2.5	3.5
Net cash provided by operating activities	176.9	65.4	95.2
Investing activities:			
Purchases of property and equipment	(54.9)	(72.2)	(101.4)
Purchases of businesses (net of cash acquired)	(8.5)	(6.7)	(16.6)
Proceeds from sales of subsidiaries and other assets (net of cash sold)	80.6	19.3	57.6
Purchases of investments	(1,390.3)	(1,571.4)	(1,078.7)
Sales/maturities of investments	1,224.9	1,655.5	1,149.5
Net cash provided (used) by investing activities	(148.2)	24.5	10.4
Financing activities:			
Cash dividends	(40.2)	(41.4)	(42.3)
Net change in short-term debt	8.1	29.9	35.9
Additions to long-term debt	4.1	14.4	6.1
Repayments of long-term debt	(13.4)	(14.8)	(14.9)
Purchase of common stock	(5.4)	(56.1)	(18.8)
Issuance of common stock	3.6	0.4	0.9
Net cash used by financing activities	(43.2)	(67.6)	(33.1)
Effect of exchange rate changes on cash	(10.7)	3.5	21.2
Cash and cash equivalents at beginning of year	382.7	356.9	263.2
Cash and cash equivalents at end of year	$ 357.5	$ 382.7	$ 356.9
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$ 26.8	$ 23.7	$ 18.4
Income taxes (Notes 2 and 5)	29.8	46.4	66.8
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	3.2	18.4	8.3

See Notes to Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

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

	1989	1988	1987
Common stock:			
Balance, beginning of year	$ 36.6	$ 38.7	$ 35.4
Contributed to an employee benefit plan, 0.2 shares in 1987	—	—	0.2
Issued for acquisitions, 0.1, 0.2 and 0.7 shares, respectively	0.1	0.2	0.7
Conversions of Class A and Class C shares into common stock, 0.1, 0.3 and 2.3 shares, respectively	0.1	0.3	2.3
Common stock purchased and retired, 0.2 and 0.6 shares, respectively	(0.2)	(0.6)	—
Treasury stock retired	—	(2.0)	—
Other, principally stock option transactions	0.1	—	0.1
Balance, end of year	$ 36.7	$ 36.6	$ 38.7
Class A common stock:			
Balance, beginning of year	$ 0.0	$ 0.0	$ 0.0
Conversions into common stock, none, 0.2 and 1.6 shares, respectively	—	—	—
Balance, end of year	$ 0.0	$ 0.0	$ 0.0
Class C common stock:			
Balance, beginning of year	$ 0.7	$ 0.8	$ 1.5
Conversions into common stock, 0.1, 0.1 and 0.7 shares, respectively	(0.1)	(0.1)	(0.7)
Balance, end of year	$ 0.6	$ 0.7	$ 0.8
Paid-in capital:			
Balance, beginning of year	$284.7	$334.7	$327.7
Contributed to an employee benefit plan	—	—	4.8
Issued for acquisitions	3.1	4.6	0.6
Conversions into common stock	—	(0.2)	(1.6)
Common stock purchased and retired	(5.2)	(15.0)	—
Treasury stock retired	—	(41.3)	—
Other, principally stock option transactions	5.0	1.9	3.2
Balance, end of year	$287.6	$284.7	$334.7
Retained earnings:			
Balance, beginning of year	$ 66.9	$ 40.8	$ 14.7
Net income	60.1	67.5	68.4
Dividends	(40.2)	(41.4)	(42.3)
Balance, end of year	$ 86.8	$ 66.9	$ 40.8
Accumulated translation adjustments:			
Balance, beginning of year	$ (17.3)	$ (8.1)	$(54.9)
Foreign currency translation adjustments	(19.3)	(9.2)	46.8
Balance, end of year	$ (36.6)	$(17.3)	$ (8.1)
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. As described in Note 4, the Company sold TIFCO Inc. in 1988 and Evanston Services Inc. in 1987, and accordingly, the results of operations for these previously unconsolidated subsidiaries are presented on the equity basis through dates of sale in the accompanying Consolidated Statements of Income.

Cash Equivalents and Short-Term Investments

Cash equivalents are comprised of highly liquid investments with maturities of three months or less at the time of purchase and are carried at cost which approximates market value.

Short-term investments are comprised of investments with maturities at time of purchase of greater than three months but less than one year and are carried at cost which approximates market value.

Foreign Currency Translation

Assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at each year end. Operating results are translated at average rates of exchange prevailing during the year. Unrealized gains or losses resulting from translation 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 the operating results 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 none, $0.7 million and $1.2 million for the years ended December 31, 1989, 1988, and 1987, 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 intangible assets included in operating expenses amounted to $16.8 million, $15.6 million and $12.3 million for the years ended December 31, 1989, 1988 and 1987, 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. Investment income earned on these funds, included in operating revenues, amounted to $81.2 million, $63.0 million and $61.3 million for the years ended December 31, 1989, 1988 and 1987, 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 generally recognized upon notification from the insurance carriers. Contingent commissions and 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.

Presentation
Unless otherwise indicated, all amounts are stated in millions of U.S. dollars. Certain prior period amounts have been reclassified to conform with the current year presentation.

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.

In 1987, the Company sold Sphere Drake Insurance Group (Sphere Drake) for $55.5 million, including the settlement of an intercompany balance of $24.3 million. The sales agreement provides indemnities from the Company for various potential liabilities of Sphere Drake. In connection with certain of these indemnities, the Company purchased from the buyer pounds sterling 25.7 million zero coupon notes with interest rates from 10% to 12% due in 1995. These long-term notes receivable are included in the Consolidated Balance Sheets at a discounted value of pounds sterling 19.3 million ($31.1 million and $34.6 million at December 31, 1989 and 1988, respectively). The repayment of these notes by the buyer is subject to offset based upon the adequacy of the loss reserves and reinsurance recoverables recorded on the books of Sphere Drake at December 31, 1986. There has been some deterioration in loss reserves and uncollectible reinsurance balances, along with a court decision issued against Sphere Drake in the United Kingdom relating to an indemnified legal contingency. The decision is subject to appeal. The Company believes that the interest income on the zero coupon notes, the recognition of which will be deferred until realization is assured, continues to be in excess of any required indemnifications and offsets under the sales agreement.

During 1989, the Company finalized reinsurance agreements providing the Atlanta and Bermuda insurance companies, currently in runoff, with insurance coverage for their reserves as of December 31, 1988 and for up to $50.0 million of insurance coverage for potential losses in excess of those reserves. The agreements also provide for a reinsurance premium adjustment whereby at any time after January 1, 2001, the reinsurance agreements can be terminated and any excess funds, net of any reinsurance premium paid to a substitute reinsurance company, would be returned to the Company. Based upon current loss projections, the estimated reinsurance premium adjustment is sufficient to cover the future runoff expenses of the Atlanta and Bermuda 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,	*1989*	*1988*	*1987*
Pre-Tax Loss	$ —	$(16.7)	$(18.9)
Income Tax Benefit			
Current	—	(5.2)	(8.4)
Deferred	—	(5.5)	(0.5)
	—	(10.7)	(8.9)
Net Loss	$ —	$ (6.0)	$(10.0)

In 1988, the $6.0 million provision relates primarily to the net estimated cost of the reinsurance agreement of the Atlanta and Bermuda insurance companies.

In 1987, the $10.0 million provision relates primarily to the loss on the disposal of Sphere Drake.

Net Liabilities of Discontinued Operations

A summary of the net liabilities of the Company's discontinued operations as of December 31, 1989 and 1988, is as follows:

	1989	*1988*
Assets		
Cash and investments	$ 23.8	$ 73.3
Other assets	18.3	47.3
	42.1	120.6
Liabilities		
Claim liabilities	5.3	109.2
Other liabilities	18.5	10.1
	23.8	119.3
Corporate reserve for estimated loss on disposal (see below)	28.8	22.7
Net liabilities of discontinued operations	$ 10.5	$ 21.4

During 1989 and 1988, the Company remitted approximately $15.6 million and $10.6 million, respectively, to the discontinued operations representing tax benefits from prior years' losses and funding of claim liabilities.

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

	1989	*1988*	*1987*
Balance, beginning of year	$22.7	$15.3	$23.1
Provision recorded for estimated loss on disposal	—	6.0	10.0
Operating income (loss) of companies being runoff	6.6	(7.6)	(4.4)
Gain (loss) on divestitures	—	—	(7.8)
U.K. tax refunds	—	9.3	—
Other	(0.5)	(0.3)	(5.6)
Balance, end of year	$28.8	$22.7	$15.3

In 1988, the Company received tax refunds including interest from the Inland Revenue in the United Kingdom amounting to $9.3 million. 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.

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 during 1987. There were no poolings of interest in 1989 or 1988.

Purchases

The cost of businesses acquired by the Company in transactions accounted for as purchases aggregated $12.2 million in 1989, including 0.1 million shares of common stock; $25.4 million in 1988, including 0.9 million shares of common stock; and $24.8 million in 1987, including 0.1 million shares of common stock. The excess of the purchase price over the fair value of net tangible assets acquired was approximately $12.4 million, $25.1 million and $18.6 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 subsidiary, 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. Under an amended agreement, the remaining balance of $8.3 million, plus interest, is due in five installments from 1990 to 1994 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.

Revenues, income before taxes and net income relating to TIFCO through date of sale were $21.8 million, $5.1 million and $3.4 million, respectively, in 1988 and $31.8 million, $9.6 million and $5.4 million, respectively, in 1987.

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. (ESI), 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.

Revenues, equity earnings of ESI and net income relating to Shand through date of sale in 1987 were $23.1 million, $2.0 million and $0.3 million respectively.

The Company recorded a $10.9 million provision in 1988 relating to the indemnities given by the Company. The provision resulted from deterioration in loss reserves and additional uncollectible reinsurance balance notified to the Company by ESI, as well as the Company's estimate of additional deterioration based on the volatile nature of ESI's book of business which includes long-duration liability exposures. The 1988 provision also incorporated legal costs associated with defending the Company against other indemnified loss contingencies. In 1989, substantially all of the Company's estimate of the additional future deterioration was recorded by ESI, primarily as a result of one large claim and substantial reserve strengthening. As a result, the Company does not anticipate realizing any interest income on the contingent deferred payment balance.

While the provision is based upon management's best judgment and is adequate at this time based on information available to the Company, there is no assurance that further adverse developments may not occur due to the variables inherent in the estimation process.

Other
In 1989, a wholly owned United Kingdom subsidiary sold real estate for cash of approximately $8.5 million, resulting in a pre-tax and after-tax gain of $5.3 million and $4.7 million, respectively. 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 and after-tax gains on these transactions were approximately $21.5 million and $16.9 million, respectively. The pre-tax gains are included in Other Income (Expenses) in the Consolidated Statements of Income.

5. Income Taxes

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

For the years ended December 31,	*1989*	*1988*	*1987*
United States	$ 28.8	$ 74.8	$ 66.9
International	73.6	54.1	75.4
	$102.4	$128.9	$142.3

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

For the years ended December 31,	*1989*	*1988*	*1987*
Current:			
Federal	$15.3	$21.8	$12.2
State and local	4.0	7.9	5.7
International	18.8	19.8	27.4
	38.1	49.5	45.3
Deferred:			
Federal	(3.5)	3.9	14.4
State and local	.5	0.2	(0.2)
International	5.2	2.5	2.5
	2.2	6.6	16.7
Total tax provision	$40.3	$56.1	$62.0

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,	*1989*	*1988*	*1987*
Excess of tax over book depreciation	$ (0.2)	$ 1.8	$ 2.2
Tax leases	(3.0)	(2.8)	(3.2)
Financial accounting accruals, net	9.4	(0.1)	0.4
Net deferred gains on subsidiary dispositions	(3.4)	2.8	—
Net operating loss and other tax credit carryforwards	—	4.2	17.4
Other	(0.6)	0.7	(0.1)
	$ 2.2	$ 6.6	$16.7

A reconciliation of the tax provision and the amount computed by applying the U.S. federal income tax rate of 34% in 1989 and 1988 and 40% in 1987 to income from continuing operations before income taxes is as follows:

For the years ended December 31,	*1989*	*1988*	*1987*
Computed "expected" tax expense	$34.8	$43.8	$56.9
State and local income taxes-net of federal income tax benefit	2.9	5.4	3.4
Foreign statutory rates over (under) U.S. Federal statutory rate	1.4	2.8	(0.6)
Benefit of income taxed at capital gains or other rates	(2.1)	—	(3.8)
Amortization of intangible assets	2.5	2.8	2.1
Other non-deductible expenses	4.7	3.8	2.7
Other, net	(3.9)	(2.5)	1.3
Total tax provision	$40.3	$56.1	$62.0

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 Revenue Agent's Report in connection with the completion of the examination of the Company's 1982 U.S. consolidated federal 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 Appeals Division of the IRS on December 30, 1988, and is currently awaiting completion of additional work by the Examinations Branch of the IRS. 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.

The Company is currently under examination by the IRS for the years 1983 through 1986. During the years under examination, the Company recorded an $11.4 million tax benefit in connection with an indemnification policy taken out against the potential adverse effects of losses arising out of certain underwriting exposures. It is expected that the IRS will review the deductions associated with this item; however, the Company believes it will be successful in sustaining these deductions.

The extraordinary credits of $1.1 million in 1989, $2.5 million in 1988 and $3.5 million in 1987 represent the realization of tax benefits resulting from the utilization of net operating loss carryforwards. At December 31, 1989, the Company had, for financial reporting purposes, net operating loss carryforwards in the U.S. of approximately $1.6 million which will expire in the years 1996 to 1998.

At December 31, 1989, the net undistributed earnings of foreign subsidiaries aggregated approximately $226.8 million. Since these earnings are considered permanently invested, no provision has been made for additional U.S. income taxes which might result upon distribution of such earnings.

In December 1987, the Financial Accounting Standards Board (FASB) issued SFAS No. 96, "Accounting for Income Taxes," which requires that deferred income taxes be calculated using the liability method and restricts the conditions under which deferred tax assets can be recorded. Under this method, future tax liabilities will be adjusted in a current period for changes in income tax rates. As a result of the complex implementation issues in applying the provisions of SFAS No. 96, the FASB has deferred the effective date of this Statement to 1992. The Company does not plan to adopt SFAS No. 96 until the required effective date. Based upon current tax rates, foreign exchange rates and the overall tax position of the Company, adoption of the Statement is not expected to have a material impact on the Company's financial position.

6. Short-Term Debt

Consolidated short-term debt consists of the following:

As of December 31,	*1989*	*1988*
Commercial paper	$ 42.5	$64.9
Notes payable to financial institutions	52.7	21.0
Current portion of long-term debt (Note 7)	5.3	5.0
	100.5	90.9
Less short-term debt reclassified as long-term (Note 7)	95.2	85.9
	$ 5.3	$ 5.0

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

As of December 31,	*1989*	*1988*	*1987*
Commercial paper:			
Balance at year end	$42.5	$64.9	$34.8
Weighted average interest rate	8.7%	9.3%	8.3%
Maximum outstanding	$64.5	$64.9	$50.0
Average outstanding	$44.8	$51.2	$29.7
Weighted average interest rate during the year	9.5%	7.9%	7.0%
Notes payable to financial institutions:			
Balance at year end	$52.7	$21.0	$20.2
Weighted average interest rate	11.5%	10.9%	8.2%
Maximum outstanding	$52.7	$34.0	$21.1
Average outstanding	$26.5	$27.6	$ 4.3
Weighted average interest rate during the year	12.1%	9.6%	8.8%

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 $95.2 million, $89.8 million and $56.1 million in 1989, 1988 and 1987, respectively.

Including the $100 million credit facility described in Note 7(B), the Company has committed unsecured lines of credit totaling $239.0 million of which $202.6 million was unused as of December 31, 1989. 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 $65.6 million of uncommitted bank lines of credit which are available for general corporate purposes, of which $38.6 million was unused at December 31, 1989.

7. Long-Term Debt

Consolidated long-term debt outstanding is as follows:

As of December 31,	*1989*	*1988*
11% Convertible subordinated debentures (A)	$ 67.6	$ 67.6
Reclassified short-term debt (B)	95.2	85.9
Long-term credit agreement (B)	6.5	12.6
Obligation under capital lease (C)	21.8	20.7
Non-recourse mortgage notes (D)	20.2	20.5
Other	9.5	12.3
	220.8	219.6
Less current portion (Note 6)	5.3	5.0
	$215.5	$214.6

The principal portion of payments required during the next five years is $5.3 million in 1990, $9.7 million in 1991, $6.4 million in 1992, $5.7 million in 1993 and $5.7 million in 1994.

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 105.87% of par value prior to April 15, 1990, and at declining prices thereafter until April 15, 1997. Commencing April 15, 1992 and annually thereafter, 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 $100 million long-term credit agreement which expires in June 1993. The agreement 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, $95.2 million and $85.9 million of short-term debt has been reclassified as long-term debt at December 31, 1989 and 1988, respectively.

In addition, in 1988 a Canadian subsidiary entered into a three-year credit agreement 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 (13.5% at December 31, 1989) 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 $2.1 million for each of the next five years and an aggregate of $34.4 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 semiannual 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 Sheets as of December 31, 1989 and 1988, are as follows:

	1989	*1988*
Future minimum lease payments to be received	$ 76.7	$ 79.0
Unguaranteed residual value accruing to the benefit of the Company	7.9	7.9
Less unearned income	(62.6)	(64.3)
Net investment in lease	$ 22.0	$ 22.6

Future minimum lease payments to be received are approximately $2.6 million for each of the next five years and an aggregate of $63.7 million thereafter.

8. Common and Preferred Stock

Common Stock

In connection with the Reed Stenhouse Companies Limited (RSC) merger in 1985, the Company issued two new classes of voting equity securities, Class A and Class C common 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, 1989, the Company had 5.5 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 $46.7 million or $40.4 million, assuming certain solvency tests are met under Canadian law, and pounds sterling 43.8 million or $70.6 million, respectively, at December 31, 1989. 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.

In 1987, the board of directors authorized a series of preferred stock, Series A Junior Participating Preferred Stock (Preferred Shares), $1.00 par value per share and declared a dividend of one preferred share purchase right (Right) for each outstanding share of common stock, each common stock equivalent and each subsequently issued share. Each Right entitles the holder thereof to buy one one-hundredth 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 are redeemable by action of the board of directors prior to becoming exercisable at a redemption price of $.01 per Right. The Rights, which were in effect as of December 31, 1989, will expire on July 6, 1997.

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, 1989, the total number of shares purchased was 3.7 million at an average price of $21.77 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. Beginning in 1988, the cost of the Company's treasury stock has been allocated as a reduction of common stock and paid-in capital.

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 one 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 exercise 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 45,000 and 2,000 shares issued in 1989 and 1988, respectively.

Performance share/unit awards may be granted based upon certain performance criteria as determined by the Compensation and Benefits 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 63,300 and 121,600 performance share/unit awards made in 1989 and 1988, respectively.

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.

Stock Option transactions under these programs were as follows:

	Number of Shares	*Option Price Per Share Range*
Outstanding, January 1, 1987	1,546,586	$17.75–$38.63
Granted	956,600	17.75– 25.38
Exercised	(48,344)	17.75– 24.50
Canceled	(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
Canceled	(278,989)	
Outstanding, December 31, 1988	2,154,773	$17.75–$38.63
Granted	481,500	25.00
Exercised	(185,736)	17.75– 31.13
Canceled	(100,883)	
Outstanding, December 31, 1989	2,349,654	$17.75–$38.63

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

1989	1,254,304
1988	994,235
1987	865,463

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 does not anticipate making any contributions to this plan until the overfunding is substantially reduced.

During 1989, the Company's primary U.S. plan referred to above purchased annuity contracts for $37.4 million to settle the accumulated benefit obligations to certain retirees as of December 31, 1988. The resulting pre-tax gain of $15.7 million has been recognized as a reduction of 1989 pension expense and is included in salaries and benefits in the Consolidated Statements of Income.

Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," 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, under SFAS No. 87, for the years ended December 31, 1989, 1988 and 1987 are summarized as follows:

	1989	*1988*	*1987*
Service cost	$ 24.8	$ 25.2	$ 15.3
Interest cost	29.9	28.9	13.4
Actual return on plan assets	(101.5)	(54.3)	(10.9)
Net amortization and deferral	48.6	3.3	(13.8)
Net pension costs	$ 1.8	$ 3.1	$ 4.0

International pension expense totaled $16.1 million in 1987.

The following table sets forth the funded status and amounts recognized in the Company's Consolidated Balance Sheets as of December 31, 1989 and 1988:

	1989		*1988*	
	U.S.	International	U.S.	International
Vested benefit obligation	$ 109.1	$ 127.2	$ 118.6	$ 122.3
Accumulated benefit obligation	$ 118.9	$ 130.0	$ 130.8	$ 124.4
Projected benefit obligation	$(153.7)	$(228.2)	$(172.2)	$(203.5)
Plan assets at fair market value	211.9	310.2	217.0	259.0
Excess of plan assets over projected benefit obligation	58.2	82.0	44.8	55.5
Unrecognized net (gain) loss	(20.4)	(25.6)	(19.3)	4.1
Unrecognized prior service cost	(2.0)	6.7	4.7	—
Unrecognized net assets being amortized over 16 years	(25.8)	(48.2)	(36.9)	(52.6)
(Accrued) prepaid pension cost	$ 10.0	$ 14.9	$ (6.7)	$ 7.0
Assumed discount rate	9.0 %	9.0–10.25%	9.5 %	9.0–10.25%
Assumed rate of compensation increase	6.0 %	6.5– 9.0 %	6.0 %	6.0– 9.0 %
Expected rate of return on plan assets	10.75%	10.5–11.0 %	10.75%	10.5–11.0 %

At December 31, 1989 and 1988, approximately 75% and 63%, respectively, of all plan assets are invested in equity securities and 25% and 37%, respectively, in cash equivalents and/or fixed income 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 in 1989, $6.5 million, (including 0.1 million shares of common stock valued at $1.4 million) in 1988 and $6.7 million, (including 0.2 million shares of common stock valued at $6.0 million) in 1987.

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:

	1989	*1988*	*1987*
Total cost	$26.8	$28.2	$24.2
Number of employees (thousands):			
Active	9.3	9.6	9.8
Retired	1.7	1.3	1.4

Certain of the Company's international subsidiaries have similar plans for their employees; however, most retirees are covered primarily by government 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, $11.9 million and $10.7 million at December 31, 1989 and 1988, respectively, is included in Other Long-term Liabilities in the Consolidated Balance Sheets.

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
1990	$ 84.8
1991	76.0
1992	69.9
1993	63.2
1994	55.4
Thereafter	317.4
Total minimum lease payments	$666.7

Rent expense for office space, which includes property taxes and certain other costs, amounted to $91.3 million, $87.3 million and $82.8 million for the years ended December 31, 1989, 1988 and 1987, 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

The Company and its subsidiaries are 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.

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 and claims contain a variety of similar 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.

Prior to its sale in 1987, Shand and its subsidiaries provided underwriting management services for and 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 by the Courts of the Commonwealth of Pennsylvania in December 1986. In January 1990, the supervisory court approved a plan of rehabilitation for Mutual Fire. As part of the process of rehabilitation, the regulator controlling Mutual Fire may assert claims against Shand and its subsidiaries based upon Shand's relationship with Mutual Fire. 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 obligates the Company to certain indemnities 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 risk management program, which includes 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, 1989:

	Operating Revenues	*Operating Income*	*Identifiable Assets*	*Depreciation & Amortization*	*Capital Expenditures*
1989					
Insurance services	$1,075.3	$119.3	$2,346.2	$68.8	$ 47.7
Human resource management consulting	153.4	16.9	174.6	6.0	6.6
Other business	20.2	(0.5)	70.1	1.0	0.7
General corporate	—	(28.1)	13.8	0.6	1.6
	$1,248.9	$107.6	$2,604.7	$76.4	$ 56.6
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

	Operating Revenue	*Operating Income*	*Identifiable Assets*
Geographical areas:			
1989			
United States	$ 770.7	$ 79.2	$1,227.8
United Kingdom	210.8	27.0	800.2
Canada, principally RSC	125.6	15.1	190.0
Other countries	141.8	14.4	372.9
General corporate	—	(28.1)	13.8
	$1,248.9	$107.6	$2,604.7
1988			
United States	$ 776.8	$102.1	$1,271.9
United Kingdom	202.7	26.7	773.6
Canada, principally RSC	116.8	11.8	177.7
Other countries	131.4	7.2	397.7
General corporate	—	(25.6)	14.3
	$1,227.7	$122.2	$2,635.2
1987			
United States	$ 780.6	$108.4	$1,267.9
United Kingdom	180.5	12.3	735.3
Canada, principally RSC	121.4	11.3	190.6
Other countries	100.8	7.7	416.4
Equity in unconsolidated operations	—	—	39.6
General corporate	—	(26.1)	12.0
	$1,183.3	$113.6	$2,661.8

15. Quarterly Financial Data (Unaudited)

Quarterly operating results for 1989 and 1988 are summarized below (in millions, except per share data).

	Operating Revenues	*Operating Income*	*Income from Continuing Operations*	*Net Income*
1989				
1st	$ 302.5	$ 27.1	$12.0	$12.0
2nd	319.6	40.9	25.3	25.3
3rd	298.0	14.4	8.0	9.1
4th	328.8	25.2	13.7	13.7
Year	$1,248.9	$107.6	$59.0	$60.1
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

Per Share of Common Stock:

	Income from Continuing Operations	*Net Income*	*Dividends*	*High*	*Low*
1989					
1st	$ .30	$ .30	$ .25	$25¾	$22⅝
2nd	.62	.62	.25	26½	24
3rd	.20	.23	.25	29¾	24¾
4th	.33	.33	.25	34	29⅛
Year	$1.45	$1.48	$1.00		
1988					
1st	$ .39	$ .39	$ .25	$24½	$17⅜
2nd	.48	.48	.25	24¼	21½
3rd	.34	.40	.25	25⅞	21⅝
4th	.50	.35	.25	28⅛	23¼
Year	$1.71	$1.63(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 & OFFICERS, MAJOR SUBSIDIARIES AND OPERATING UNITS

ALEXANDER & ALEXANDER SERVICES INC.
BOARD OF DIRECTORS

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

James D. Berry[2][3]

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

John A. Bogardus, Jr.[4]
Former Chairman of the Board

Dr. Robert E. Boni[1][2][3]
Chairman & Chief Executive Officer
Armco Inc.
(A diversified steel company.)

Peter C. Godsoe[3]
Vice Chairman
The Bank of Nova Scotia

Angus M.M. Grossart[2][4]
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

EXECUTIVE & OTHER CORPORATE OFFICERS

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

Michael K. White
Executive Vice President & Director

William M. Wilson
Executive Vice President & Director

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

R. Alan Kershaw
Vice President & Treasurer

Jayne D. Maas
Vice President & Director of Taxes

Dr. Robert H. Moore
Senior Vice President
Corporate Relations

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

Donald L. Seeley
Vice President
Financial Management

Thomas Soper III
Vice President
Human Resources

Frank R. Wieczynski
Secretary

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

Dennis L. Mahoney
Chairman
Alexander Howden Limited

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

HUMAN RESOURCE MANAGEMENT CONSULTING SERVICES

Alexander Consulting Group Inc.

(1) Member, Executive Committee
(2) Member, Audit Committee
(3) Member, Compensation and Benefits Committee
(4) Member, Finance-Investment Committee

INVESTOR INFORMATION

Approximate Number of Equity Security Holders
As of March 2, 1990, there were approximately 2,850 record holders of the Company's common stock, 886 beneficial holders of Class A common stock and 1,696 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 1990 Dividend Payment Dates
March 30, June 29, September 28, December 31.

Notice of Form 10-K
A copy of the Company's 1989 Annual Report on Form 10-K 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 additional information should contact:
Frank R. Wieczynski
(301) 363-5000

Transfer Agents and Registrars
First Chicago Trust Company of New York
30 West Broadway
New York, N.Y. 10007-2192

Security Trust Company
B&O Building
2 North 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 & Touche

Annual Meeting of Shareholders
Date: Thursday, May 17, 1990
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

Antigua & Barbuda
Argentina
Australia
Austria
Bahamas
Bahrain
Barbados
Belgium
Bermuda
Bolivia
Brazil
British Virgin Islands
Canada
Cayman Islands
Chile
China
Colombia
Costa Rica
Curacao
Cyprus
Denmark
Dominica
Dominican Republic
Ecuador
Fiji
Finland
France
Greece
Grenada
Guadeloupe
Guatemala
Guyana
Haiti
Hong Kong
Indonesia
Ireland
Israel
Italy
Jamaica
Japan
Kenya
Kuwait
Luxembourg
Malaysia
Mexico
Montserrat
Morocco
Netherlands
New Zealand
Nigeria
Norway
Oman
Pakistan
Panama
Papua New Guinea
Paraguay
Peru
Philippines
Portugal
Puerto Rico
Qatar
St. Kitts & Nevis
St. Lucia
St. Vincent & the Grenadines
Saudi Arabia
Singapore
South Korea
Spain
Swaziland
Sweden
Switzerland
Taiwan
Thailand
Trinidad & Tobago
Turkey
Turks & Caicos Islands
United Arab Emirates
United Kingdom
United States
Uruguay
U.S. Virgin Islands
Venezuela
West Germany
Zaire

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Alexander & Alexander

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NEW YORK, N.Y. 10036