



Shareholders Report

Seventeenth Annual Shareholders Meeting
10th June, 2002

The Fairmont Southampton Princess Hotel

Southampton, Bermuda



Chartered in 1986, First Monetary Mutual Limited is a Bermuda based insurance company owned and operated by commercial banks, savings banks and savings and loan associations in the states of New York and Pennsylvania. Membership in the organization affords primary or wraparound Director's and Officer's Liability insurance coverage as a core benefit, and opportunities to build revenue streams through participation in the company's title and private mortgage reinsurance programs.

Ancillary benefits include a shareholder's meeting allowance, member reinvestment program, free web site design hosting, on-line access to the American Banker and comprehensive risk management services and our newest service, The Mortgage Exchange.

Two Bermuda symbols, the graceful longtail bird and a Bermuda moongate represent First Monetary's Annual Shareholders Meeting held each year in Bermuda. Bermuda's longtail bird, is a symbol of beauty and freedom. The Bermuda moongate is a coral-stone arch shaped like full moon and symbolizes unity, peace and happiness.



President's Report

2002 Report to Members

It's delightful to be "home" again and to welcome you to our 17th annual Bermuda shareholders meeting. The world is a dramatically different place since last we met. We've all been touched by the events of the last year in profound and lasting ways. As an organization, First Monetary honors the memory of lives lost, and the service of those who have given--and continue to give--so much for America.

THE NEW MARKET REALITY

As earthshaking as recent events were personally, they were near cataclysmic from an insurance perspective. September 11 was, by far, the most significant disaster in the history of insurance, and its effects have only been amplified by a high profile financial collapse that followed. Take heed, Presidents and CEO's -- the lessons of risk management, and the consequences of ignoring them, are being painfully driven home.

For several years, we've lived with the uncertainties of an artificially protracted insurance cycle, wondering, year after year, when we'd see the market turn. While it took a mega-event to precipitate change, what's happening now was not the result of a singular occurrence. We've said for years that the pricing/product relationship for many types of insurance products was becoming wildly skewed as the result of hyper-competition, and that things couldn't continue as they had. We shouldn't gloat, but that prediction has been vindicated.

In late 1999 and early 2000, insurers began to reverse the downward spiral of premium rates. An entire industry, hampered by adverse loss development, under-reserving, losses in stock portfolios and reductions in interest rates, struggled to return to profitability in 2001. Then came 9/11, negating any gains, and revealing dimensions of risk-like terrorism -- previously unknown.

To make matters worse, fallout from the collapse of Enron is affecting lines of insurance coverage, including D&O, virtually untouched by last September's events. Unlike the hard market of the mid-80's, which was essentially a liability crisis, the hardening we're now

experiencing crosses all lines of insurance. The year 2002 came in accompanied by an urgent need to return to underwriting profitability, and has provoked more severe contractions in capacity, greater price increases, additional policy restrictions, new exclusions and a greater number of insurer/reinsurer insolvencies than would normally be seen. For the first time in many years,



Francis J Shashaty, CPCU

non-renewal notices are going out in the mail alongside dramatically higher bills.

FIRST MONETARY PREPARED

It's times like these that a management philosophy like FM's, one that avoids wild swings in premium, sheds and avoids unnecessary risk exposures, and consistently applies a reserving policy that makes worst case claims scenarios easy to handle and reinsurers extremely comfortable pays handsome dividends. First Monetary looks awfully smart compared with large insurers in the broad commercial market. Coming into this meeting, we have no latent claims exposures or investment portfolio losses to concern ourselves with. Equally, or perhaps more important, we've secured a 2002 reinsurance contract on a very favorable basis.

It's a déjà vu situation for First Monetary. From an underwriting perspective, we are again in a position to quote coverage to groups other carriers are now declining, to grow while others contract, and thrive while others struggle. The attractiveness and competitiveness of our D&O product can only improve as buyers find out how vulnerable they are to the whims of the commercial market, and take in the cost of sticker shock renewals.

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THE FINANCIAL SNAPSHOT

A casual viewer would miss a lot if he or she relied entirely on current financials to form an opinion of this company without a context statement. An explanation is needed to unearth the hidden strengths of our balance sheets.

To date, the requirement to maintain a trust with New York State's Insurance Department have ensured FM would incur structural costs until its maturation in 2002. Confronted with this operational reality, and a static New York State D&O market, FM committed itself to the functional equivalent of a "branch opening strategy" in its 2000 business plan. Consistent with that plan, we acknowledged the company would incur a period of losses in the early going as expenses outpaced revenue growth. To protect the new and existing members against the budget loss to their share accounts, FM created a Rate Stabilization Reserve, to be used to allow members to avoid capital losses to their share account. Based on that plan, we remain on track, despite a temporary setback in 2001 precipitated by unforeseeable decline in interest rates and claims developments.

A close look at our situation and fundamentals reveals that the company is healthy and poised for strong resurgence provided that membership goals in our expansion plan can be achieved. In that outline, we forecast growth totaling thirty members, a pragmatic goal. While we have seen growth these past two years, the numbers haven't materialized at the pace originally anticipated.

The rate of growth we have achieved, however, coupled with a surprisingly fast expansion of PMI program, and new contributions from title reinsurance, has resulted in real and accelerating gross written premium. PMI results exceeded budgeted projections by a substantial margin last year, and we expect the number to pick up as more members start to utilize the program, and utilize it in greater volume.

Net income before Federal income tax posted an expected deficit, which grew again after shrinking the prior

year in line with estimates. Two uncontrollable variables account for a significant portion of the variance from forecast, a substantial decline in investment income directly attributable to an atypically rapid fall in interest rates, and increased expenses for claims, which went from what was effectively a zero figure in 2000 to \$60,000 in 2001. The upside to this is that interest rates have bottomed out, and are likely to tick upward as the economy stabilizes. With respect to claims, the effect is equally transitory. First Monetary's standard practice of conservatively reserving claims will benefit us in the 2002 reporting period. The \$60,000 claim we incurred last year has been settled for 1/3 the filed amount, permitting a corresponding takedown in the claim reserve to be put through in 2002. Member growth and further expansion in reinsurance income will narrow the gap further, and the benefit will be amplified by the positive effect this will have on our elective tax structure.

PROGRESS AGAINST THE BUSINESS PLAN

A suddenly altered D&O market is again awakening to the fact that First Monetary can provide a much needed safe haven for financial institutions ostracized by fair weather friends in the commercial market, but that won't keep us from transitioning the company from a single state, mono-line, captive mutual insurance company into a multi-state, multi-product, bank-owned service organization. We started that process with the addition of Employment Practices Liability coverage to the matrix in 1997, and have been adding new colors to the product revenue chart ever since.

FM's role is now defined as a provider and developer of unique, niche products that permit community bankers to offer insurance and generate insurance income without incurring huge cash outlays or taking on substantial expenses and risks. Our latest concept ideas to reinsure risk on policy coverages bank patrons need are being progressively translated into successful working programs that benefit community banks, community bank customers and First Monetary alike.

We've also made it a central goal to move our newly diversified company beyond New York's borders. FM has now secured formal regulatory approvals from both

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the Pennsylvania Banking Department and Federal Reserve for all banks in the Keystone State to participate in our organization, eliminating two potential impediments to growth. At this writing, ten have committed to First Monetary membership, with several more close to decisions. Regional promotions and meetings are taking place in partnership with the Pennsylvania Association of Community Bankers. PACB's immediate past Chairman, James McLaughlin, serves as a First Monetary officer, and several Pennsylvania bankers sit in as directors and alternate directors. With much of our forecast growth expected to come from our neighbor to the west, provisions have been made to create additional Board seats for those associates. We welcome their contributions.

The success of this expansion was largely made possible and driven by First Monetary's decision to enter the business of reinsurance. With the D&O market moribund - until this year at least - the reinsurance component of our operation has provided several important benefits. It gave us an attractive product that could draw new members, restore vitality to our marketing effort, relieve the pressures a soft D&O market subjected us to, and sustained important ancillary services like american-banker - firstmonetary online and INTERmoNETary Services.

Our Private Mortgage Reinsurance product grew from practically nothing to post almost \$50,000 in earnings contributions in just two years. With the working model in place, and success under our belt, FM launched Title Reinsurance in the fourth quarter of 2001, and is already starting to see returns.

Having come to realize the significant part that lending officers play in the growth of these lines, First Monetary sponsored a Mortgage Technology and Risk Management Conference and separate seminar last year to tout their benefits. Not only has this action provided the company an opportunity to cultivate a new kind of relationship with operations people, it's provided us the

chance to provide those people with tools and information they need to promote our programs properly, like the Monetary System Workstation laptop, and hand-on demonstrations of the new Monetary Mortgage and Deposit System. The latter item helps community banks manage their asset and liability risks, using the Internet to facilitate no-cost inter-bank deposits and mortgage transactions. Our beta testers have already suggested applications and tie-ins to other areas, like housing and personal property exchanges. With respect to reinsurance and mortgage technology, we'll continue to develop products wherever opportunities present themselves.

When the insurance trust matures later this year, we will once again take our pulse and reformulate our action plans. Contingency plans to effect an expense reduction can be formulated at year-end if a need for them becomes apparent. Discounting meeting and marketing related items, administrative expenses are actually down 10% from where they were twelve years ago, so the focus would have to be on those items. At this point, we remain hopeful that we can change perceptions, and simply grow our way clear of that necessity. We're just 25 members away from the target we need to hit.

I'd like to thank our new Chairman, Angelo Di Lorenzo, for his friendship, counsel and support, our board for their vision and faith, our domestic and Bermuda-based business associates for keeping things running and turning concepts into concrete products, past Chairmen Dave Swanson and Richard Komosinski for their years of distinguished service and all of you for making the effort worthwhile. Together, it's a great partnership.

Sincerely,

Francis J. Shashaty CPCU
President & CEO