MERCHANTS GROUP INC
Form 10-K
March 31, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
OR
| | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM __________ TO ___________.

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002
COMMISSION FILE NUMBER 1-9640

MERCHANTS GROUP, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	16-1280763
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 MAIN STREET, BUFFALO, NEW YORK	14202
(Address of principal executive offices)	(Zip Code)

716-849-3333
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Title of each class - COMMON STOCK, $.01 PAR VALUE PER SHARE NAME OF each exchange on which registered - AMERICAN STOCK EXCHANGE, INC.

Securities registered pursuant to Section 12 (g) of the Act: NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes |x| No | |

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |x|

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes | | No |x|

As of March 21, 2003, 2,110,152 shares of common stock were outstanding. The aggregate market value of the common shares held by non-affiliates of Merchants Group, Inc. on March 21, 2003 was $19,960,000. Solely for purposes of this calculation, the Company deemed every person who beneficially owned 5% or more of its common stock and all directors and executive officers to be affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2003 Annual Meeting of stockholders are incorporated by reference into Part III.

MERCHANTS GROUP, INC.

ANNUAL REPORT ON FORM 10-K
DECEMBER 31, 2002

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PART I

Item 1. BUSINESS.

General

Merchants Group, Inc. (the Company), which was incorporated in August 1986 as a Delaware holding company, offers property and casualty insurance to preferred risk individuals and small to medium sized businesses in the northeastern United States through its wholly owned subsidiary, Merchants Insurance Company of New Hampshire, Inc. (MNH).

Administration

The Company and MNH operate and manage their business in conjunction with Merchants Mutual Insurance Company (Mutual), a New York domiciled mutual property and casualty insurance company, under a management agreement (the Management Agreement). At December 31, 2002, Mutual owned 12.1% of the Company's issued and outstanding common stock. The Company and MNH do not have any operating assets and MNH has only one employee. Under the Management Agreement, Mutual provides the Company and MNH with the facilities, management and personnel required to operate their day-to-day business. All costs incurred by Mutual with respect to underwriting expenses are shared pro rata between Mutual and MNH based upon their annual direct premiums written, and unallocated loss adjustment expenses are allocated on the basis of the number of claims outstanding each month that are attributable to each company. All of Mutual's and MNH's investment expenses are shared pro rata based upon the average book value of the invested assets of each company. MNH also pays Mutual an annual management fee of $50,000. The Management Agreement requires that the Company and MNH pay Mutual 110% of Mutual's costs of providing them with non-insurance related services, and that the Company pay Mutual an annual fee of one half of one percent (.5%) of the average book value of the Company's invested assets exclusive of the Company's shares of MNH. Since the inception of the Management Agreement, Mutual has not provided the Company or MNH with any non-insurance related services.

The Management Agreement has certain features that are intended to prevent conflicts of interest or to deal with them on an equitable basis should they occur. Generally, business opportunities which are presented to the common officers or employees of the companies must be presented to each company's Board of Directors and approved and determined to be fair to each company in the transaction by a majority of the directors of each company who are not affiliated with any other company in the transaction.

Any amendment to or modification of the Management Agreement must be approved by the New York Insurance Department (the Department). The Management Agreement provides that it may be terminated by any party to the agreement upon five years written notice. On July 23, 1998, the Company gave notice to Mutual of the Company's intention to terminate the Management Agreement effective July 23, 2003. Mutual and MNH have jointly developed and paid for all accounting, computer and insurance marketing systems used in their businesses. Upon termination of the Management Agreement, each company has the right, at no cost, to obtain copies of all these systems, together with the right to use these systems in perpetuity.

The Boards of Directors of the Company, MNH and Mutual have agreed in principle for Mutual to continue to provide administrative and management services to the Company and MNH and to manage the traditional property and casualty insurance business of MNH under a new agreement (the "Services Agreement"). The new arrangement is intended to be effective as of January 1, 2003, thereby superceding the Management Agreement as of that date, and also provides for the pooling of the insurance business traditionally written by MNH and Mutual (the "Traditional Business"), in order to achieve common underwriting results.

The Services Agreement perpetuates the existing relationship among the companies for the services provided under the Management Agreement, except for changes in determining the fees for administrative and investment management services and the termination provisions for the various services. The Services Agreement provides for negotiated fees (subject to periodic adjustment) for accounting, actuarial, and other administrative services. The fee for investment services is 20 basis points (annually) for the first $100 million of invested assets managed by Mutual, plus 8 basis points (annually) for the amount of invested assets in excess of $100 million. The Company and MNH have the discretion to remove assets from their portfolio managed by Mutual. The Services Agreement does not provide for the payment by MNH of the $50,000 annual management fee as required under the Management Agreement. The Company and MNH expect the fees in 2003 under the Services Agreement to approximate what they would have been under the Management Agreement had it remained in place. In future years, the fees under the Services Agreement may be greater or less than under the Management Agreement, depending on the nature and amount of premiums written by MNH, if any, in addition to its Traditional Business.

Unlike the Management Agreement, which was subject to a five-year notice of termination for all services provided, the Services Agreement contains notice of termination provisions that vary for the services rendered. Underwriting services may be terminated on one year's notice, but the termination may not be effective before January 1, 2008. Claims services may be terminated on 6 months notice, but not before January 1, 2005. Administrative or investment services may be terminated upon one year's notice at any time.

Under the terms of the proposed reinsurance pooling agreement (the "Pooling Agreement"), Mutual and MNH have agreed to "pool," or share, underwriting results on their Traditional Business, retroactive to and effective as of January 1, 2003. The Pooling Agreement applies to premiums earned and losses incurred after the effective date. It will not apply to any new endeavor of either Mutual or MNH outside of their Traditional Business, unless the companies agree otherwise.

The Pooling Agreement provides for MNH to cede, or transfer, to Mutual all of its premiums and risks on its Traditional Business during the term of the agreement, and then to assume from Mutual a percentage of all of Mutual's and MNH's Traditional Business (the "Pooled Business"). MNH will assume 40% of the Pooled Business in 2003, though not to exceed $68 million in net written premiums. MNH's share of the Pooled Business will be reduced to 35% of the pooled business in 2004, though not to exceed $59.5 million in net written premiums, and to 30% of the pooled business in 2005, though not to exceed $50.0 million in net written premiums. MNH's share of the Pooled Business will be reduced to 25% in 2006 and 2007, though not to exceed $42.5 million and $37.5 million in net written premiums, respectively. If the parties agree, MNH may increase its share or maximum assumed net premiums written, of the Pooled Business for any year. The decreasing assumption of Traditional Business under the Pooling Agreement is intended to provide MNH with the capacity to pursue insurance opportunities independently of Mutual, thereby reducing its dependency on Mutual as its only source of business. The Company and MNH are seeking to identify new business initiatives to employ the available capacity. Generally, the new business initiatives are expected to be in lines of business which are complementary to the Traditional Business underwritten through the Pooling Agreement with the Mutual. At this time, no specific initiatives have been identified by the Company. MNH will continue to service and insure its Traditional Business through Mutual, but Mutual will retain a share of the risk for such business under its control pursuant to a profit and loss sharing arrangement in the Pooling Agreement based on the loss and loss adjustment expense experience of the Pooled Business. The Company believes the Pooling Agreement and profit (or loss) sharing feature included therein will further align the interests of MNH and Mutual.

The Pooling Agreement may be terminated by either party at the beginning of any calendar year on or after January 1, 2008 upon not less than 13 months notice. However, the Pooling Agreement may be terminated effective as of January 1, 2006 or 2007 upon 13 months notice, but only by MNH and only if the ratio of net losses and loss adjustment expenses to net earned premiums on a cumulative basis from the inception of the Pooling Agreement, as of the date notice is given, exceeds 76%.

The proposed Services Agreement and Reinsurance Pooling Agreement are subject to the approvals of the New Hampshire and New York Insurance Departments, which presently are being sought. In order to ensure uninterrupted service to policyholders and agents pending regulatory approval of the proposed agreements, the Boards of Directors of the Company, MNH and Mutual have agreed to extend the effective date of termination of the Management Agreement until the earlier of the effective date of the Services Agreement, upon approval by the insurance departments, or January 1, 2004.

Marketing

Mutual markets the Traditional Business of the Company and Mutual jointly through approximately 485 independent agents. The primary marketing efforts of the Company and Mutual (collectively referred to as "Merchants") are directed to those independent agents who through their insurance expertise, access to a broad range of products and focus on service, provide value for the insurance consumer.

Mutual and the Company offer the same portfolio of insurance products, the Company to "preferred" risks and Mutual to "standard" risks. Preferred risks meet more restrictive underwriting criteria than standard risks and generally generate lower losses. Accordingly, the preferred risks are charged preferred rates, generally 10-15% lower than standard rates.

The Company believes that Merchants as a regional insurance group has certain advantages, including a closer relationship with its agents and a better knowledge of its operating territories, that enable it to compete effectively against larger regional and national carriers. The Company believes Merchants distinguishes itself from its competitors by providing its agents and policyholders with superior service and ease of doing business, products that target certain segments of the commercial and personal insurance markets, and an agents' compensation program which, in addition to standard commission rates, provides agents with a profit sharing plan.

Through Mutual, the Company services its agents from six Strategic Business Centers and from its home office in Buffalo, New York. The Strategic Business Centers are located in the Company's operating territories and focus primarily on policy sales and underwriting. The manager of a Strategic Business Center appoints new agents, agrees upon annual unit sales and premium objectives with the principal(s) of each agency, and ensures that the principal(s) of the agency communicates these objectives to the agency's sales staff. Strategic Business Center managers and Territory Managers, or "TM's," develop customized business plans for each agent that identify the opportunities to increase profitable business and the actions required to achieve the objectives agreed to by the agency and the Company.

TM's meet frequently with targeted agents' sales staff to review Merchants' renewal policies, as well as to solicit policies new to the agent and/or Merchants. While TM's are capable of providing quotes directly to the agent while in an agent's office, much of that capability is migrating to Merchants' internet website: merchantsgroup.com. There, agents will be able to obtain instant quotes for selected commercial lines of business. Presently, only the businessowners line is available for instant quoting but Merchants expects that most commercial lines will be available for quoting by the end of 2003. In addition, selected lines will be enabled for "issue from quote", allowing agents to enter all underwriting information required to issue policies for their customers over the password protected "Agency Gateway" of the website. This will allow for quicker responses to agents' quote requests and will reduce expenses associated with manual quoting.

Each Strategic Business Center has an Agents' Advisory Council that meets at least twice a year. The Advisory Councils provide a forum for Merchants and its agents to discuss issues of mutual interest, and assure that the agents' business needs are being considered by Merchants. Additionally, the Co-chairpersons of the Advisory Councils from each Strategic Business Center meet twice each year with senior officers of Mutual.

In addition to standard commissions paid as a percentage of premiums written, the Company's agents are eligible to participate in the Agents' Profit Sharing Plan. This plan rewards agents based on premiums written and the loss and allocated loss adjustment expense ratio on business placed by the agent with the Company and Mutual. Company payments under the Agents' Profit Sharing Plan for 2002 totaled $948,000, or 1.3% of total direct premiums written. The Company believes the terms of its Agents' Profit Sharing Plan encourage its agents to increase the volume of profitable Traditional Business they place with Merchants.

Insurance Underwriting

The Company is licensed to issue insurance policies in 13 states, primarily in the northeastern United States. In 2002, net premiums written totaled $70,528,000, with 38% of the net premiums written derived from commercial lines of insurance and 62% from personal lines of insurance. In 2002, net premiums written for MNH and Mutual combined totaled $164,096,000, with 44% derived from commercial business and 56% derived from personal business.

The following table sets forth the distribution of the Company's direct premiums written by state for the years indicated:

	As of December 31,		
	2000	2001	2002
New York	66%	66%	67%
New Jersey	16	12	9

New Hampshire	8	10	10
Rhode Island	4	5	5
Pennsylvania	2	2	5
Massachusetts	3	3	2
Other	1	2	2
Total	100%	100%	100%

The Company and Mutual are licensed to underwrite most major lines of property and casualty insurance. They issue policies primarily to individuals and small to medium sized commercial risks. The types of risks insured include:

- Personal automobile - full coverage of standard performance automobiles, generally requiring drivers with good driving records during the past three years.

- Homeowners' - properties generally with no losses in the last three years that are less than 30 years old and valued between $125,000 and $500,000.

- Commercial automobile - primarily light and medium duty vehicles operating in a limited radius, with complete background information required of all drivers.

- Commercial multi-peril - properties with medium to high construction quality and low to moderate fire exposure, and occupancies with low to moderate exposure to hazardous materials and processes.

- General liability - low hazard service, mercantile and light processing businesses, generally with at least three years of business experience and with no losses in the last three years.

- Workers' compensation - risks with low loss frequency and severity, low to moderate exposure to hazardous materials and processes, and favorable experience modification factors. Generally, workers' compensation insurance is written in conjunction with other commercial insurance.

Agents of the Company are also agents of Mutual, which generally sells the same lines of insurance as the Company to standard risk individuals and businesses. Applicants that meet the Company's preferred risk criteria are issued policies by the Company at a policy premium lower than rates charged by Mutual for standard risks. Applicants that do not meet the Company's underwriting criteria, but which meet the less restrictive criteria of Mutual, are issued policies by Mutual, generally at higher premium rates.

The Company and Mutual utilize automated underwriting procedures for personal automobile, homeowners and certain commercial lines of business, which perform an initial review of policy applications based upon established underwriting guidelines. Applications that do not meet the guidelines for automated acceptance are either referred to underwriters who review the applications and assess exposure, or rejected if the risk characteristics are such that neither the Company nor Mutual would insure the applicant.

From 1993 through 1995, under a quota share reinsurance agreement with Mutual, MNH assumed 10% of the standard risks insured by Mutual, which would not generally have met MNH's more stringent underwriting guidelines. The terms of that agreement allow Mutual to reduce its cessions to MNH to 0% of Mutual's direct voluntary premiums written for any calendar year prior to the beginning of that calendar year. Mutual has not ceded any of its voluntary direct written premiums to MNH since 1995 and has informed the Company that it will not cede any of its voluntary direct written premiums to MNH in 2003 under this agreement.

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The Company establishes premium rates for most of its policies based on its loss experience, in some cases after considering prospective loss costs suggested by the Insurance Services Office, Inc., an industry advisory group, for the preferred individual and commercial classes of business that it insures. The Company establishes rates independently for its personal automobile and homeowners insurance policies and its specialty products, such as its Contractors Coverall Plus and businessowners' policies. Mutual develops rates in the same manner.

The following table shows, for each of the years in the three year period ended December 31, 2002 (i) the amount of the Company's net premiums written attributable to various personal lines and commercial lines and (ii) underwriting results attributable to each such line as measured by the calendar year loss and allocated loss adjustment expense (LALAE) ratio for such line. The LALAE is the ratio of incurred losses and allocated loss adjustment expenses to net premiums earned for a given period.

	Year ended December 31,						
	2000			2001			
	Premiums Written			Premiums Written			Premiums Written
	Amount	%	LALAE Ratio	Amount	%	LALAE Ratio	Amount
	(dollars in thousands)						
Personal							
Auto Liability	$17,295	18.3%	86.9%	$20,059	21.3%	96.4%	$21,565
Auto Physical Damage	12,031	12.8	55.6	13,254	14.1	53.8	12,694
Homeowners' Multi-Peril	9,144	9.7	60.6	9,847	10.5	39.1	9,620
Total	38,470	40.8	71.1	43,160	45.9	70.8	43,879
Commercial							
Auto Liability	15,548	16.5	96.1	12,685	13.5	73.2	6,227
Auto Physical Damage	4,065	4.3	59.3	2,972	3.2	44.2	1,225
Commercial Multi-Peril	25,900	27.4	60.9	27,411	29.2	91.0	14,885
Workers' Compensation	7,421	7.9	84.5	6,735	7.2	71.1	3,778
Other Lines	2,938	3.1	12.6	1,010	1.0	(39.5)	534

Total	55,872	59.2	69.8	50,813	54.1	74.7	26,649
Total Personal & Commercial	$94,342	100.0%	70.3	$93,973	100.0%	72.6	$70,528

Calendar year loss ratios set forth in the table above include an estimate of losses for that accident year, as well as increases or decreases in estimates made in that year for prior accident year losses. Depending on the size of the increase or decrease in prior accident year losses, calendar year loss ratios may not be as indicative of the profitability of policies in force in a particular year as accident year loss ratios, which do not take into account increases or decreases in reserves for prior accident year losses.

The following table sets forth the composition of voluntary direct premiums written for 1998 through 2002:

	As of December 31,				
	1998	1999	2000	2001	2002
Commercial	58%	61%	64%	58%	40%
Personal	42	39	36	42	60
Total	100%	100%	100%	100%	100%

Commercial Lines

The Company's commercial business is primarily retail and mercantile in nature and generally consists of small to medium sized, low hazard commercial risks which as a group have relatively stable loss ratios. The Company's underwriting criteria attempts to exclude lines of business and classes of risks that are considered by the Company to be high hazard or volatile, or which involve substantial risk of latent injury or other long-tail liability exposures. Although the commercial underwriting objectives of the Company and Mutual are similar, the Company has refined its selection criteria to include specific classes of businesses, occupancies, and operations with lower hazard ratings, which present a relatively lower exposure to loss and are charged a correspondingly lower premium. The Company and Mutual offer specialized products within the commercial multi-peril line such as the Contractors Coverall Plus policy for artisan and trade contractors, with the Company writing those contractors that meet stricter eligibility criteria.

The Company believes that it and Mutual can insure commercial business profitably by selecting those classes of risks that offer better than average profit potential and charging rates commensurate with the quality of the risk insured. Merchants competes for commercial business based upon the service it provides to agents and policyholders, the compensation it pays to its agents and the price of its products. Merchants establishes prices after considering its costs, the exposures inherent in a particular class of risk, estimated investment income, projected future trends in loss frequency and severity, the degree of competition within a specific territory and reasonable provisions for profit. Accordingly, the prices of the Company's commercial products may vary considerably in relation to competitors' prices.

Personal Lines

The Company offers personal automobile and homeowners' insurance to preferred risk individuals, generally requiring experienced drivers with no accidents or moving violations in the last three years for personal automobile insurance, and medium to high value homes with systems that are less than thirty years old in fire protected areas for homeowners' insurance. Personal automobile premium rates attempt to cover costs associated with required participation in involuntary personal automobile programs, in addition to the costs directly associated with the policies written voluntarily.

Recently in New York, some insurers have stopped insuring persons with poor driving records or with a poor history of maintaining insurance in force. This has caused an increase in the number of people obtaining insurance from New York's involuntary personal automobile insurance program (NYAIP), which is responsible for the substantial increase in premiums written by the Company through the NYAIP. Due to the magnitude of the increase in the NYAIP and the poor loss experience associated with that business, the Company has been unable to cover the costs of the NYAIP business with premium rates charged for its voluntary personal automobile business. The Company cannot predict the size of the NYAIP in future years.

Pooling Agreement

The Company and Mutual have agreed, subject to regulatory approval which is pending, to pool their Traditional Business premiums and losses effective January 1, 2003. The Company believes pooling of risks will be advantageous for the following reasons: (1) Mutual's risk selection, pricing, marketing and claims philosophies and practices are consistent with and complementary to the Company's; (2) as market conditions change, management can adjust eligibility criteria to permit Merchants as a group to fully participate in a favorable rate environment without concern for any conflict of interest; (3) pooling, especially with Mutual subject to profit and loss sharing, more closely aligns the interests of the Company and Mutual; and (4) by reducing its share of participation in the pool, the Company is able to create more capacity to pursue other endeavors, which it might not otherwise be able to do as a result of regulatory constraints on non-renewal of business, particularly for personal lines business. See "Competition" in this Item on page 18.

Involuntary Business

As a condition to writing voluntary business in most states in which it operates, the Company must participate in state-mandated programs which provide insurance for individuals and businesses unable to obtain insurance voluntarily, primarily for personal automobile insurance. The legislation creating these programs usually allocates a pro rata portion of the risks attributable to such insureds to each company writing voluntary business in the state on the basis of its historical voluntary premiums written or the number of automobiles which it historically insures voluntarily.

The Company's gross (direct and assumed) premiums written attributable to involuntary policies were $2,158,000, $5,850,000 and $8,292,000 in 2000, 2001 and 2002, respectively, mostly in New York. The Company is unable to predict with any degree of accuracy the level of its annual involuntary business for 2003 or future years.

Claims

Insurance claims on policies written by the Company are investigated and settled by claims adjusters employed by Mutual pursuant to the Management Agreement. Mutual maintains three claims offices within their operating territories. In areas where there is insufficient claim volume to justify the cost of internal claims staff, the Company and Mutual use independent appraisers and adjusters to investigate claims. The Company's claims policy emphasizes timely investigation of claims, settlement of valid claims for equitable amounts, maintenance of adequate reserves for claims and control of external claims adjustment expenses. In order to support its claims policy, the Company maintains a program designed to ensure that as soon as practical, claims are assigned an accurate value based on available information. The program includes the centralization of certain branch claims operations and an emphasis on the training of claims adjusters and supervisors by senior claims staff. This claims policy is designed to support the Company's marketing policy and provide agents and policyholders with prompt service and support.

Claims settlement authority levels are established for each adjuster, supervisor and manager based on their expertise and experience. When the Company receives notice of a claim, it is assigned to an adjuster based upon its type, severity and line of business. The claims staff then reviews the claim, obtains appropriate information and establishes a loss reserve. Claims that exceed certain dollar amounts or that cannot be readily settled are assigned to more senior claims staff.

Loss and Loss Adjustment Expense Reserves

The Company, like other insurance companies, establishes reserves for losses and loss adjustment expenses (LAE). These reserves are estimates intended to cover the probable ultimate cost of settling all losses incurred and unpaid, including those losses not yet reported to the Company. An insurer's ultimate liability is likely to differ from its interim estimates because during the life of a claim, which may be many years, additional facts affecting the amount of damages and an insurer's liability may become known. The reserves of an insurer are frequently adjusted based on monitoring by the insurer and are periodically reviewed by state insurance departments. The Company retains an independent actuarial firm to satisfy state insurance departments' requirements with respect to the certification of reserves for losses and LAE.

Loss reserves are established for known claims based on the type and circumstance of the loss and the results of similar losses. For claims not yet reported to the Company, loss reserves are based on statistical information from previous experience periods adjusted for inflation, trends in court decisions and economic conditions. LAE reserves are intended to cover the ultimate cost of investigating all losses that have occurred and defending lawsuits, if any, arising from these losses. LAE reserves are evaluated periodically using statistical techniques which compare current costs with historical data. Inflation is implicitly reflected in the reserving process through analysis of cost trends and review of historical reserve results. With the exception of workers' compensation claims, loss reserves are not discounted for financial statement purposes.

The Company's reserving process is based on the assumption that past experiences, adjusted for the effect of current developments and trends, are relevant in predicting future events. In the absence of specific developments, the process also assumes that the legal climate regarding the claims process and underlying liabilities remains constant. Other assumptions employed by the Company or its actuarial firm change from time to time as circumstances change. In estimating loss and LAE reserves, the Company employs a number of actuarial methods, depending on their applicability to each line of business, in order to balance the advantages and disadvantages of each method. Therefore, a range of estimates is developed for each line of business. However, the Company does not believe it is appropriate to sum the high and low values developed using different actuarial methods for each line of business to determine a range for the Company's total loss and LAE reserves. Therefore the Company's actuary and its consulting actuary only provide the Company with their respective "best estimates" of total loss and LAE reserves by summing their "best estimate" for each line of business. Due to the Company's small size, the presence or absence of a limited number of moderate losses, as well as the timing of the reporting of such losses to the Company by claimants could result in changes in actuarial estimates that are significant to the Company's net income for a quarter or a year. As such, management recognizes that the "best estimate" may not be more accurate than other amounts within a few percentage points of total loss and LAE reserves.

Due to uncertainties inherent in the estimation of incurred losses and LAE the Company, like most property and casualty insurance companies, has recorded changes in reserves for prior accident year losses in most years. In 2000, the Company increased its reserves for prior years by $1,428,000, primarily due to higher than anticipated frequency and severity of losses related to personal automobile, commercial automobile and workers' compensation policies. In 2001 and 2002, the Company decreased its reserves for prior years by $1,474,000 and $3,785,000, respectively, primarily due to favorable loss development related to workers' compensation policies.

The following table sets forth the changes in the reserve for losses and LAE for 2000, 2001 and 2002.

	Year Ended December 31,	
	2000	2001
	(in thousands)	
Reserve for losses and LAE at beginning of year	$133,526	$145,075
Less reinsurance recoverables	6,026	13,826
Net balance at beginning of year	127,500	131,249
Provision for losses and LAE for claims occurring in:		
Current year	69,946	76,618
Prior years	1,428	(1,474)

	71,374	75,144
Losses and LAE payments for claims occurring in:		
Current year	26,655	28,719
Prior years	40,970	45,561
	67,625	74,280
Reserve for losses and LAE at end of year, net	131,249	132,113
Plus reinsurance recoverables	13,826	19,242
Balance at end of year	$145,075	$151,355

The first line of the following table presents, as of the end of the year at the top of each column, the estimated amount of unpaid losses and LAE for claims arising in that year and in all prior years, including claims that had occurred but were not yet reported to the Company. For each column, the rows of the table present, for the same group of claims, the amount of unpaid losses and LAE as re-estimated as of the end of each succeeding year. The estimate is modified as more information becomes known about the number and severity of claims for each year. The "cumulative redundancy (deficiency)" represents the change in the estimated amount of unpaid losses and LAE from the end of the year at the top of each column through the end of 2002.

For each column in the table, the change from the liability for losses and LAE shown on the first line to the liability as re-estimated as of the end of the following year was included in operating results for the following year. That change includes the change in the previous year's column from the liability as re-estimated one year later to the liability as re-estimated two years later which, in turn, includes the change in the second preceding column from the liability as re-estimated two years later to the liability as re-estimated three years later, and so forth.

The rows of the lower portion of the table present, as of the end of each succeeding year, the amount of paid losses and LAE for claims unpaid at the end of the year at the top of each column:

	As of December 31,						
	1992	1993	1994	1995	1996	1997	1
						(in thousands)	
Liability for losses and LAE:							
	$ 86,159	$ 89,939	$ 97,614	$113,718	$126,260	$130,781	$12
Liability re-estimated as of:							
One year later	88,284	94,921	108,659	120,550	130,768	128,636	12

Two years later	91,224	100,607	113,091	128,192	133,029	130,498	12
Three years later	95,396	106,382	121,051	129,724	132,948	127,893	11
Four years later	99,779	112,983	121,791	131,647	129,210	122,508	11
Five years later	104,699	112,963	122,886	127,183	124,238	122,347	
Six years later	104,808	112,886	120,128	123,521	124,319		
Seven years later	105,183	110,843	117,589	123,679			
Eight years later	103,196	109,864	117,626				
Nine years later	102,837	110,450					
Ten years later	103,295						
Cumulative Redundancy (Deficiency):							
	$(17,136)	(20,511)	(20,012)	(9,961)	1,941	8,434	1
	% (19.9)	(22.8)	(20.5)	(8.8)	1.5	6.4	
Paid (Cumulative) as of:							
One year later	35,724	34,551	36,916	38,549	40,954	42,433	3
Two years later	56,003	56,965	60,074	64,323	69,035	66,477	6
Three years later	69,863	72,963	77,982	84,638	86,364	86,313	8
Four years later	80,156	83,998	91,948	96,491	98,300	97,770	8
Five years later	86,808	93,295	99,171	104,063	105,787	104,282	
Six years later	91,919	96,949	103,829	109,492	109,639		
Seven years later	94,022	99,525	107,367	111,851			
Eight years later	95,347	102,260	108,747				
Nine years later	97,272	103,208					
Ten years later	98,099						

The loss and LAE reserves reported in the Company's consolidated financial statements prepared in accordance with generally accepted accounting principles (GAAP) differ from those reported in the statements filed by MNH with the New Hampshire Insurance Department in accordance with statutory accounting principles (SAP) as follows:

	As of December 31,		
	2000	2001	2002
		(in thousands)	
Loss and LAE reserves on a SAP basis	$131,178	$132,113	$127,756
Adjustments:			
Ceded reinsurance balances recoverable	13,826	19,242	19,380
Write-down of reinsurance recoverable	71	-	-
Loss and LAE reserves on a GAAP basis	$145,075	$151,355	$147,136

Reinsurance

The Company follows the customary industry practice of reinsuring a portion of the exposure under its policies and as consideration pays to its reinsurers a portion of the premium received on its policies. Insurance is ceded principally to reduce an insurer's liability on individual risks and to protect against catastrophic losses. Although reinsurance does not legally discharge an insurer from its primary liability for the full amount of coverage provided by its policies, it does make the assuming reinsurer liable to the insurer to the extent of the reinsurance ceded.

The Company is a party to reinsurance contracts under which certain types of policies are automatically reinsured without the need for approval by the reinsurer with respect to the individual risks that are covered ("treaty" reinsurance). The Company also is a party to reinsurance contracts which are handled on an individual policy or per risk basis and require the specific agreement of the reinsurer as to each risk insured ("facultative" reinsurance). Occasionally, the Company may secure facultative reinsurance to supplement its coverage under treaty reinsurance.

Prior to January 1, 1998, the Company's excess of loss reinsurance agreements for automobile liability, general liability and workers' compensation insurance provided for recovery of losses over $500,000 up to a maximum of $5,000,000 per occurrence. For claims occurring prior to 1993, the $500,000 threshold was indexed for inflation for casualty lines other than workers' compensation and New York State no-fault, and applied retroactively to all occurrences until they are settled. There was no index provision for casualty claims occurring after 1992. This coverage was supplemented by additional treaty reinsurance covering losses up to $5,000,000 in excess of the first $5,000,000. Prior to January 1, 1998, property reinsurance agreements provided for recovery of property losses over $500,000 up to $2,000,000 per occurrence without any index provision.

Between January 1, 1998 and December 31, 2001, the Company's property and casualty excess of loss reinsurance agreement provided for recovery of casualty losses over $500,000 up to $10,000,000 per occurrence and property losses over $500,000 up to $10,000,000 per risk. This coverage is supplemented by a contingent casualty layer of reinsurance for workers' compensation claims of $5,000,000 in excess of the first $10,000,000 subject to a calendar year limit of $20,000,000. Effective January 1, 2002, the Company increased its retention on casualty losses to $750,000.

Property catastrophe coverage provides for recovery of 47.5% of $5,000,000 and of 95% of the next $50,000,000, subject to aggregate retained losses of $5,000,000 per occurrence. The property catastrophe reinsurance coverage is shared by the Company and Mutual on a pro rata basis based upon the gross reported losses of the Company and Mutual for a covered event.

During 2000, the Company implemented a program to underwrite specialized commercial auto insurance. All policies issued under this program were 100% reinsured through certain subscribing underwriting members of Lloyd's of London and therefore had no impact on net premiums earned or net losses and LAE incurred by the Company. This program was discontinued in 2001.

Effective January 1, 1993, Mutual and MNH entered into a quota share reinsurance agreement under which MNH may assume up to 10% of Mutual's direct voluntary written premiums and related losses and allocated LAE in exchange for a reinsurance commission of 35%. The agreement also provides for MNH to

pay a contingent commission to Mutual equal to any underwriting profit on the premiums assumed. Mutual pays the ceded premiums, net of commissions and paid losses, to MNH on a monthly basis and MNH invests these funds and earns investment income. To the extent commissions and paid losses exceed premiums, MNH is required to pay the net monthly balance to Mutual. The agreement may be terminated by either party effective as of any January 1 with the prior approval of the New York Superintendent of Insurance and upon six months' notice to the other party. In addition, the agreement may be terminated by MNH at any time if any amount payable to MNH by Mutual becomes more than 90 days overdue or if there is a change in control of Mutual approved by the New York Superintendent of Insurance. Further, the agreement allows Mutual to reduce its cessions to MNH from a maximum of 10% to a minimum of 0% of Mutual's direct voluntary premiums written for any calendar year prior to the beginning of that calendar year. Mutual has not ceded any of its direct voluntary written premiums to MNH since 1995 and has informed the Company that it will not cede any voluntary direct written premiums to MNH in 2003 pursuant to this agreement.

Under the terms of the Pooling Agreement (see Administration above), Mutual and MNH have agreed to pool, or share, underwriting results on their Traditional Business, effective as of January 1, 2003. The Pooling Agreement will not apply to any new endeavor of either Mutual or MNH outside of their Traditional Business, unless the companies agree otherwise.

The Pooling Agreement provides for MNH to cede, or transfer, to Mutual all of its premiums and risks on its Traditional Business during the term of the agreement, and then to assume from Mutual a percentage of all of Mutual's and MNH's Traditional Business (the "Pooled Business"). MNH will assume 40% of the Pooled Business in 2003, though not to exceed $68 million in net written premiums. MNH's share of the Pooled Business will be reduced to 35% of the pooled business in 2004, though not to exceed $59.5 million in net written premiums, and to 30% of the pooled business in 2005, though not to exceed $50.0 million in net written premiums. MNH's share of the Pooled Business will be reduced to 25% in 2006 and 2007, though not to exceed $42.5 million and $37.5 million in net written premiums, respectively. If the parties agree, MNH may increase its share or maximum assumed net premiums written, of the Pooled Business for any year. The decreasing assumption of Traditional Business under the Pooling Agreement is intended to provide MNH with the capacity to pursue insurance opportunities independently of Mutual, thereby reducing its dependency on Mutual as its only source of business. MNH will continue to service and insure its Traditional Business through Mutual, but Mutual will retain a greater share of the risk for such business under its control pursuant to a profit and loss sharing arrangement in the Pooling Agreement. The Company believes the Pooling Agreement and profit (or loss) sharing feature included therein will further align the interests of MNH and Mutual.

The Pooling Agreement may be terminated by either party at the beginning of any calendar year upon not less than 13 months notice, but not effective before January 1, 2008. However, the Pooling Agreement may be terminated effective as of January 1, 2006 or 2007 upon 13 months notice, but only by MNH and only if the ratio of net losses and loss adjustment expenses to net earned premiums on a cumulative basis from the inception of the Pooling Agreement, as of the date notice is given, exceeds 76%. See PART 1, Item 1. BUSINESS. Administration.

Investments

The primary source of funds for investment by the Company is premiums collected. Although premiums, net of commissions and other underwriting costs, are taken into income ratably over the terms of

the policies, they provide funds for investment from the date they are received. Similarly, although establishment of and changes in reserves for losses and LAE are included in results of operations immediately, the amounts so set aside are available to be invested until the Company pays those claims.

The investments of the Company are regulated by New Hampshire insurance law and are reviewed by the Board of Directors of the Company. Other than certain short-term investments held to maintain liquidity, the Company primarily invests in medium-term bonds, mortgage-backed and other asset-backed securities including collateralized mortgage obligations, and tax-exempt securities. The mortgage-backed securities held by the Company are typically purchased at expected yields which are greater than comparable maturity Treasury securities and are AAA or AA rated.

The Company had $28,685,000 of tax-exempt bonds in its investment portfolio at December 31, 2002. The Company believes these tax-exempt bonds are of high quality (rated A or better) and, at the time of purchase, offered an after-tax total return potential greater than comparable taxable securities.

At December 31, 2002, the Company had $6,420,000 of short-term investments with maturities less than 30 days, and $4,965,000 of non-investment grade securities. These non-investment grade securities represented 2% of the investment portfolio as compared to $10,163,000, or 5%, of the investment portfolio at December 31, 2001.

The table below gives information regarding the Company's investments as of the dates indicated.

	As of December 31,				
	2000		2001		
	Amount	%	Amount	%	Amount
	(dollars in thousands)				
Fixed Maturities (1):					
U.S. Government and Agencies	$ 44,055	20.4%	$ 41,965	19.7%	$ 12,855
Corporate Bonds	135,895	63.0	144,248	67.7	152,028
Tax-Exempt Bonds	16,207	7.5	8,999	4.2	28,685
Total Bonds	196,157	90.9	195,212	91.6	193,568
Preferred Stocks (2)	13,911	6.5	9,422	4.4	7,367
Short-Term Investments (3)	4,550	2.1	6,905	3.2	6,420
Other (4)	1,036	.5	1,593	.8	2,042
Total Invested Assets	$215,654	100.0%	$213,132	100.0%	$209,397

(1) Fixed Maturities are shown at their carrying amounts in the respective balance sheet. Held to Maturity fixed maturities are included at amortized cost. Available for Sale fixed maturities are included at fair value.

(2) Shown at fair value.

(3) Shown at cost, which approximates fair value.

(4) Shown at estimated fair value or unpaid principal balance, which approximates estimated fair value.

The table below sets forth the Company's net investment income and net realized gains and losses, excluding the effect of income taxes, for the periods shown:

	Year Ended December 31,	
	2000	2001
	(in thousands)	
Average investments	$212,832	$213,449
Net investment income	13,903	13,295
Net investment income as a percentage of average investments (1)	6.5%	6.2%
Net realized gains (losses) on investments	$109	(580)

(1) The taxable equivalent yield for the years ended December 31, 2000, 2001 and 2002 was 7.2%, 6.5% and 5.4%, respectively, assuming an effective tax rate of 34%.

The table below sets forth the carrying value of bonds and percentage distribution of various maturities at the dates indicated. Fixed Maturities are shown at their carrying amounts in the respective balance sheet. Held to Maturity fixed maturities are included at amortized cost. Available for Sale fixed maturities are included at fair value. The estimated repayment date is used instead of the ultimate repayment date for mortgage-backed and other asset-backed securities.

	As of December 31,					
	2000		2001		2002	
	Amount	%	Amount	%	Amount	%
	(dollars in thousands)					
1 year or less	$ 78,181	39.9%	$ 40,356	20.7%	$ 81,736	42
1 year through 5 years	81,827	41.7	111,445	57.1	106,696	55
5 years through 10 years	34,562	17.6	39,029	20.0	3,198	1
More than 10 years	1,587	.8	4,382	2.2	1,938	1
Total	$196,157	100.0%	$195,212	100.0%	$193,568	100

Competition

The property and casualty insurance business is highly competitive. The Company is in direct competition with many national and regional multiple-line insurers, many of which are substantially larger than the Company and have considerably greater financial resources. Competition is further intensified by the independent agency system because each of the independent agents who sells the Company's policies also represents one or more other insurers. Also, the Company's agents compete with direct writing insurers and this indirectly affects the Company.

Historically, the property and casualty industry has tended to be cyclical in nature. During the "up" cycle, or "hard market," the industry is characterized by price increases, strengthening of loss and LAE reserves, surplus growth and improved underwriting results. Near the end of the "up" cycle, an increase in capacity causes insurance companies to begin to compete for market share on the basis of price. This price competition causes the emergence of the "down" cycle, or "soft market," characterized by a reduction in the premium growth rate and a general decline in profitability. Generally, the down cycle is eventually accompanied by a decline in the adequacy of loss and LAE reserves and a decrease in premium writing capacity. The property and casualty insurance industry experienced a cyclical downturn for most of the 1990's due primarily to intense premium rate competition and an excess capacity to write premiums. Recently, there has been price firming primarily within the commercial lines segment of the property casualty industry. However, many of the circumstances which led to the current cyclical downturn in the property and casualty insurance industry continue to exist, and the Company cannot predict for how long this price firming or "hard market" will continue.

Regulation

General

MNH is subject to regulation under applicable insurance statutes, including insurance holding company statutes, of the various states in which it writes insurance. Insurance regulation is intended to provide safeguards for policyholders rather than to protect stockholders of insurance companies or their holding

companies. Insurance laws of the various states establish regulatory agencies with broad administrative powers including, but not limited to, the power to grant or revoke licenses to transact insurance business and to regulate trade practices, investments, premium rates, the deposit of securities, the form and content of financial statements and insurance policies, accounting practices, the maintenance of specified reserves and capital, and insurers' consumer privacy policies. The regulatory agencies of each state have statutory authority to enforce their laws and regulations through various administrative orders, civil and criminal enforcement proceedings, and the suspension or revocation of certificates of authority. In extreme cases, including insolvency, impending insolvency and other matters, a regulatory authority may take over the management and operation of an insurer's business and assets.

Under insolvency or guaranty laws in the states in which MNH operates, insurers doing business in those states can be assessed up to prescribed limits for policyholder losses caused by other insurance companies that become insolvent. The extent of any requirement for MNH to make any further payment under these laws is not determinable. Most laws do provide, however, that an assessment may be excused or deferred if it would threaten a solvent insurer's financial strength. In addition, MNH is required to participate in various mandatory pools or underwriting associations in certain states in which it operates.

The property and casualty insurance industry has been the subject of regulations and legislative activity in various states attempting to address the affordability and availability of different lines of insurance. The regulations and legislation generally restrict the discretion an insurance company has in operating its business. It is not possible to predict the effect, if any, that new regulations and legislation would have on the Company and MNH.

The Company depends on cash dividends from MNH to pay cash dividends to its stockholders and to meet its expenses. MNH is subject to New Hampshire state insurance laws which restrict its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of the insurer's policyholders' surplus as of the preceding December 31st. The maximum amount of dividends that MNH could pay during any twelve-month period ending in 2003 without the prior approval of the New Hampshire Insurance Commissioner is $5,492,000. MNH paid $3,700,000 of dividends to the Company in 2002. Dividends of $2,300,000, $900,000 and $500,000, were paid in February 2002, May 2002 and November 2002, respectively.

In certain states in which it operates, MNH is required to maintain deposits with the appropriate regulatory authority to secure its obligations under certain insurance policies written in the jurisdiction. At December 31, 2002, investments of MNH having a par value of $1,900,000 were on deposit with regulatory authorities.

MNH and Mutual are required to file detailed annual reports with the appropriate regulatory agency in each of the states in which they do business. Their business and accounts are subject to examination by such agencies at any time, and the laws of many states require periodic examination. The State of New Hampshire Insurance Department most recently examined the accounts of MNH as of December 31, 1999. MNH's annual statement as of that date was accepted as submitted, without adjustment.

In 1993 the National Association of Insurance Commissioners (NAIC) adopted a risk-based capital measurement formula to be applied to all property and casualty insurance companies. The formula calculates a minimum required statutory net worth, based on the underwriting, investment, credit, loss reserve and other business risks inherent in an individual company's operations. Any insurance company that

does not meet threshold risk-based capital measurement standards could be forced to reduce the scope of its operations and ultimately could become subject to statutory receivership proceedings. MNH's capital substantially exceeds the statutory minimum as determined by the risk-based capital measurement formula as of December 31, 2002.

The NAIC has established eleven financial ratios (the Insurance Regulatory Information System, or "IRIS") to assist state insurance departments in their oversight of the financial condition of insurance companies operating in their respective states. The NAIC calculates these ratios based on information submitted by insurers on an annual basis and shares the information with the applicable state insurance departments. The ratios relate to leverage, profitability, liquidity and loss reserve development. Each of the Company's ratios for 2002 falls within the usual or acceptable range as published by the NAIC.

Rates

Premium rate regulations vary greatly among states and lines of insurance, but generally require either approval of the regulatory authority or review by the authority prior to changes in rates. Rate filings are based upon actuarial analysis of historical results and competition in the market. However, in certain states, insurers writing in designated commercial risk, professional liability and public entity insurance markets may periodically revise rates within the limits of applicable flexibility bands (flex-bands) on a file and use basis, but must obtain the state insurance department's prior approval in order to implement rate increases or decreases outside these flex-bands.

Renewal of Policies

Many states restrict the ability of insurers to non-renew insurance policies or to exit a line of business. In particular, New York substantially limits the ability of insurers to non-renew personal automobile insurance. This restricts the Company's ability to mitigate its exposure to the NYAIP.

Insurance Holding Companies

The Company is subject to statutes governing insurance holding company systems. Typically, these statutes require the Company to file information periodically concerning its capital structure, ownership, financial condition and general business operations and material inter-company transactions not in the ordinary course of business. Under the terms of applicable New Hampshire statutes, any person or entity desiring to purchase shares which would result in such person beneficially owning 10% or more of the Company's outstanding voting securities would be required to obtain regulatory approval prior to the purchase.

Involuntary Business

As a condition to writing voluntary insurance in most of the states in which it operates, the Company must participate in programs that provide insurance for persons or businesses unable to obtain insurance voluntarily. Uncertainties as to the size of the involuntary market population make it difficult to predict the amount of involuntary business in a given year.

Employees

The Company has one full time employee. At December 31, 2002, Mutual had 335 full-time equivalent employees. The Company believes that Mutual's relationship with its employees is satisfactory.

Item 2. PROPERTIES.

Although the Company has no facilities, it benefits from the facilities of Mutual pursuant to the Management Agreement, under which the Company is charged a proportionate share of the costs of such facilities.

The Company's corporate headquarters are located in Buffalo, New York in a building owned by Mutual that contains approximately 113,000 square feet of office space. Mutual also has regional underwriting and/or claims office facilities in Buffalo, Albany and Hauppauge, New York; Manchester, New Hampshire; Moorestown, New Jersey and Columbus, Ohio. All of the offices except the Buffalo office are leased.

Item 3. LEGAL PROCEEDINGS.

MNH, like many other property and casualty insurance companies, is subject to environmental damage claims asserted by or against its insureds. Management of the Company is of the opinion that based on various court decisions throughout the country certain of these claims should not be recoverable under the terms of MNH's insurance policies because of either specific or general coverage exclusions contained in the policies. However, there is no assurance that the courts will agree with MNH's position in every case, nor can there be assurance that material claims will not be asserted under policies which a court will find do not explicitly or implicitly exclude claims for environmental damages. Management, however, is not aware of any pending claim or group of claims which would result in a liability that would have a material adverse effect on the financial condition of the Company or MNH.

In addition to the foregoing matters, MNH is a defendant in a number of other legal proceedings in the ordinary course of its business. Management of the Company is of the opinion that the ultimate aggregate liability, if any, resulting from such proceedings will not materially affect the financial condition of the Company or MNH.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's common stock is traded on the American Stock Exchange (AMEX symbol: MGP). The following table sets forth the high and low closing prices of the common stock for the periods indicated as reported on the American Stock Exchange.

2002:	High	Low	Dividend
Fourth Quarter	$ 23.00	$ 21.90	$ .10
Third Quarter	24.36	22.80	.10
Second Quarter	24.99	24.00	.10
First Quarter	24.30	20.01	.10

2001:	High	Low	Dividend

Fourth Quarter	$ 23.10	$ 20.30	$ .10
Third Quarter	22.60	20.20	.10
Second Quarter	21.25	18.10	.10
First Quarter	19.39	17.50	.10

The number of stockholders of record of the Company's Common Stock as of February 19, 2003 was 81. Securities held by nominees are counted as one stockholder of record.

The Company has paid a quarterly cash dividend to its common stockholders since the third quarter of 1993. Continued payment of this dividend and its amount will depend upon the Company's operating results, financial condition, capital requirements and other relevant factors, including legal restrictions applicable to the payment of dividends by its insurance subsidiary, MNH.

As a holding company, the Company depends on dividends from its subsidiary, MNH, to pay cash dividends to its stockholders. MNH is subject to New Hampshire state insurance laws which restrict its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of the insurer's policyholders' surplus as of the preceding December 31. The maximum amount of dividends that MNH could pay during any twelve-month period ending in 2003 without prior approval of the New Hampshire Insurance Commissioner is $5,492,000.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise Of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number Remaini Future Equity C (Exclu Reflecte
	(a)	(b)	
Equity Compensation Plans Approved by Security Holders	0	N/A	
Equity Compensation Plans Not Approved by Security Holders	0 (1)	$21.81	
Total	0	-	

(1) Through an employment agreement with MNH, MNH's Chief Operating Officer participates in a non-cumulative bonus equal to the product of 80,000 and the difference between the average of the last reported sales prices of the Company's common stock for (i) the 20 business days immediately following the release of the Company's year-end results and (ii) for the

20 business days immediately following the release of the Company's year-end results for the prior year.

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Item 6. SELECTED FINANCIAL DATA.

The selected financial data set forth in the following table for each of the five years in the period ended December 31, 2002 have been derived from the audited consolidated financial statements of the Company.

	As of December 31,		
	1998	1999	2000
	(in thousands, except p		
Net premiums written	$ 92,758	$ 94,470	$ 94,342
Net premiums earned	$ 93,540	$ 94,775	$ 94,259
Net investment income	13,277	13,147	13,903
Net realized investment gains (losses)	(2)	60	109
Other revenues	153	434	355
Total revenues	106,968	108,416	108,626
Net losses and loss adjustment expenses	65,234	66,086	71,374
Amortization of deferred policy acquisition costs	24,788	25,115	24,979
Other underwriting expenses	8,173	6,801	5,266
Total expenses	98,195	98,002	101,619
Income before income taxes	8,773	10,414	7,007
Provision for income taxes	2,850	3,621	2,668
Net income	$ 5,923	$ 6,793	$ 4,339
Earnings per share:			
Basic	$2.05	$2.48	$1.75
Diluted	$2.04	$2.48	$1.74
Weighted average number of shares outstanding:			
Basic	2,895	2,738	2,485
Diluted	2,904	2,743	2,487
Balance Sheet Data: (at year end)			
Total investments	$215,172	$212,911	$215,654
Total assets	274,523	269,523	281,621
Reserve for losses and loss adjustment expenses	136,685	133,526	145,075
Unearned premiums	49,382	49,616	50,857

Stockholders' equity	71,783	69,387	70,122
Dividend Data:			
Cash dividend per common share	$.20	$.35	$.40

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Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

2002 Compared to 2001.

Total revenues for 2002 were $95,111,000, a decrease of $12,185,000, or 11% from $107,296,000 in 2001.

Direct premiums written for 2002 were $72,803,000, a decrease of $28,150,000 or 28%, from $100,953,000 for 2001. Voluntary direct premiums written for 2002 were $66,806,000, a decrease of $29,709,000 or 31% from $96,515,000 for 2001.

Voluntary personal lines direct premiums written for 2002 were $39,981,000, a decrease of $211,000 or 1% from $40,192,000 in 2001. Private passenger automobile direct premiums written, which comprised 73% and 74% of total voluntary personal lines direct premiums written in 2002 and 2001, respectively, decreased 1% in 2002 compared to 2001. This slight decrease in voluntary personal lines direct premiums written is due to rate increases implemented in some territories being more than offset by the effect of the Company's decision not to accept new private passenger automobile (PPA) applications effective April 1, 2002 in certain states where the Company intends to reduce its PPA exposures due to unfavorable market conditions. PPA new business units (PPA policies written by the Company for the first time) decreased 56% to 2,429 in 2002 from 5,565 in 2001. As a result, total voluntary PPA policies in force at December 31, 2002 decreased 10% to 21,407, from 23,890 at December 31, 2001. Homeowners direct premiums written which comprised 26% and 25% of total voluntary personal lines direct premiums written in 2002 and 2001, respectively, increased 1% to $10,349,000 in 2002 from $10,209,000 in 2001.

Voluntary commercial lines direct premiums written for 2002 were $26,825,000, a decrease of $29,498,000 or 52%, from $56,323,000 for 2001. Total commercial lines new business units in 2002 decreased 69% compared to 2001. Total commercial lines policies in force decreased 52% to 11,179 at December 31, 2002 from 23,281 at December 31, 2001. Direct premiums written decreased for every commercial line of business in 2002 compared to 2001.

The decrease in voluntary commercial lines direct premiums written is consistent with the actions undertaken by the Company in the fourth quarter of 2001 to exit certain classes of commercial insurance, thereby reducing direct premiums written in business segments that it believes do not provide the opportunity to earn a satisfactory return. Mutual exited most of the same classes of commercial insurance at the same time and in the same jurisdictions as the Company. The Company believes that a portion of the decrease in voluntary commercial lines direct premiums written was due in part to some commercial business, other than in exited classes and related policies, moving to other insurance carriers. As a result of the withdrawal from certain classes of commercial insurance, the Company expects its commercial business to continue to decline during the first half of 2003.

Involuntary direct premiums written, primarily involuntary private passenger automobile insurance, which comprised 8% and 4% of total direct premiums written in 2002 and 2001, respectively, were $5,998,000 for 2002 compared to $4,438,000 in 2001, an increase of $1,560,000 or 35%. This increase resulted primarily from increased assignments from the NYAIP, which provides coverage for individuals who are unable to obtain auto insurance in the voluntary market. Assignments from the NYAIP vary depending upon a company's private passenger automobile market share and the size of the NYAIP. The

Company believes it is likely that, due to a decrease in the willingness of several major competitors to insure non-standard business voluntarily, the number of policies written by the NYAIP may continue to increase and therefore the amount of the Company's involuntary direct written premiums may also continue to increase. However, the Company is unable to predict the volume of future assignments from the NYAIP.

In order to minimize the adverse impact of assignments from the NYAIP in 2003, the Company has purchased territorial credits from another insurance company pursuant to Section 6.A.7. of the New York Automobile Insurance Plan Manual. The credits against NYAIP assignments are generated by the other insurance company for writing PPA business in certain localities in New York with PPA market availability problems. The other insurance company, by nature of its concentration in PPA business in "credit" territories, generated more credits than it required to offset its NYAIP assignments. The credits purchased will reduce the Company's share of the NYAIP from February 2003 through January 2004. The Company believes that the costs of the credits purchased will be substantially less than the amount the Company would have lost had it written the additional NYAIP business.

Net premiums written decreased $23,445,000 or 25% to $70,528,000 for 2002 from $93,973,000 for 2001, primarily due to the 28% decrease in direct premiums written. Net premiums earned for 2002 were $83,120,000, a decrease of $10,765,000 or 11%, from $93,885,000 in 2001. The decrease in net premiums earned resulted from the 25% decrease in net premiums written. The decrease in net premiums earned was smaller than the decrease in net premiums written since the Company's insurance policies generally earn over a twelve-month policy term. As a result of the decrease in net premiums written that occurred in 2002, it is likely that net premiums earned will continue to decrease throughout 2003.

Net investment income was $10,403,000 in 2002, a decrease of 22% from $13,295,000 in 2001. The average pre-tax yield associated with the investment portfolio decreased 115 basis points to 5.4% for 2002, due to lower available reinvestment rates. Average invested assets for 2002 decreased 3% compared to 2001.

Net realized investment gains were $953,000 for 2002 compared to net realized investment losses of $580,000 for 2001. During the fourth quarter of 2002, the Company sold its entire investment in a real estate investment trust and recorded a realized loss on the transaction of $430,000. The market value of this security was equal to the proceeds from the sale of $586,000. This security was purchased in 1999 and had performed to expectations from the time of purchase until the fourth quarter of 2002. The Company believed that a proposed change in ownership of the trust was not in the best interest of the Company or of other preferred owner interests and as a result concluded that the risks inherent in holding the investment were greater than the loss recorded from its sale. The Company did not realize any other realized investment losses during 2002.

Other revenues, which are comprised primarily of service fee income reduced by premium receivable charge-offs, were $635,000 for 2002, a decrease of $61,000 or 9%, from $696,000 for 2001.

Net losses and LAE were $62,813,000 for 2002, a decrease of $12,271,000 or 16% from $75,144,000 for 2001. The loss and LAE ratio decreased to 75.6% for 2002 from 80.0% for 2001. Incurred losses for 2001 included $1,305,000 of losses and LAE related to the September 11, 2001 terrorist attack in the World Trade Center (WTC event) in New York City, which added 1.4 percentage points to that year's loss and LAE ratio. Without the effect of the WTC event, the Company's loss and LAE ratio for 2001 would have been 78.6%.

The Company recorded decreases to its estimate of losses and LAE related to prior accident years of $3,785,000 and $1,474,000 in 2002 and 2001, respectively. These decreases in losses and LAE relating to prior accident years reduced the loss and LAE ratio in 2002 and 2001 by 4.6 and 1.6 percentage points, respectively. The decrease recorded in 2001 was primarily the result of favorable loss development related to known claims on workers' compensation policies. The following table documents the changes in the estimate of losses and LAE related to prior accident years recorded in 2002, for the Company's major lines of business:

Accident Year	Home-owners	PPA Liability	Commercial Auto Liability	Workers' Compen-sation	Commercial Package
Prior to 1999	$(160)	$ 303	$ (215)	$ (461)	$1,844
1999	14	67	561	(292)	750
2000	9	(678)	(1,333)	(38)	607
2001	(238)	3,413	(1,197)	(3,021)	(2,383)
Total	$(375)	$3,105	$(2,184)	$(3,812)	$ 818

The Company's reduction in its estimate of losses and LAE related to prior accident years represented 2.9% of the recorded reserve for losses and LAE at December 31, 2001, calculated on a SAP basis. During 2002, both paid and incurred losses and LAE emerged at amounts that were less than anticipated when reserves for loss and LAE were estimated and recorded at December 31, 2001, particularly for the commercial auto liability and the workers' compensation lines of business. Greater than anticipated loss and LAE emergence in the Company's PPA liability line of business, particularly for accidents occurring in 2001, somewhat offset the favorable emergence noted on other lines of business.

The Company made no changes to the key assumptions used in evaluating the adequacy of its reserves for losses and LAE during 2002. A reasonable possibility exists in any year that relatively minor fluctuations in the estimate of reserves for losses and LAE may have a significant impact on the Company's net income. This is due primarily to the size of the Company's reserves for losses and LAE ($147,136,000 at December 31, 2002) relative to its net income.

Involuntary automobile insurance business increased the Company's calendar year loss and LAE ratio by approximately 9.0 and 3.2 percentage points for the years ended December 31, 2002 and 2001, respectively. The combined ratio on involuntary automobile business was greater than the combined ratio on voluntary automobile business.

The ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned increased to 33.7% in 2002 from 32.9% due to the percentage decrease in net premiums earned being greater than the percentage decrease in other underwriting expenses. Expenses that vary directly with the Company's premium volume, primarily commissions, premium taxes and state assessments, represented 20.0% and 19.8% of net premiums earned in 2002 and 2001, respectively. Other underwriting expenses, such as salaries, employee benefits and other operating expenses vary indirectly with premium volume and comprise the remainder of the Company's expenses.

The Company's effective income tax rate increased to 40.5% in 2002 from 34.6% in 2001 primarily due to a reduction in tax-exempt investment income and dividends received.

2001 Compared to 2000.

Total revenues for 2001 were $107,296,000, a decrease of $1,330,000, or 1%, from $108,626,000 in 2000.

Direct premiums written for 2001 were $100,953,000, a decrease of $6,281,000 or 6%, from $107,234,000 for 2000. Voluntary direct premiums written for 2001 were $96,515,000, a decrease of $9,201,000 or 9%, from $105,716,000 for 2000.

Voluntary personal lines direct premiums written for 2001 were $40,192,000, an increase of $1,701,000 or 4% from $38,491,000 in 2000. Private passenger automobile direct premiums written, which comprised 74% of total voluntary personal lines direct premiums written in 2001 and in 2000, increased 4% in 2001 compared to 2000 primarily due to a 3% increase in policies in force at December 31, 2001 as compared to December 31, 2000. Homeowners direct premiums written increased 7% in 2001 compared to 2000 due to a 7% increase in policies in force, resulting primarily from a 7% increase in new business units in 2001 as compared to 2000.

Voluntary commercial lines direct premiums written for 2001 were $56,323,000, a decrease of 16% from $67,225,000 in 2000. This decrease was attributable in part to the discontinuation in 2001 of a program to underwrite specialized commercial auto insurance (the Auto Program) which produced $5,470,000 of direct premiums written in 2000. All policies issued under the Auto Program were 100% reinsured through certain Lloyd's syndicates and therefore had no impact on net premiums written, net premiums earned or net losses and LAE incurred by the Company. The Company recorded all direct underwriting expenses incurred, including commissions with respect to the acquisition of these policies, which were offset by reinsurance commission income.

The Company continued to experience higher loss frequency for certain of its commercial lines of business not adequately covered by premiums collected from those lines of business. In response to these higher losses, the Company has filed for and received approval of rate increases in certain lines of business, revised its underwriting guidelines, and removed discretionary pricing credits where warranted. As a consequence of these actions, voluntary commercial lines direct premiums written for 2001, excluding Auto Program premiums written, decreased $5,416,000 or 9%, to $56,339,000 from $61,755,000 for 2000. Direct premiums written for all of the Company's commercial lines of business, except commercial package policies, decreased in 2001 compared to 2000. Commercial lines policies in force at December 31, 2001 decreased 18% compared to commercial lines policies in force at December 31, 2000. Commercial lines new business units decreased 45% in 2001, compared to 2000.

Involuntary direct premiums written, primarily involuntary private passenger automobile insurance, which comprised 4% and 1% of total direct premiums written during 2001 and 2000, respectively, were $4,438,000 for 2001 compared to $1,518,000 in 2000, an increase of $2,920,000 or 192%. This increase resulted primarily from increased assignments from the NYAIP, which experienced substantial growth in vehicles insured.

Net premiums written decreased $369,000 or less than 1% to $93,973,000 for 2001 from $94,342,000 for 2000.

Net premiums earned for 2001 were $93,885,000, a decrease of $374,000, or less than 1%, from $94,259,000 in 2000. This decrease in net premiums earned resulted primarily from a decrease in assumed premiums earned and is consistent with the decrease in net written premiums.

Net investment income was $13,295,000 in 2001, a decrease of 4% from $13,903,000 in 2000, primarily due to a decrease in average portfolio yield. Lower reinvestment rates in the Company's targeted maturity sector (2 years) led to the decrease in average portfolio yield.

Net realized investment losses were $580,000 for 2001 compared to net realized investment gains of $109,000 for 2000. Net realized investment losses for 2001 included $781,000 of unrealized losses related to the Company's fixed maturity investment in a commercial finance company. The Company believes that the decline in fair value of this investment is other than temporary and has therefore recorded a realized loss.

Other revenues were $696,000 for 2001, an increase of $341,000, or 96%, from $355,000 for 2000. This increase resulted from an increase in premium installment fee income and a decrease in charge-offs related to uncollectible premiums receivable. The reduction in charge-offs resulted from a decline in the average age of the Company's premium receivable.

Net losses and LAE were $75,144,000 for 2001, an increase of $3,770,000 or 5% from $71,374,000 for 2000. The loss and LAE ratio increased to 80.0% for 2001 from 75.7% for 2000. Losses and LAE include $1,305,000 related to the September 11, 2001 terrorist attack on the World Trade Center (WTC) in New York City. The WTC event added 1.4 percentage points to the Company's loss and LAE ratio for 2001. Excluding the effect of the WTC event, the increase in the loss and LAE ratio resulted primarily from the increase in involuntary automobile insurance business which increased the Company's net loss and LAE ratio by 6.3 percentage points in 2001, compared to 2.7 percentage points in 2000.

The ratio of amortized deferred policy acquisition costs and other underwriting expenses to net premiums earned increased to 32.9% in 2001 from 32.1% in 2000, primarily due to higher agency incentive commissions and lower commissions earned on ceded reinsurance. Expenses that vary directly with the Company's premium volume, primarily commissions, premium taxes and state assessments, represented 20.7% and 20.0% of net premiums earned in 2001 and 2000, respectively. Certain other underwriting expenses, such as salaries, employee benefits and other operating expenses vary indirectly with volume and comprise the remainder of the Company's underwriting expenses.

The Company's effective income tax rate was 34.6% for 2001 compared to 38.1% for 2000.

Critical Accounting Policies

Reserve for Losses and LAE

The Company establishes reserves for losses and LAE, which are estimates of future payments to be made to settle all insurance claims for reported losses and estimates of incurred but not reported losses based upon past experience modified for current trends. With the exception of workers' compensation losses, loss reserves are not discounted. Estimated amounts of salvage and subrogation on paid and unpaid losses are deducted from the liability for unpaid claims. The estimated liabilities may be more or less than the amount ultimately paid when the claims are settled. Management and the Company's independent consulting actuary regularly review the estimates of reserves needed and any changes are reflected in current operating results.

Loss reserves are established for known claims based on the type and circumstance of the loss and the results of similar losses. For claims not yet reported to the Company, loss reserves are based on statistical information from previous experience periods adjusted for inflation, trends in court decisions and economic conditions. LAE reserves are intended to cover the ultimate cost of investigating all losses that have occurred and defending lawsuits, if any, arising from these losses. LAE reserves are evaluated periodically using statistical techniques which compare current costs with historical data. Inflation is implicitly reflected in the reserving process through analysis of cost trends and review of historical reserve results.

The Company's reserving process is based on the assumption that past experiences, adjusted for the effect of current developments and trends, are relevant in predicting future events. In the absence of specific developments, the process also assumes that the legal climate regarding the claims process and underlying liabilities remains constant. Other assumptions employed by the Company or its actuarial firm change from time to time as circumstances change. In estimating loss and LAE reserves, the Company employs a number of actuarial methods, depending on their applicability to each line of business, in order to balance the advantages and disadvantages of each method. Therefore, a range of estimates is developed for each line of business. However, the Company does not believe it is appropriate to sum the high and low values developed using different actuarial methods for each line of business to determine a range for the Company's total loss and LAE reserves. Therefore the Company's actuary and its consulting actuary only provide the Company with their respective "best estimates" of total loss and LAE reserves by summing their "best estimate" for each line of business. Due to the Company's small size, the presence or absence of a limited number of moderate losses, as well as the timing of the reporting of such losses to the Company by claimants could result in changes in actuarial estimates that are significant to the Company's net income for a quarter or a year. As such, management recognizes that the "best estimate" may not be more accurate than other amounts within a few percentage points of total loss and LAE reserves.

The Company has recorded changes in reserves for prior accident year losses in most years. In 2000, the Company increased its reserves for prior years by $1,428,000, primarily due to higher than anticipated frequency and severity of losses related to personal automobile, commercial automobile and workers' compensation policies. In 2001 and 2002, the Company decreased its reserves for prior years by $1,474,000 and $3,785,000, respectively, primarily due to favorable loss experience related to workers compensation policies. The total reserves for losses and LAE were $147,136,000 and $151,355,000 at December 31, 2002 and 2001, respectively.

Liquidity and Capital Resources

In developing its investment strategy, the Company determines a level of cash and short-term investments which, when combined with expected cash flow, is estimated to be adequate to meet expected cash obligations. Historically, the excess of premiums collected over payments on claims, combined with cash income from investments, has provided the Company with short-term funds in excess of normal operating demands for cash. In 2002 and 2001, however, the Company's operating activities used cash totaling $5,979,000 and $1,549,000, respectively. This increase in cash used by operations was primarily the result of a $14,412,000 (16%) decrease in premiums collected somewhat offset by a $7,050,000 (9%) decrease in loss and LAE payments and a $4,625,000 (15%) decrease in underwriting expense payments. The Company's intention to continue to reduce direct premiums written in business segments where returns are unsatisfactory will likely result in future negative cash flows from operations. The Company believes that careful management of the relationship between assets and liabilities will minimize the likelihood that

investment portfolio sales will be necessary to fund insurance operations, and that the effect of any such sale on the Company's stockholders' equity will not be material.

The Company's objectives with respect to its investment portfolio include maximizing total return within investment guidelines while protecting policyholders' surplus and maintaining flexibility. Like other property and casualty insurers, the Company relies on premiums as a major source of cash, and therefore liquidity. Cash flows from the Company's investment portfolio, either in the form of interest or principal payments, are an additional source of liquidity. Because the duration of the Company's investment portfolio relative to the duration of its liabilities is closely managed, increases or decreases in market interest rates are not expected to have a material effect on the Company's liquidity, or its results of operations.

At December 31, 2002, the Company owned 126 investment securities of which 12 had unrealized losses. As of December 31, 2002 all of the Company's fixed maturity investments were exchange traded and had an active secondary market. The Company did not record any other than temporary investment impairments during 2002. The total potential impact on the Company's future earnings and on its financial position if the unrealized losses associated with its investment portfolio at December 31, 2002 were to become other than temporary would be $719,000, or $435,000 after taxes.

At December 31, 2002, $4,965,000 or 2% of the Company's investment portfolio was invested in non-investment grade securities, including three fixed maturity securities included in the totals above with an aggregate market value of $1,876,000 and aggregate unrealized losses of $394,000. At December 31, 2001, $10,163,000 or 5% of the Company's investment portfolio was invested in non-investment grade securities.

The Company generally designates newly acquired fixed maturity investments as available for sale and carries these investments at fair value. Unrealized gains and losses related to these investments are recorded as accumulated other comprehensive income within stockholders' equity. At December 31, 2002, the Company recorded as accumulated other comprehensive income in its Consolidated Balance Sheet $1,937,000 of net unrealized gains, net of taxes, associated with its investments classified as available for sale.

At December 31, 2002, the Company's portfolio of fixed maturity investments represented 92.4% of invested assets. Management believes that this level of bond holdings is consistent with the Company's liquidity needs because it anticipates that cash receipts from net premiums written, investment income and maturing securities will enable the Company to satisfy its cash obligations. Furthermore, a portion of the Company's bond portfolio is invested in mortgage-backed and other asset-backed securities which, in addition to interest income, provide monthly paydowns of bond principal.

At December 31, 2002, $95,905,000, or 49.5%, of the Company's fixed maturity portfolio was invested in mortgage-backed and other asset-backed securities. The Company invests in a variety of collateralized mortgage obligation ("CMO") products but has not invested in the derivative type of CMO products such as interest only, principal only or inverse floating rate securities. All of the Company's CMO investments have a secondary market and their effect on the Company's liquidity does not differ from that of other fixed maturity investments.

During 2002 the Company repurchased 114,300 shares of its common stock at an average price of $21.29 and was holding 1,139,700 shares in treasury as of December 31, 2002.

The Company maintains a $2,000,000 unsecured credit facility from a bank in the form of a master grid note. Any borrowings under this facility are payable on demand and carry an interest rate which can be fixed or variable and is negotiated at the time of each advance. This facility is available for general working capital purposes and for repurchases of the Company's common stock. No amounts were outstanding related to this loan at December 31, 2002.

As a holding company, the Company is dependent upon cash dividends from MNH to meet its obligations and to pay any cash dividends. MNH is subject to New Hampshire insurance laws which place certain restrictions on its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of the insurer's policyholders' surplus as of the preceding December 31st. The maximum amount of dividends that MNH could pay during any twelve month period ending in 2003 without the prior approval of the New Hampshire Insurance Commissioner is $5,492,000. MNH paid $3,700,000 of dividends to the Company in 2002. Dividends were paid in February 2002, May 2002 and November 2002, of $2,300,000, $900,000 and $500,000, respectively. The Company paid a quarterly cash dividend to its common stockholders of $.10 per share in 2002, which amounted to $856,000.

Regulatory guidelines suggest that the ratio of a property and casualty insurer's annual net premiums written to its statutory surplus should not exceed 3 to 1. The Company has consistently followed a business strategy that would allow MNH to meet this 3 to 1 regulatory guideline. MNH's ratio of net premiums written to statutory surplus for 2002 was 1.3 to 1.

Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment of Disposal of Long-Lived Assets." This SFAS supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". SFAS No. 144 requires that Long-Lived Assets to be disposed of be measured at the lower of carrying amount or fair value less cost to sell. The provisions of SFAS Nos. 143 and 144 are not expected to have any impact on the Company's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 145, "Recission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 addresses a number of different issues and is effective at various dates in 2002 and 2003, with earlier application encouraged. None of the provisions of SFAS No. 145 had or are expected to have a material impact on the Company's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The provisions of SFAS No. 146 are not expected to have any impact on the Company's consolidated financial statements.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FASB Interpretation No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of FASB Interpretation No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has complied with the required disclosure. The provisions of FASB Interpretation No. 45 are not expected to have any impact on the Company's consolidated financial statements.

In January 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities." FASB Interpretation No. 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain-entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FASB Interpretation No. 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. The provisions of FASB Interpretation No. 46 are not expected to have any impact on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - An Amendment of FASB Statement No. 123." SFAS No. 148 provides alternative methods of transition for voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS No. 123 as provided in SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The provisions of SFAS No. 148 are not expected to have any impact on the Company's consolidated financial statements.

Federal Legislation

The Terrorism Risk Insurance Act of 2002 ("TRIA"), signed into law on November 26, 2002, provides a federal backstop for losses related to the writing of the terrorism peril in property and casualty insurance policies. Under the TRIA, the Company had until February 24, 2003, to notify commercial policyholders about requirements of the law, let them know that the company was required to offer terrorism coverage and let them know how the coverage would be priced.

The Company has distributed disclosure notices to its commercial policyholders. The notices explained the TRIA and notified them of their coverage. Except for a few select cases, full policy limit coverage has been provided for terrorism for policyholders. The terrorism rating plan, with rates that vary based on geographical and risk-type factors, will go into effect in the near future. The plan will charge all commercial policies a nominal terrorism premium to encourage them to accept coverage while minimizing the company's administrative costs.

Environmental Claims

MNH, like many other property and casualty insurance companies, is subject to environmental damage claims asserted by or against its insureds. Management of the Company is of the opinion that based on various court decisions throughout the country, certain of these claims should not be recoverable under the terms of MNH's insurance policies because of either specific or general coverage exclusions contained in the policies. However, there is no assurance that the courts will agree with MNH's position in every case, nor can there be assurance that material claims will not be asserted under policies which a court will find do not explicitly or implicitly exclude claims for environmental damages. Management, however, is not aware of any pending claim or group of claims which would result in a liability that would have a material adverse effect on the financial condition of the Company or MNH.

Inflation

Inflation affects the Company, like other companies in the property and casualty insurance industry, by contributing to higher losses, LAE and operating costs, as well as greater investment income resulting from the higher interest rates which can prevail in an inflationary period. Premium rates, however, may not keep pace with inflation since competitive forces may limit the Company's ability to increase premium rates. The Company considers inflationary trends in estimating its reserves for claims reported and for incurred but not reported claims.

Relationship with Mutual

The Company's and MNH's business and day-to-day operations are closely aligned with those of Mutual. This is the result of a combination of factors. Mutual has had a historical ownership interest in the Company and MNH. Prior to November 1986 MNH was a wholly-owned subsidiary of Mutual. Following the Company's initial public offering in November 1986 and until a secondary stock offering in July 1993 the Company was a majority-owned subsidiary of Mutual. At December 31, 2002 Mutual owned 12.1% of the Company's common stock. Under the Management Agreement, Mutual provides the Company and MNH with all facilities and with personnel to operate their business. With the exception of the Chief Operating Officer of MNH, the only officers of the Company or MNH who are paid full time employees are employees of Mutual whose services are purchased under the Management Agreement. Also, the operation of MNH's insurance business, which offers substantially the same lines of insurance as Mutual through the same independent insurance agents, creates a very close relationship among the companies.

During 1998, Mutual initiated discussions with the Company concerning proposals for the acquisition of the Company by Mutual. The Company determined that the terms proposed by Mutual were inadequate. The Company also determined that the Management Agreement, as currently written, creates a conflict of interest between the Company and Mutual in their joint operation and prevents the Company's shareholders from realizing the Company's fair value in a sale or merger. Accordingly, on July 23, 1998 the Company gave notice to Mutual of its intention to terminate the Management Agreement effective July 23, 2003. The Boards of Directors of the Company, MNH and Mutual have agreed in principle for Mutual to continue to provide administrative and management services to MGI and to manage the traditional property and casualty insurance business of MNH under a new services agreement. The new arrangement between Mutual and MNH is intended to be effective as of January 1, 2003, thereby superceding the Management Agreement as of that date, and also provides for the pooling of the insurance business traditionally written by each company, in order to achieve common underwriting results.

The proposed services agreement and reinsurance pooling arrangements are subject to the approvals of the New Hampshire and New York Insurance Departments, which presently are being sought. In order to ensure uninterrupted service to policyholders and agents pending regulatory approval of the proposed agreements, the Boards of Directors of the Company, MNH and Mutual have agreed to extend the effective date of termination of the existing Management Agreement until the earlier of the effective date of the proposed services agreement or January 1, 2004. See PART 1, Item 1. BUSINESS. Administration, Reinsurance, which is incorporated herein by reference.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995:

With the exception of historical information, the matters and statements discussed, made or incorporated by reference in this Annual Report on Form 10-K constitute forward-looking statements and are discussed, made or incorporated by reference, as the case may be, pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, statements relating to the Company's plans, strategies, objectives, expectations and intentions. Words such as "believes," "forecasts," "intends," "possible," "expects," "anticipates," "estimates," or "plans," and similar expressions are intended to identify forward-looking statements. Such forward-looking statements involve certain assumptions, risks and uncertainties that include, but are not limited to, those associated with factors affecting the property-casualty insurance industry generally, including price competition, the Company's dependence on state insurance departments for approval of rate increases, size and frequency of claims, escalating damage awards, natural disasters, fluctuations in interest rates and general business conditions; the Company's dependence on investment income; the geographic concentration of the Company's business in the northeastern United States and in particular in New York, New Hampshire, New Jersey, Rhode Island, Pennsylvania and Massachusetts; the adequacy of the Company's loss reserves; the Company's dependence on the general reinsurance market; government regulation of the insurance industry; exposure to environmental claims; dependence of the Company on its relationship with Merchants Mutual Insurance Company and the uncertainty concerning the outcome of the negotiations concerning renewal or extension of the Company's Management Agreement with Mutual beyond its termination date of July 23, 2003; the Company's intention to reduce written premium on business segments that it believes no longer provide a satisfactory return; and the other risks and uncertainties discussed or indicated in all documents filed by the Company with the Securities and Exchange Commission. The Company expressly disclaims any obligation to update any forward-looking statements as a result of developments occurring after the filing of this report.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Market risk represents the potential for loss due to changes in the fair value of financial instruments. The market risk related to the Company's financial instruments primarily relates to its investment portfolio. The value of the Company's investment portfolio of $209,397,000 at December 31, 2002 is subject to changes in interest rates and to a lesser extent on credit quality. Further, certain mortgage-backed and asset-backed securities are exposed to accelerated prepayment risk generally caused by interest rate movements. As interest rates decline, mortgage holders are more likely to refinance existing mortgages at lower rates. Acceleration of future repayments could adversely affect future investment income, if reinvestment of the accelerated receipts was made in lower yielding securities.

The table below provides information related to the Company's fixed maturity investments at December 31, 2002. The table presents cash flows of principal amounts and related weighted average interest rates by expected maturity dates. The cash flows are based upon the maturity date or, in the case of mortgage-backed and asset-backed securities, expected payment patterns. Actual cash flows could differ from those shown in the table.

Expected Cash Flows of Principal Amounts ($ in 000's):

	2002	2003	2004	2005	2006

Held to Maturity					
Mortgage & asset backed securities	$ 3,416	$ 676	$ 0	$ 0	$ 0
Average interest rate	7.0%	7.2%	0.0%	0.0%	0.0%
Total	$ 3,416	$ 676	$ 0	$ 0	$ 0
Available for Sale					
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 4,191	$ 0	$ 8,234	$ 0	$ 0
Average interest rate	4.1%	0.0%	3.6%	0.0%	0.0%
Obligations of states and political subdivisions	6,395	1,377	8,652	9,738	2,144
Average interest rate	7.2%	4.1%	3.2%	3.4%	4.5%
Corporate securities	27,681	6,853	17,821	0	0
Average interest rate	4.8%	7.7%	4.0%	0.0%	0.0%
Mortgage & asset backed securities	38,841	18,346	13,771	11,928	4,842
Average interest rate	5.6%	5.6%	5.6%	5.6%	5.6%
Total	$77,108	$26,576	$48,478	$21,666	$6,986

The discussion and the estimated amounts referred to above include forward-looking statements of market risk which involve certain assumptions as to market interest rates and the credit quality of the fixed maturity investments. Actual future market conditions may differ materially from such assumptions. Accordingly, the forward-looking statements should not be considered projections of future events by the Company.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements required in response to this Item are submitted as part of Item 14 (a) of this report, and are incorporated in this item by reference.

Quarterly data for the two most recent fiscal years is set forth below:

	Three months ende	
	3/31	6/30

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	(in thousands, except per sh	
2002		
Net premiums earned	$23,130	$21,569
Net investment income	2,570	2,726
Net realized investment gains (losses)	73	1,310
Other revenues	227	210
Total revenues	$26,000	$25,816
Income before income taxes	$240	$2,840
Net income	$142	$1,704
Net income per diluted share	$.07	$.81
2001		
Net premiums earned	$23,353	$23,154
Net investment income	3,563	3,472
Net realized investment gains (losses)	43	39
Other revenues	137	117
Total revenues	$27,096	$26,782
Income (loss) before income taxes	$331	$1,910
Net income (loss)	$212	$1,217
Net income (loss) per diluted share	$.09	$.52

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information in response to this item is incorporated by reference herein to the information under the caption "Election of Directors" presented in the Company's definitive proxy statement filed or to be filed pursuant to Regulation 14A and used in connection with the Company's 2003 Annual Meeting of Shareholders to be held on or about May 7, 2003, provided, however, that information appearing under the heading "Report of the Audit Committee" is not incorporated herein and should not be deemed included in this document for any purpose.

Item 11. EXECUTIVE COMPENSATION.

The information in response to this item is incorporated by reference herein to the information under the captions "Executive Compensation" and "Compensation of Directors" presented in the Company's definitive proxy statement filed or to be filed pursuant to Regulation 14A and used in connection with the Company's 2003 Annual Meeting of Shareholders to be held on or about May 7, 2003, provided, however that information appearing under the captions "Compensation Committee Report on Executive Compensation" and "Performance Comparison" is not incorporated herein and should not be deemed to be included in this document for any purpose.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information in response to this item is incorporated by reference herein to the information under the caption "Security Ownership of Certain Beneficial Owners" and "Security Ownership of Management" presented in the Company's definitive proxy statement filed or to be filed pursuant to Regulation 14A and used in connection with the Company's 2003 Annual Meeting of Stockholders to be held on or about May 7, 2003.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information in response to this item is incorporated herein by reference to the information under the caption "Management Agreement" and "Certain Transactions" presented in the Company's definitive proxy statement filed or to be filed pursuant to Regulation 14A and used in connection with the Company's 2003 Annual Meeting of Shareholders to be held on or about May 7, 2003.

Item 14. CONTROLS AND PROCEDURES.

The Company's chief operating officer and chief financial officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) as of a date (the "Evaluation Date") within 90 days before the filing date of this annual report, concluded that as of the Evaluation Date the Company's disclosure controls and procedures were effective to ensure that material information relating to the Company was being made known to them by others within the Company in a timely manner, including the period when this annual report was being prepared.

There were no significant changes in the Company's internal controls or, to the knowledge of the Company's chief operating officer and chief financial officer, in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the Evaluation Date.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) (1) The following financial statements of Merchants Group, Inc. are included on pages F-1 to F-22:

Report of Independent Accountants
Consolidated Balance Sheet - December 31, 2001 and 2002.
Consolidated Statement of Operations - Years ended December 31, 2000, 2001 and 2002.

Consolidated Statement of Changes in Stockholders' Equity - Years ended December 31, 2000, 2001 and 2002. Consolidated Statement of Cash Flows - Years ended December 31, 2000, 2001 and 2002.

Notes to Consolidated Financial Statements.

(2) The following financial statement schedules of Merchants Group, Inc. are filed herewith pursuant to Item 8:

Schedule I -
Summary of Investments - Other Than Investments in Related Parties.

Schedule II -
Amounts Receivable From/Payable to Related Parties, and Underwriters, Promoters and Employees Other Than Related Parties.

Schedule III -
Condensed Financial Information of Registrant.

Schedule V -
Supplemental Insurance Information (see Schedule X).

Schedule VI - Reinsurance

Schedule X -
Supplemental Insurance Information Concerning Property - Casualty Subsidiaries

(b) Reports on Form 8-K.

On March 7, 2003, the Company filed a Form 8-K reporting that it reached an agreement in principle with Merchants Mutual Insurance Company whereby Merchants Mutual Insurance Company would continue to provide management services to the Company for the Company's traditional insurance business and to pool the insurance business traditionally written by each company.

(c) Exhibits required by Item 601 of Regulation S-K:

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(3) (a) Restated Certificate of Incorporation (incorporated by reference to Exhibit No. 3C to Amendment No. 1 to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on November 7, 1986).

(b) Restated By-laws (incorporated by reference to Exhibit No. 3D to Amendment No. 1 to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on November 7, 1986).

(10) (a) Management Agreement dated as of September 29, 1986 by and among Merchants Mutual Insurance Company, Registrant and Merchants Insurance Company of New Hampshire, Inc. (incorporated by reference to Exhibit No. 10A to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on September 30, 1986).

(b) Agreement of Reinsurance No. 6922 between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire, Inc. and General Reinsurance Corporation (incorporated by reference to Exhibit No. 10E to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on

September 30, 1986).

(c) Agreement of Reinsurance No. 7299 between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire, Inc. and General Reinsurance Corporation, (incorporated by reference to Exhibit No. 10o to the Company's 1987 Annual Report on Form 10-K (File No. 1-9640) filed on March 19, 1988).

(d) Agreement of Reinsurance dated January 27, 1993, between Merchants Mutual Insurance Company and Merchants Insurance Company of New Hampshire, Inc. (incorporated by reference to Exhibit (3) in the Company's Current Report on Form 8-K (File No. 1-9640) filed on January 29, 1993).

(e) Agreement of Reinsurance No. 8009 between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire, Inc. and General Reinsurance Corporation, (incorporated by reference to Exhibit 10e to the Company's 1995 Annual Report on Form 10-K filed on March 28, 1996).

(f) Casualty Excess of Loss Reinsurance Agreement between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire, Inc. and American Reinsurance Company (filed herewith).

(g) Property Per Risk Excess of Loss Reinsurance Agreement between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire and American Re-Insurance Company (filed herewith).

(h) Property Catastrophe Excess of Loss Reinsurance Agreement between Merchants Mutual Insurance Company, Merchants Insurance Company of New Hampshire, Inc. and the Subscribing Reinsurers Executing the Interest and Liabilities Agreements Attached Hereto,

effective January 1, 2002 (incorporated by reference to Exhibit 10g to the Company's September 30, 2002 Quarterly Report on Form 10-Q filed on November 8, 2002).

(i) Quota Share Reinsurance Treaty Agreement between Merchants Insurance Company of New Hampshire, Inc. and The Subscribing Underwriting Members of Lloyd's, London specifically identified on the schedules attached to this agreement dated January 1, 2000 (incorporated by reference to Exhibit 10h to the Company's 2000 Annual Report on Form 10-K filed on March 28, 2001).

* (j) Merchants Mutual Capital Accumulation Plan (incorporated by reference to Exhibit No. 10G to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on September 30, 1986).

* (k) Merchants Mutual Capital Accumulation Plan, fifth amendment, effective January 1, 1999 (incorporated by reference to Exhibit 10j to the Company's 2000 Annual Report

on Form 10-K filed on March 28, 2001).

* (l) Merchants Mutual Capital Accumulation Plan Trust Agreement (restated as of January 1, 1996 (incorporated by reference to Exhibit 10(i) to the Company's 1996 Annual Report on Form 10-K (File No. 1-9640) filed on March 28, 1997).

* (m) Merchants Mutual Supplemental Executive Retirement Plan dated as of December 29, 1989 and Agreement of Trust dated as of December 29, 1989 (incorporated by reference to Exhibit No. 10K to the Company's 1989 Annual Report on Form 10-K (File No. 1-9640) filed on March 21, 1990).

* (n) Amendment dated June 10, 1992 to Agreement of Trust under Merchants Mutual Supplemental Executive Retirement Plan dated as of December 29, 1989 (incorporated by reference to Exhibit No. 10R to the Company's 1992 Annual Report on Form 10-K (File No. 1-9640) filed on March 31, 1993).

* (o) Merchants Group, Inc. 1986 Stock Option Plan As Amended Through February 16, 1993 (incorporated by reference to Exhibit No. 10E to the Company's 1992 Annual Report on Form 10-K (File No. 1-9640) filed on March 31, 1993).

* (p) Form of Amended Indemnification Agreement entered into by Registrant with each director and executive office of Registrant (incorporated by reference to Exhibit No. 10N to Amendment No. 1 to the Company's Registration Statement on (No. 33-9188) Form S-1 filed on November 7, 1986).

* (q) Merchants Mutual Insurance Company Adjusted Return on Equity Incentive Compensation Plan January 1, 2000 (incorporated by reference to Exhibit 10p to the Company's 2000 Annual Report on Form 10-K filed on March 28, 2001).

* (r) Merchants Mutual Insurance Company Adjusted Return on Equity Long Term Incentive Compensation Plan January 1, 2000 (incorporated by reference to Exhibit 10q to the Company's 2000 Annual Report on Form 10-K filed on March 28, 2001).

* (s) Amendment No. 1 to Employee Retention Agreement between Robert M. Zak and Merchants Mutual Insurance Company originally dated as of May 31, 1999, dated February 6, 2002 (filed herewith).

* (t) Amendment No. 1 to Employee Retention Agreement between Edward M. Murphy and Merchants Mutual Insurance Company originally dated as of March 1, 1999, dated February 6, 2002 (filed herewith).

* (u) Amendment No. 1 to Employee Retention Agreement between Kenneth J. Wilson and Merchants Mutual Insurance Company originally dated as of March 1, 1999, dated February 6, 2002 (filed herewith).

* (v) Consulting Agreement between Stephen C. June and Merchants Insurance Company of New Hampshire, Inc. ("MNH") dated as of

May 7, 2001 (incorporated by reference to Exhibit 10U of the Company's 2001 Annual Report on Form 10-K (File No. 1-9640) filed on March 27, 2002).

*	(w)	Employment Agreement between Stephen C. June and MNH dated as of April 1, 2002 (incorporated by reference to Exhibit 10V of the Company's 2001 Annual Report on Form 10-K (File No. 9640) filed on March 27, 2002).
(11)	(a)	Statement re computation of per share earnings (incorporated herein by reference to Note 9 to the Consolidated Financial Statements included in Item 8).
(21)		List of Subsidiaries of Registrant (incorporated by reference to Exhibit No. 22 to the Company's Registration Statement (No. 33-9188) on Form S-1 filed on September 30, 1986).
(23)		Consent of Independent Accountants (filed herewith).
99(a)		Certification Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code (filed herewith).

* Indicates a management contract or compensation plan or arrangement.

The Company will forward upon request any exhibit not contained herein upon payment of a fee equal to the Company's reasonable expenses in furnishing the exhibits. Requests should be directed to:

INVESTOR RELATIONS
MERCHANTS GROUP, INC.
250 MAIN STREET
BUFFALO, NEW YORK 14202

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MERCHANTS GROUP, INC.
SCHEDULE I - SUMMARY OF INVESTMENTS -
OTHER THAN INVESTMENTS IN RELATED PARTIES
December 31, 2002
(in thousands)

Type of Investment	Amortized Cost/Cost	Market Value	Amount at which shown in the balance sheet
Fixed maturities:			
United States Government and government agencies and authorities	$ 12,425	$ 12,855	$ 12,855
Corporate bonds	55,067	56,123	56,123
Mortgage and asset backed securities	94,582	96,072	95,905
Tax exempt bonds	28,320	28,685	28,685

Total fixed maturities	190,394	193,735	193,568
Preferred stocks	7,364	7,367	7,367
Short-term investments	6,420	6,420	6,420
Other	2,042	2,042	2,042
	$206,220	$209,564	$209,397

MERCHANTS GROUP, INC.
SCHEDULE II - AMOUNTS RECEIVABLE FROM/PAYABLE TO RELATED PARTIES,
AND UNDERWRITERS, PROMOTERS AND EMPLOYEES OTHER
THAN RELATED PARTIES
Years ended December 31, 2000, 2001 and 2002
(in thousands)

	2000	2001	2002
Receivable from (payable to) Merchants Mutual Insurance Company (1):			
Balance at beginning of period	$(618)	$(608)	$ (852)
Change during the period	10	(244)	(2,385)
Balance at end of period	$(608)	$(852)	$(3,237)

(1) Under a Management Agreement, Merchants Mutual Insurance Company (Mutual) provides employees, services and facilities for Merchants Insurance Company of New Hampshire, Inc. (MNH) to carry on its insurance business on a cost reimbursed basis. The balance in the intercompany receivable (payable) account indicates the amount due from (to) Mutual for the excess (deficiency) of premiums collected over (from) payments for losses, employees, services and facilities provided to MNH.

MERCHANTS GROUP, INC.
SCHEDULE III - CONDENSED FINANCIAL INFORMATION OF REGISTRANT
(in thousands except per share and share amounts)

BALANCE SHEET December 31,

	2001	2002
Assets		
Investment in subsidiary	$ 68,454	$ 67,581
Other assets	354	405
Total assets	$ 68,808	$ 67,986
Liabilities and Stockholders' Equity		
Other liabilities	$ 57	$ 62
Demand loan	200	--
Total liabilities	257	62
Stockholders' equity:		
Preferred stock, $.01 par value, authorized and unissued 3,000,000 shares	--	--
Preferred stock, no par value, $424.30 stated value, no shares issued or outstanding at December 31, 2001 or 2002	--	--
Common stock, $.01 par value, authorized 10,000,000 shares; issued and outstanding of 2,224,452 shares at December 31, 2001 and 2,210,152 shares at December 31, 2002	32	32
Additional paid in capital	35,795	35,795
Treasury stock, 1,025,400 shares at December 31, 2001 and 1,139,700 shares at December 31, 2002	(20,332)	(22,766)
Accumulated other comprehensive income (loss)	1,812	1,937
Accumulated earnings	51,244	52,926
Total stockholders' equity	68,551	67,924
Total liabilities and stockholders' equity	$ 68,808	$ 67,986

MERCHANTS GROUP, INC.
SCHEDULE III - CONDENSED FINANCIAL INFORMATION OF REGISTRANT
Continued
(in thousands)

INCOME STATEMENT

	Year ended December 31,		
	2000	2001	2002
Revenues:			

Equity in net income of subsidiary	$4,462	$887	$2,702
Investment income (loss)	(23)	44	(4)
Total revenues	4,439	931	2,698
Expenses:			
General and administrative expenses	174	174	177
Operating income before income taxes	4,265	757	2,521
Income tax benefit	(74)	(64)	(17)
Net income	$4,339	$821	$2,538

MERCHANTS GROUP, INC.
SCHEDULE III - CONDENSED FINANCIAL INFORMATION OF REGISTRANT
(in thousands)

STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents:

	Year ended December 31,		
	2000	2001	2002
		(in thousands)	
Cash flows from operating activities:	$ (169)	$ (5)	$ (1
Cash flows from investing activities:			
Receipt of subsidiary common stock dividend	5,200	5,060	3,7
Purchase of other investments, net	(86)	(175)	(1
Cash flows from investing activities	5,114	4,885	3,6
Cash flows from financing activities:			
Purchase of treasury stock	(2,924)	(4,269)	(2,4
Proceeds from (repayment of) demand loan, net	(1,025)	200	(2
Cash dividends	(993)	(925)	(8
Exercise of common stock options	-	115	
Cash flows from financing activities	(4,942)	(4,879)	(3,4
Net increase (decrease) in cash and cash equivalents	3	1	
Cash and cash equivalents, beginning of year	1	4	
Cash and cash equivalents, end of year	$ 4	$ 5	$

Reconciliation of net income to net cash provided by operations:

Net income	$4,339	$821	$2,5
Adjustments to reconcile net income to net cash provided by operations:			
Equity in income of subsidiary	(4,462)	(887)	(2,7
Increase (decrease) in other liabilities	10	(1)	
(Increase) decrease in other (non-investment) assets	(56)	64	
Other, net	-	(2)	
Net cash used in operating activities	$ (169)	$ (5)	$ (1

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MERCHANTS GROUP, INC.
SCHEDULE III - CONDENSED FINANCIAL INFORMATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

Cash dividends of $5,200,000, $5,060,000 and $3,700,000 were paid to the Registrant by its consolidated subsidiary in the years ended December 31, 2000, 2001 and 2002, respectively.

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MERCHANTS GROUP, INC.
SCHEDULE VI - REINSURANCE
YEARS ENDED DECEMBER 31, 2000, 2001, 2002
(in thousands except percentages)

	Gross amount	Ceded to other companies	Assumed from other companies	Net amount	Percentage of amount assumed to net
Year ended December 31, 2000					
Property and Casualty Premiums	$107,234	$13,532	$ 640	$94,342	.7%
Year Ended December 31, 2001					
Property and Casualty Premiums	$100,953	$ 8,392	$1,412	$93,973	1.5%
Year ended December 31, 2002					
Property and Casualty Premiums	$ 72,803	$ 4,569	$2,294	$70,528	3.3%

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MERCHANTS GROUP, INC.
SCHEDULE X - SUPPLEMENTAL INSURANCE INFORMATION CONCERNING
PROPERTY - CASUALTY SUBSIDIARIES
Years ended December 31, 2000, 2001 and 2002
(in thousands)

	Deferred policy acquis-ition costs	Reserves for losses and loss adjustment expenses	Discount if any, deducted from reserves	Unearned premiums	Net earned premiums	Net investment income	Losses & loss adjustment expense incurred related t (1) Current years	(2) Prior years
Year ended:								
December 31, 2000	$12,331	$145,075	$7,170	$50,857	$94,259	$13,903	$69,946	$ 1,428
December 31, 2001	$12,354	$151,355	$6,714	$50,179	$93,885	$13,295	$76,618	$(1,474
December 31, 2002	$ 8,817	$147,136	$5,746	$35,119	$83,120	$10,403	$66,658	$(3,785

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Merchants Group, Inc.
Date: March 27, 2003   BY: /s/Robert M. Zak, Senior Vice President
Robert M. Zak, Senior Vice President and
Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/Richard E. Garman Richard E. Garman	Director, Chairman of the Board	March 27, 2003

/s/Brent D. Baird ---------------------- Brent D. Baird	Director, President	March 27, 2003
/s/Robert M. Zak ---------------------- Robert M. Zak	Director, Sr. VP & Chief Operating Officer	March 27, 2003
/s/Kenneth J. Wilson ---------------------- Kenneth J. Wilson	Vice President & CFO (principal financial and accounting officer)	March 27, 2003
/s/Andrew A. Alberti ---------------------- Andrew A. Alberti	Director	March 27, 2003
/s/Frank J. Colantuono ---------------------- Frank J. Colantuono	Director	March 27, 2003
/s/Thomas E. Kahn ---------------------- Thomas E. Kahn	Director	March 27, 2003
/s/Henry P. Semmelhack ---------------------- Henry P. Semmelhack	Director	March 27, 2003

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CERTIFICATIONS

I, Robert M. Zak, certify that:

1. I have reviewed this annual report on Form 10-K of Merchants Group, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this report (the Evaluation Date); and

c. presented in this report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditor and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Date: March 27, 2003 By:/s/ Robert M. Zak

Robert M. Zak, Senior Vice President and
Chief Operating Officer
(Chief Executive Officer)

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CERTIFICATIONS

I, Kenneth J. Wilson, certify that:

1. I have reviewed this annual report on Form 10-K of Merchants Group, Inc.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

    a. designed such disclosure controls and procedures that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

    b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this report (the Evaluation Date); and

    c. presented in this report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditor and the audit committee of registrant's board of directors (or persons performing the equivalent function):

    a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 27, 2003 By:/s/ Kenneth J. Wilson

Kenneth J. Wilson, Vice President and
Chief Financial Officer
(Chief Financial Officer)

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Report of Independent Accountants

To the Board of Directors
and Stockholders of
Merchants Group, Inc.

In our opinion, the consolidated financial statements listed in the index appearing under Item 15 (a) (1) on page 41 present fairly, in all material respects, the financial position of Merchants Group, Inc. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules appearing under Item 15 (a) (2) on page 41 present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers
Buffalo, New York
February 12, 2003

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MERCHANTS GROUP, INC.

CONSOLIDATED BALANCE SHEET

(in thousands)

Assets	December 31, 2001	December 31, 2002
Investments:		
Fixed maturities:		
Held to maturity at amortized cost	$ 13,042	$ 4,092
Available for sale at fair value	182,170	189,476
Preferred stock at fair value	9,422	7,367
Other long-term investments at fair value	1,593	2,042
Short-term investments	6,905	6,420
Total investments	213,132	209,397
Cash	1,197	9
Interest due and accrued	2,309	1,594
Premiums receivable, net of allowance for doubtful accounts of $431 in 2001 and $288 in 2002	21,685	14,496
Deferred policy acquisition costs	12,354	8,817
Ceded reinsurance balances receivable	18,810	19,086
Prepaid reinsurance premiums	3,559	1,091
Deferred income taxes	4,790	4,195
Other assets	8,727	10,031
Total assets	$286,563	$268,716

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.

CONSOLIDATED BALANCE SHEET

(in thousands except share and per share amounts)

Liabilities and Stockholders' Equity	December 31, 2001	December 31, 2002
Liabilities:		
Reserve for losses and loss adjustment expenses	$ 151,355	$ 147,136
Unearned premiums	50,179	35,119
Demand loan	200	--
Payable to affiliate	852	3,237
Other liabilities	15,426	15,300

Total liabilities	218,012	200,792
Stockholders' equity:		
Common stock, $.01 par value, authorized 10,000,000 shares, issued and outstanding 2,224,452 shares at December 31, 2001 and 2,110,152 shares at December 31, 2002	32	32
Additional paid in capital	35,795	35,795
Treasury stock, 1,025,400 shares at December 31, 2001 and 1,139,700 shares at December 31, 2002	(20,332)	(22,766)
Accumulated other comprehensive income	1,812	1,937
Accumulated earnings	51,244	52,926
Total stockholders' equity	68,551	67,924
Commitments and contingencies	--	--
Total liabilities and stockholders' equity	$ 286,563	$ 268,716

The accompanying notes are an integral part of these consolidated financial statements.

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MERCHANTS GROUP, INC.

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands except per share amounts)

	Year ended December 31,		
	2000	2001	20
Revenues:			
Net premiums earned	$ 94,259	$ 93,885	$ 83,
Net investment income	13,903	13,295	10,
Net realized investment gains (losses)	109	(580)	
Other revenues	355	696	
Total revenues	108,626	107,296	95,
Expenses:			
Net losses and loss adjustment expenses	71,374	75,144	62,
Amortization of deferred policy acquisition costs	24,979	24,880	22,
Other underwriting expenses	5,266	6,017	5,
Total expenses	101,619	106,041	90,

Income before income taxes	7,007	1,255	4,
Income tax provision	2,668	434	1,
Net income	$ 4,339	$ 821	$ 2,
Earnings per share:			
Basic	$ 1.75	$ .35	$ 1
Diluted	$ 1.74	$ .35	$ 1
Weighted average number of shares outstanding			
Basic	2,485	2,343	2,
Diluted	2,487	2,343	2,

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(in thousands)

	Year ended December 31,		
	2000	2001	2002
Net income	$ 4,339	$ 821	$ 2,538
Other comprehensive income before tax:			
Unrealized gains on securities	482	4,454	1,161
Reclassification adjustment for gains included in net income	(100)	(124)	(952)
Other comprehensive income before tax	382	4,330	209
Income tax provision related to items of other comprehensive income	69	1,643	84
Other comprehensive income	313	2,687	125
Comprehensive income	$ 4,652	$ 3,508	$ 2,663

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands except per share amounts)

	Year ended December 31, 2000	2001	2002
Common stock:			
Beginning and end of year	$ 32	$ 32	$ 32
Additional paid in capital:			
Beginning of year	35,680	35,680	35,795
Exercise of common stock options	--	115	--
End of year	35,680	35,795	35,795
Treasury stock:			
Beginning of year	(13,139)	(16,063)	(20,332)
Purchase of treasury shares	(2,924)	(4,269)	(2,434)
End of year	(16,063)	(20,332)	(22,766)
Accumulated other comprehensive income (loss)			
Beginning of year	(1,188)	(875)	1,812
Other comprehensive income	313	2,687	125
End of year	(875)	1,812	1,937
Accumulated earnings:			
Beginning of year	48,002	51,348	51,244
Net income	4,339	821	2,538
Cash dividends ($.40/share in 2000, in 2001 and in 2002)	(993)	(925)	(856)
End of year	51,348	51,244	52,926
Total stockholders' equity	$ 70,122	$ 68,551	$ 67,924

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2000	2001	2
Cash flows from operations:			
Collection of premiums	$ 94,497	$ 91,807	$
Payment of losses and loss adjustment expenses	(67,625)	(74,280)	
Payment of underwriting expenses	(30,643)	(31,414)	
Investment income received	12,949	12,999	
Investment expenses paid	(387)	(304)	
Income taxes paid	(2,436)	(1,133)	
Other cash receipts	209	776	
Net cash provided by (used in) operations	6,564	(1,549)	
Cash flows from investing activities:			
Proceeds from fixed maturities sold or matured	70,453	104,712	
Purchase of fixed maturities	(68,326)	(99,685)	(
Net (increase) decrease in preferred stock	(1,491)	5,261	
Net increase in other long-term investments	(239)	(557)	
Net (increase) decrease in short-term investments	(2,006)	(2,355)	
Settlement of securities transactions	--	--	
Net cash provided by (used in) investing activities	(1,609)	7,376	
Cash flows from financing activities:			
Settlement of affiliate balances, net	(10)	244	
Proceeds (repayment) of demand loan, net	(1,025)	200	
Purchase of treasury stock	(2,924)	(4,269)	
Proceeds from exercise of common stock options	--	115	
Cash dividends	(993)	(925)	
Net cash used in financing activities	(4,952)	(4,635)	
Increase (decrease) in cash	3	1,192	
Cash, beginning of year	2	5	
Cash, end of year	$ 5	$ 1,197	$

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATONS

(in thousands)

	Year ended December 31, 2000	2001	2002
Net income	$ 4,339	$ 821	$ 2,538
Adjustments:			
Depreciation and amortization	(642)	(1,104)	23
Net realized investment (gains) losses	(109)	580	(953)
(Increase) decrease in assets:			
Interest due and accrued	(699)	507	715
Premiums receivable	121	(1,842)	7,189
Deferred policy acquisition costs	(22)	(23)	3,537
Ceded reinsurance balances receivable	(7,693)	(5,721)	(276)
Prepaid reinsurance premiums	(1,158)	767	2,468
Deferred income taxes	(331)	(170)	511
Other assets	117	(1,190)	(1,304)
Increase (decrease) in liabilities:			
Reserve for losses and loss adjustment expenses	11,549	6,280	(4,219)
Unearned premiums	1,241	(678)	(15,060)
Other liabilities	(149)	224	(1,148)
Net cash provided by (used in) operations	$ 6,564	$ (1,549)	$ (5,979)

The accompanying notes are an integral part of these consolidated financial statements.

MERCHANTS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

Principles of consolidation and basis of presentation

The consolidated financial statements of Merchants Group, Inc. (the "Company") include the accounts of the Company, its wholly-owned subsidiary, Merchants Insurance Company of New Hampshire, Inc. ("MNH"), and M.F.C. of New York, Inc., an inactive premium finance company which is a wholly-owned subsidiary of MNH. MNH is a stock property and casualty insurance company domiciled in the state of New Hampshire. MNH offers property and casualty insurance to preferred risk individuals and small to medium sized businesses in the northeast United States, primarily in New York, New Hampshire and New Jersey where a majority of its policies are written. As a holding company, the Company has had no operations.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles ("GAAP") which differ in some respects from those followed in reports to insurance regulatory authorities. In its Annual Statement filed with regulatory authorities, MNH reported policyholders' surplus of $52,626,000 and $54,917,000 at December 31, 2001 and 2002, respectively. MNH's net income as reported in its Annual Statement was $3,981,000 in 2000, $443,000 in 2001 and $6,575,000 in 2002. All significant intercompany balances and transactions have been eliminated.

The National Association of Insurance Commissioners has published the "Accounting Practices and Procedures Manual effective January 1, 2001" (the "Codification"). This publication codifies statutory accounting principles effective as of that date. The Codification has been adopted by the New Hampshire Insurance Department. MNH followed the statutory accounting guidance contained in the Codification when preparing its 2001 statutory financial statements. The statutory accounting principles prescribed by the Codification vary in certain instances from those previously used by MNH to prepare its Annual Statement at December 31, 2000 as filed with regulatory authorities. The effect of adopting Codification as of January 1, 2001 was an increase to MNH's surplus of $4,826,000.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Investments

The Company has classified its investments in fixed maturities as either held to maturity or available for sale. Fixed maturities classified as held to maturity are presented at amortized cost and consist of debt securities that management intends and has the ability to hold until maturity. Fixed maturities classified as available for sale are presented at fair value and consist of debt securities that management may not hold until maturity. All preferred stocks are classified as available for sale and are presented at fair value. The net aggregate unrealized gain or loss, net of applicable income taxes, related to fixed maturities and preferred stock classified as available for sale is included as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Fixed maturities include mortgage backed and asset backed securities that are valued using the interest method. The Company estimates prepayments utilizing published data when applying the interest method. Periodic adjustments to prepayment assumptions are credited or charged to investment income.

Other long-term investments include collateralized mortgage obligation residuals, carried at unpaid principal balances which do not vary significantly from fair value. Short-term investments, consisting primarily of money market mutual funds, have original maturities of three months or less and are carried at cost, which approximates fair value. Realized gains and losses on the sale of investments are based on the cost of the specific investment sold.

Net premiums earned

Premiums are recorded as revenue ratably over the terms of the policies written (principally one year). Unearned premiums are calculated using a monthly pro rata method.

Deferred policy acquisition costs

Policy acquisition costs, such as commissions (net of reinsurance commissions), premium taxes and certain other underwriting expenses which vary directly with premium volume are deferred and amortized over the terms of the related insurance policies. Deferred policy acquisition costs are evaluated on an aggregate basis at least quarterly to determine if recorded amounts exceed estimated recoverable amounts after allowing for anticipated investment income. Premium deficiency if any, is recorded as amortization of deferred policy acquisition costs.

Reinsurance

Reinsurance assumed from business written through state reinsurance facilities has been reflected in unearned premiums, loss reserves, premiums earned and losses incurred based on reports received from such facilities. Ceded reinsurance premiums, losses and ceding commissions are netted against earned premiums, losses and commission expense, respectively.

Reserve for losses and loss adjustment expenses

Liabilities for unpaid losses and loss adjustment expenses ("LAE") are estimates of future payments to be made to settle all insurance claims for reported losses and estimates of incurred but not reported losses based upon past experience modified for current trends. With the exception of workers' compensation losses, loss reserves are not discounted. Estimated amounts of salvage and subrogation on paid and unpaid losses are deducted from the liability for unpaid claims. The estimated liabilities may be more or less than the amount ultimately paid when the claims are settled. Management and the Company's independent consulting actuary regularly review the estimates of reserves needed and any changes are reflected in current operating results.

The Company discounts its liability for workers' compensation case reserves on a tabular basis, using the National Council on Compensation Insurance Workers' Compensation Statistical Plan Table III A at a rate of 3.5%. The amount of discount at December 31, 2001 and 2002 is $6,714,000 and $5,746,000, respectively. Reserves for losses incurred but not reported and for LAE are not discounted.

Structured settlements have been negotiated for claims on certain insurance policies. Structured settlements are agreements to provide periodic payments to claimants, and are funded by annuities purchased from various life insurance companies. The Company remains primarily liable for payment of these claims. Accordingly, a liability and a corresponding deposit in the amount of $7,475,000 and $8,456,000 at December 31, 2001 and 2002, respectively, are recorded in the Company's consolidated balance sheet.

Income taxes

The Company and its wholly-owned subsidiaries file a consolidated federal income tax return. The Company follows the asset and liability approach to account for income taxes, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities.

Other financial instruments

The fair values of the Company's other financial instruments, principally premiums receivable and certain non-insurance related liabilities, do not vary significantly from the amounts assigned in these financial statements.

2. Related Party Transactions

The Company and MNH have one paid employee. Under a management agreement Merchants Mutual Insurance Company ("Mutual"), which owns 12.1% of the Company's outstanding common stock at December 31, 2002, provides the Company and MNH with the facilities, management and personnel required to manage their day-to-day business. All underwriting, administrative, claims and investment expenses incurred on behalf of Mutual and MNH are shared on an allocated cost basis, determined as follows: for underwriting and administrative expenses, the respective share of total direct premiums written for Mutual and MNH serves as the basis of allocation; for claims expenses, the average number of outstanding claims is used; investment expenses are shared based on each company's share of total invested assets. MNH also pays an annual management fee of $50,000 to Mutual. On July 23, 1998, the Company gave notice to Mutual of its intent to terminate the management agreement under its terms, which termination is effective July 23, 2003. The Boards of Directors of Mutual and the Company have agreed in principle for Mutual to continue to provide administrative and management services to the Company and to manage the traditional property and casualty insurance business of MNH on substantially the same terms as currently exist. The proposed management agreement is subject to the approvals of the New Hampshire and New York Insurance Departments, which presently are being sought. Pending the receipt of regulatory approval of the proposed agreement, the Boards of Directors of Mutual, the Company and MNH have agreed to extend the effective date of termination of the existing management agreement until the earlier of the date the new management agreement is approved by the insurance regulators or January 1, 2004.

MNH's agents are also licensed to sell Mutual's products. The agents are informed of the underwriting criteria of each company as well as the classes of business that are acceptable to each company. Underwriters review each application submitted by an agent to determine which company's underwriting criteria the risk meets and then issue a policy in the appropriate company. The payable to or receivable from affiliate (Mutual) is non-interest bearing and represents the net of premiums collected and loss and operating expense payments made by Mutual on behalf of MNH. This balance is settled in cash on a monthly basis.

3. Investments

Investments in fixed maturities and preferred stock

The amortized cost and estimated fair value of investments in fixed maturities held to maturity and available for sale and the cost and estimated fair value of preferred stock are as follows:

	Amortized Cost/Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
December 31, 2001				
Fixed maturities:				
Held to maturity				
Mortgage and asset backed securities	$ 13,042	$ 993	$ --	$ 14,035
Available for sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 41,422	$ 666	$ 123	$ 41,965
Obligations of states and political subdivisions	8,805	202	8	8,999
Corporate securities	71,035	1,535	120	72,450
Mortgage and asset backed securities	57,553	1,231	28	58,756
Total	$178,815	$ 3,634	$ 279	$182,170
Preferred stock	$ 9,389	$ 105	$ 72	$ 9,422

	Amortized Cost/Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
December 31, 2002				
Fixed maturities:				
Held to Maturity				

Mortgage and asset backed securities	$ 4,092	$ 167	$ --	$ 4,259
	========	========	========	========
Available for sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 12,425	$ 430	$ --	$ 12,855
Obligations of states and political subdivisions	28,320	365	--	28,685
Corporate securities	55,067	1,450	394	56,123
Mortgage and asset backed securities	90,490	1,513	190	91,813
	--------	--------	--------	--------
Total	$186,302	$ 3,758	$ 584	$189,476
	========	========	========	========
Preferred stock	$ 7,364	$ 138	$ 135	$ 7,367
	========	========	========	========

The amortized cost and fair value of fixed maturities by expected maturity at December 31, 2002 are shown below. Mortgage and asset backed securities are distributed in the table based upon management's estimate of repayment periods. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Held to maturity		
Due in one year or less	$3,416	$3,556
Due after one year through five years	676	703
Due after five years through ten years	--	--
Due after ten years	--	--
	------	------
Total	$4,092	$4,259
	======	======
Available for sale		
Due in one year or less	$ 77,108	$ 78,320
Due after one year through five years	103,706	106,020
Due after five years through ten years	3,579	3,198
Due after ten years	1,909	1,938
	---------	--------
Total	$186,302	$189,476
	========	========

Discount and premium pertaining to collateralized mortgage obligations are amortized over the securities' estimated redemption periods using the effective interest method. Yields used to calculate premium or discount are adjusted for prepayments quarterly.

Fixed maturities with a par value of $1,900,000 were on deposit at December 31, 2002 with various state insurance departments in compliance with applicable insurance laws.

Proceeds from sales of available for sale fixed maturity securities and preferred stock and gross realized gains and losses related to such sales are as follows:

	Year ended December 31,		
	2000	2001	2002
	(in thousands)		
Proceeds from sales	$5,555	$10,938	$54,189
Gross realized gains	109	218	1,442
Gross realized losses	--	17	489

Net investment income

Net investment income consists of:

	Year ended December 31,		
	2000	2001	2002
	(in thousands)		
Fixed maturities	$12,718	$12,366	$9,917
Short-term investments	404	277	181
Other	1,168	954	639
Total investment income	14,290	13,597	10,737
Investment expenses	387	302	334
Net investment income	$13,903	$13,295	$10,403

4. Reinsurance

MNH follows the customary practice of reinsuring a portion of the exposure under its policies. Insurance is ceded principally to reduce net liability on individual risks and to protect against catastrophic losses. Although reinsurance does not legally discharge an insurer from its primary liability for the full amount of coverage provided by its policies, it does make the assuming reinsurer liable to the insurer to the extent of the reinsurance ceded.

The effect of reinsurance on premiums written and earned for the years ended December 31, 2000, 2001 and 2002 is as follows:

	2000		2001		
	Premiums Written	Premiums Earned	Premiums Written	Premiums Earned	Prem Writ
			(in thousands)		
Direct	$107,234	$105,919	$100,953	$101,871	$ 72
Assumed	640	714	1,412	1,173	2
Ceded	(13,532)	(12,374)	(8,392)	(9,159)	(4
Net Premiums	$ 94,342	$94,259	$ 93,973	$ 93,885	$ 70

Reinsurance ceded transactions decreased net losses and LAE by $9,506,000, $9,987,000 and $3,656,000 for the years ended December 31, 2000, 2001 and 2002 respectively.

As a result of the reinsurance agreements maintained by MNH, MNH is exposed to certain credit risk if one or more of its primary reinsurers were to become financially unstable. As of December 31, 2002, MNH has recognized amounts to be recovered from its primary reinsurers related to ceded losses and ceded unearned premiums totaling $19,374,000. MNH generally does not require collateral for reinsurance recoverable.

5. Reserve for Losses and Loss Adjustment Expenses

Activity in the reserve for losses and LAE is summarized as follows:

	2001	2002
	(in thousands)	
Reserve for losses and LAE at beginning of year	$145,075	$151,355
Less reinsurance recoverables	13,826	19,242
Net balance at beginning of year	131,249	132,113
Provision for losses and LAE for claims occurring in:		
Current year	76,618	66,658
Prior years	(1,474)	(3,785)
	75,144	62,873

Loss and LAE payments for claims occurring in:		
Current year	28,719	26,387
Prior years	45,561	40,843
	74,280	67,230
Reserve for losses and LAE at end of year, net	132,113	127,756
Plus reinsurance recoverables	19,242	19,380
Balance at end of year	$151,355	$147,136

In 2001, the Company decreased its reserves for prior years by $1,474,000 primarily due to favorable loss development related to its automobile and workers' compensation policies. In 2002, the Company decreased its reserves for prior years by $3,785,000 primarily due to favorable loss development related to its workers' compensation policies and commercial automobile liability policies, somewhat offset by unfavorable development on its private passenger automobile liability policies.

6. Demand Loan

The Company has arranged for a $2,000,000 unsecured credit facility from a bank. Any borrowings under this facility are payable on demand and carry an interest rate which can be fixed or variable and is negotiated at the time of each advance. This facility is available for general working capital purposes and for repurchases of the Company's common stock.

7. Income Taxes

The provision (benefit) for income taxes consists of:

	Year ended December 31,		
	2000	2001	2002
	(in thousands)		
Current	$ 2,999	$ 605	$ 1,248
Deferred	(331)	(171)	481
Total income tax provision	$ 2,668	$ 434	$ 1,729

A reconciliation of the difference between the Company's total income tax provision and that calculated using statutory income tax rates is as follows:

Year ended December 31,

	2000	2001	2002
		(in thousands)	
Computed provision at statutory rate	$ 2,382	$ 427	$ 1,451
Adjustments:			
State income taxes, net of federal effect	640	274	447
Tax-exempt investment income	(214)	(115)	(85)
Dividend exclusion	(208)	(165)	(94)
Other items	68	13	10
Total income tax provision	$ 2,668	$ 434	$ 1,729

Deferred tax (liabilities) assets are comprised of the following:

	December 31, 2001	December 31, 2002
	(in thousands)	
Deferred policy acquisition costs	$(4,706)	$(3,525)
Unrealized investment gains	(811)	(1,248)
Bond discounts	(607)	(739)
Salvage and subrogation	(234)	(233)
Other	--	(26)
Total deferred tax liabilities	(6,358)	(5,771)
Discounting of reserve for losses and loss adjustment expenses	7,456	6,736
Unearned premiums	3,200	2,344
State income taxes	221	260
Other	271	626
Total deferred tax assets	11,148	9,966
Net deferred income taxes	$ 4,790	$ 4,195

Although realization is not assured, based upon the evidence available the Company believes that it is more likely than not that the net deferred income tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are not achieved.

8. Stockholders' Equity

Dividends

The Company depends on dividends from its subsidiary, MNH, to pay cash dividends to its stockholders and to meet its expenses. MNH is subject to New Hampshire state insurance laws which restrict its ability to pay dividends without the prior approval of state regulatory authorities. These restrictions limit dividends to those that, when added to all other dividends paid within the preceding twelve months, would not exceed 10% of an insurer's policyholders' surplus as of the preceding December 31. The maximum amount of dividends that MNH could pay during any twelve-month period ending in 2003, without the prior approval of the New Hampshire Insurance Commissioner, is $5,492,000.

Stock option plan

The Company's stock option plan (the "Plan"), which reserved 200,000 shares of common stock for issuance to the Company's and MNH's officers and key employees of the Company's affiliate, Mutual, expired in 1996. Under the Plan, qualified and non-qualified stock options were granted at amounts not less than the fair market value of the Company's stock on the date of grant. Options granted under the Plan have a 10 year life and vested in cumulative annual increments of 25% commencing one year from the date of grant.

In accounting for the Plan, the Company remains under the expense recognition provisions of Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" but follows the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 "Accounting for Stock Based Compensation". No options were granted in 2000, 2001 or 2002 and, therefore, no compensation expense was recognized in those years.

A summary of the status of the Company's outstanding options as of December 31, 2000, 2001 and 2002, and changes during the years ending on those dates is presented below:

	2000		2001		200
	Options Outstanding	Weighted Average Exercise Price	Options Outstanding	Weighted Average Exercise Price	Options Outstanding
Beginning of year	47,000	$19.87	45,500	$19.84	35,500
Granted	--	--	--	--	--
Exercised	--	--	(8,000)	14.38	--
Forfeited	(1,500)	21.00	(2,000)	21.00	--
End of year	45,500	19.84	35,500	21.00	35,500
Options exercisable at year-end	45,500	19.84	35,500	21.00	35,500

The following table summarizes information about the Company's outstanding stock options at December 31, 2002:

Number Outstanding at 12/31/02	Remaining Contractual Life in Years	Average Exercise Price	Number Exercisable at 12/31/02
35,500	3.1	$21.00	35,500

Common stock repurchases

During 2000, 2001 and 2002, the Company repurchased 165,100, 214,300 and 114,300 shares of its common stock, respectively. The Company was holding 1,025,400 and 1,139,700 of these shares in treasury as of December 31, 2001 and 2002, respectively.

Preferred stock

The Company's Preferred stock, no par value, $424.30 stated value, consists of 10,000 shares authorized; no shares were issued or outstanding at December 31, 2001 or December 31, 2002. The Company also has 3,000,000 shares of $.01 par value preferred stock which is authorized and unissued.

9. Earnings Per Share

The computations for basic and diluted earnings per share are as follows:

	Year Ended December 31		
	2000	2001	2002
	(in thousands except per share amounts)		
Basic:			
Net income	$4,339	$ 821	$2,538
Weighted average shares outstanding	2,485	2,343	2,125
Basic earnings per share		$ 1.75	$ .35
			$ 1.19
Diluted:			
Net income	$4,339	$ 821	$2,538
Weighted average shares outstanding	2,485	2,343	2,125
Plus incremental shares from assumed conversion of stock options	2	--	4
Weighted average shares outstanding-adjusted	2,487	2,343	2,129

Diluted earnings per share	$ 1.74	$ .35	$ 1.19
	======	======	======

10. Benefit Programs

Mutual maintains a capital accumulation plan which is a profit sharing plan under Section 401(a) of the Internal Revenue Code that covers all employees who have completed six months of service. Mutual matches at least 15% and up to 100% of employee contributions, based on the combined net operating profits of Mutual and MNH. Additional contributions may be made at the discretion of the Board of Directors of Mutual. Under the terms of the management agreement, the Company's portion of the total contribution was $606,000, $486,000 and $370,000 for the years ended December 31, 2000, 2001 and 2002, respectively.

11. Commitments and Contingencies

MNH, like many other property and casualty insurance companies, is subject to environmental damage claims asserted by or against its insureds. Management is of the opinion that based on various court decisions throughout the country, such claims should not be recoverable under the terms of MNH's insurance policies because of either specific or general coverage exclusions contained in the policies. However, there is no assurance that the courts will agree with MNH's position in every case, nor can there be assurance that material claims will not be asserted under policies which a court will find do not explicitly or implicitly exclude claims for environmental damages. Management, however, is not aware of any pending claim or group of claims which would result in a liability that would have a material adverse effect on the financial condition of MNH.

In addition to the foregoing, MNH is a defendant in a number of other legal proceedings in the ordinary course of its business. Management of the Company is of the opinion that the ultimate aggregate liability, if any, resulting from such proceedings will not materially affect the financial condition of MNH or the Company.