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PERSPECTIVES - 2005

FORECAST *Change* PARKER, SMITH & FEEK

PRESIDENT'S MESSAGE

Welcome to our 2005 edition of Parker, Smith & Feek's "Perspectives." I appreciate this chance to bring you up to date on happenings in our industry and our company. For all of us at Parker, Smith & Feek and for the thousands of agents and brokers and insurers that constitute our industry, the past year was a remarkable one shaped by change, transition, and controversy.

In 2004 the insurance industry was rocked by scandal. New York State Attorney General Eliot Spitzer alleged that a major insurance broker and several carriers were defrauding policyholders. This triggered a series of investigations of insurance marketing practices and the use of "contingent income" to reward insurance brokers for placement of accounts with selected carriers. The incident served to reinforce why our own account teams have rigorously followed our "best coverage, best company" rule in marketing and recommending coverage for our clients. Our mission is to help our clients meet their risk management needs. The outgrowth of this controversy will likely be more rigorous standards for disclosure of all sources of income, and appropriate justification that insurance recommendations were made with the best interest of policyholders in mind. This is in complete alignment with our commitment to act as client advisors, not policy salespeople, and has been a cornerstone of our firm's culture since 1937. (If you have any concerns about our practices or these events, please call me personally.)

Good news for all of us in 2004 was the improving economy. This welcome change coincided with continued moderation in pricing in property and casualty insurance. It was refreshing to see some return to normalcy in the insurance marketplace after four years of rising prices.

2004 was also an excellent year for our firm. We experienced significant growth in nearly all of our practice areas. We added many new clients and hired new employees to strengthen our service teams.

A critical aspect of our culture is our commitment to quality of operations and best practices, delivering service that is timely, accurate and meets the needs of a demanding clientele with complex business issues. We received two important awards which underscore the commitment and dedication of our staff to quality and client service. I am delighted to announce that we received the PAR Excellence Award for our diligence in operations and client support; and the AMS Automation Agency of the Year Award, for our use of technology. Both awards are discussed more fully later in this report.

2004 marked my first full year as President and Vic Parker's final year as Chairman and CEO. As an integral part of our longstanding corporate succession plan, Vic completed his management transition and formally retired in January of this year. Vic still maintains an office in the firm and remains a valued advisor and counselor. I will now have the title of President and CEO, and the Directors of Parker, Smith & Feek have elected Chuck Szopa as Chairman of the Board. In his 19th year at Parker, Smith & Feek, Chuck will also continue as the head of our Anchorage office.

In preparing for our Annual Employees Meeting, several clients recorded videotaped messages to be viewed in honor of Vic's retirement. Beyond wishing Vic well and acknowledging a brilliant 33 year career with Parker, Smith & Feek, each spoke about how important their relationship with Vic and with the firm was to their business. Our relationship with each of our clients, our vendors and our friends is something we greatly value and we look forward to continuing to build these relationships in the future.

Thank you for your trust and confidence in the past year. Best of success in 2005!

President & CEO
Parker, Smith & Feek

Our industry has experienced an unprecedented scandal that continues to create turmoil now months after the instigating event was discovered. The original incident that triggered the upheaval was an investigation conducted by New York's Attorney General, Eliot Spitzer. The investigation revealed that Marsh, Inc., a large publicly traded global insurance broker had received indirect compensation from insurance companies related to placement of their clients' business, and specifically "steering" this business to the insurer who paid higher commission. Brokerage representatives created a "bid rigging" scheme by arranging false quotes from other insurers which made the targeted insurer appear to be the best deal, and would provide the broker with the highest bonus commission. The activities of bid rigging and steering are illegal, and in the ensuing settlement Marsh agreed to return millions of dollars to policy holders as restitution. Other publicly held brokers have agreed to similar settlements.

Arising out of this investigation, insurance commissioners and regulators shined a bright light on insurance broker compensation in general and focused particular scrutiny on a long-standing insurance industry practice known as "contingent commission." Unfortunately the press and insurance commissioners have used the term "contingent commission" as the umbrella term for all of the issues being discussed. In fact, contingent commission is very different than the illegal and unethical practices for which Marsh and others have been cited. Contingency commissions are governed by annual agreements (not client-specific) based primarily on the overall profitability of the business brought by the broker to the insurer. We, as is true of nearly all insurance brokers large or small, have accepted contracts with major insurers that include contingent commissions. These agreements are drafted and regulated by the insurance companies.

At Parker, Smith & Feek there has never been any question – before or after the industry scandal – as to where our loyalties lie, and that is with our clients. We have never entered into any practice even closely resembling "steering" or "bid rigging," and we exercise strict management of our contingency agreements to be certain they never create confusion about our priorities.

We remain private and independent. Our employees are compensated through salary, not commissions, and could never profit individually by engaging in any of these practices. Every element of our business practice has been designed to maximize our ability to serve our clients.

Commercial Insurance

After many years of steady increases in pricing in most lines of commercial (property and casualty) insurance, renewal rates began to soften in 2004. Property and D&O rates lead the trend in late 2003, with much of the casualty and auto marketplace following by mid 2004. In most cases the reductions weren't dramatic, but it was not unusual to see rate reductions of 5% to 10% for standard business. These reductions also coincided with liberalization of

coverage terms and many insurers relaxing some of the coverage restrictions imposed since 2000. By no means was this universal – insurers were still carefully underwriting individual risks – but clearly the marketplace had concluded that rates were sufficient to return much of the industry to profitability. Not all classes of business enjoyed rate decreases. The construction industry, especially the residential sector, remains problematic. Construction defect and mold claims continue to produce significant losses and create insurance challenges.

2004 marked the first year since 1978 that the property/casualty industry recorded an underwriting profit. Coupled with an increase in overall capacity created by the formation of a number of new insurance companies and a desire by most insurers to expand market share, more competition for profitable clients has been created.

This has occurred despite the worst hurricane season the industry has ever experienced, as hurricanes Charley, Frances, Ivan and Jeanne pounded Florida in the third quarter. Those insured losses are estimated at over $21 billion dollars.

Among the significant events to watch in 2005 will be the fate of TRIA (Terrorism Risk Insurance Act). TRIA was created in 2002 following the September 11, 2001 attack on the World Trade Center, and provides a federally funded reinsurance backstop for carriers who sustain significant losses caused by a foreign terrorist attack. The law as enacted by Congress is scheduled to expire at the end of 2005. If not renewed, carriers will be faced with insuring the risk of terrorism with no reinsurance support (the reinsurance industry currently excludes terrorism) or perhaps not offering terrorism coverage to their policyholders.

The trends in early 2005 point toward continuing market softening. We expect most lines of coverage to see another 5% to 10% decline. Again, this is specific to class of business and overall account specifics, but the general trend is very encouraging for many of our policyholders.

Employee Benefits

The 2004 world of employee benefits saw the continued march of health care costs. For the fifth year in a row, the cost of employee health care benefits topped the list of challenges for corporate America. Average costs rose another 13.5% in 2004, with prospects for only a slight reduction to 12.5% in 2005. Employers have attacked the escalation in costs with a number of strategies including:

- Shifting more of the cost burden on employees through higher payroll contributions, higher deductibles and copays for patients.
- Consumer Driven Health Care Plans designed to get the patient more involved in the direct cost of care through a combination of higher deductibles and a side fund that employers set up to assist the employee with their financial exposures. The new Health Savings Account created by Congress at the end of 2003 is an example.
- Disease Management Programs to provide more sophisticated tools to assist patients in pursuing the best course of action for serious acute and chronic health care issues. The systems vary in approach and success, but all employers of any size will be adding these programs in the coming years.

The challenge for employers in 2005 and 2006 will be attracting and retaining employees with the benefits packages that were often curtailed in the economic downturn of 1999 through 2003. As the economy heats up, the competition for employees will follow, and benefits will once again rise to a higher level of importance. Those employers that needed to drop their match for employee contributions for a 401(k) will add them back in 2005. Dental was dropped in favor of voluntary programs. These too will move back to a mainstream offering in 2005 or 2006.

Parker, Smith & Feek added several new clients in 2004, and created a specialized partnership with Digital Insurance to better serve our clients with fewer than 10 employees. We added new software to assist our staff in creating timely and informative communications material for use by our clients. The new software also allows us to better manage the marketing of our plans for renewal discussions when appropriate. Our objective is to excel in our responsiveness to our employer/clients and their employees throughout the year and into the future.

Surety

In 2004 the surety industry as a whole lost money again for the fourth consecutive year. The good news is that the loss activity was down, but the loss projections were up

due to a reevaluation and adjustment of existing loss reserves. The big news for the year was the merger of St. Paul/Travelers, the two largest writers of surety bonds. Their combined operations represent nearly 30% market share.

Capacity for the very large projects needing bonds continues to be limited to approximately $500,000,000 for a single bond. Therefore project owners may have to segment their projects into smaller pieces, or accept a partial bond.

While there have been rate adjustments by some underwriters, the changes have not been significant. In certain cases, underwriting requirements are starting to soften somewhat. Personal guarantees may be negotiable for the most sought after accounts, but underwriters are adhering strictly to the basic indices for liquidity, profitability, and debt assumption.

Personal Insurance

Last year began an evolution of new coverages designed to provide insurance protection in an increasing volatile world. In general, these coverages are directed toward high net worth individuals and address security concerns prevalent in affluent lifestyles, and are international in scope. For example, Kidnap and Ransom insurance is increasing in availability and provides for crisis management and negotiating counsel, plus ransom monies, legal costs and settlements. Similar policies have extended coverage for car jacking, child abduction, and home invasion incidents.

Identity fraud or theft is another personal security concern now covered by insurance. Policies cover the costs of an anti-fraud specialist to arrange notification of relevant agencies and law enforcement. These specialists also help to restore credit record accuracy, financial accounts, and government records.

Travel safety is receiving heightened attention from insurers with resulting enhancements in coverage. Travel security advisories and guidance are now available online, and comprehensive information on political stability and terrorism is also available. Medical and health emergencies are covered worldwide including the costs of transporting family members to US hospitals and medical centers.

Closer to home, we are now able to offer homeowners insurance protection for wrongful employment acts and employment-related lawsuits. This insurance covers the costs of defending allegations for wrongful termination, sexual harassment, or discrimination from residential staff such as gardeners, housekeepers, or nannies.

Directors & Officers Liability policies are now available for individuals who serve as outside directors on boards.

Our personal insurance department also saw improvements in insurance protection for high value homes, cars, and collections. We anticipate this trend and the movement to personal security coverages to continue in 2005.

The past year's new growth was distributed across all practice areas. We continued to develop individual expertise among our team members in their selected areas and made key additions to our staff to broaden and deepen our experience in target areas.

The Construction practice welcomed many new clients in both the Puget Sound region and in Alaska. As our largest industry practice area, construction continues to be one of the most challenging. Our experience in managing claims and providing risk management guidance keep us leaders in insuring and bonding contractors. We saw our growth in this area spearheaded by our younger principals.

One clear trend which contributed to growth in both construction and our Real Estate practice as well, is the resurgence of the Owner Controlled Insurance Program (OCIP) and Contractor Controlled Insurance Program (CCIP.) These project-specific insurance programs have been instrumental in the development of large mixed-use residential projects. A premier example we are working with is the $150mm Lincoln Square project currently under construction in Bellevue, Washington. Our experience in designing and administering these programs have made us a leader in our trade area and we have similar new projects preparing to break ground in the greater Seattle area.

Our Real Estate practice has grown hand-in-hand with our construction group. We offer our real estate clients a seamless insurance program that adjusts from the risk exposures during the construction phase to the public opening for occupancy. We arranged insurance programs for private developers, public entities, and other property owners during the past year and anticipate additional work in this area as our regional economy improves.

Our Healthcare practice enjoyed significant growth and welcomed two major healthcare providers as clients, the University of Washington Hospitals and Highline Community Hospital. We added to our Healthcare practice team with new executives in Bellevue, Anchorage, and Oregon. The insurance markets in healthcare have stabilized, at this writing, making it possible to focus on longer term deductible strategies and retention levels, and we are able to assist our clients in strengthening their clinical risk management programs at the same time.

Our Financial Services practice grew with the addition of three regionally headquartered insurance companies, Symetra Financial Corporation (formerly Safeco Life and Investments), Mutual of Enumclaw Insurance, and PEMCO Financial.

Technology and Life Sciences experienced growth, mainly in newly formed companies. The insurance marketplace has developed a comfort level and experience base with technology and life science companies that has resulted in lower premiums and reduced volatility in rate structures. The reduction in investor- driven class action suits has also reduced the pressure on insurance underwriters to restrict coverage and availability of insurance protection for directors and officers of companies in these industries.

Our Retail and Hospitality groups noted a cautious expansion among businesses they serve, with the potential of accelerated growth in the near future. Our remaining practice areas had modest gains during the past year, many of these being traditional industry areas like Forest Products, Food Processing, and Manufacturing which mirror the economic health of our region.

Parker, Smith & Feek at a Glance

Founded -	1937, Seattle, Washington
Ownership -	Privately held S-Corporation.
Offices -	Bellevue, Washington and Anchorage, Alaska
Annual Sales -	$250 million in policy premiums. Ranked in Top 100 US Insurance Brokers.*
Insurance Companies -	Over 300 national and international insurers represented
Employees -	165 salaried staff. No commission salespeople.

Parker, Smith & Feek is an ownership partner in Assurex Global, an international corporation of 130 independently owned insurance brokers with more than 20,000 insurance professionals generating over $19 billion in annual policy premiums.

**Business Insurance, July, 2004*

As insurance brokers we know, when policy language has been reviewed, certificates of insurance prepared, or bid bonds delivered, whatever the task - the defining role of what we do is in the details. It may be a stretch to say that beauty is in the details, because unfortunately, the devil can be there, too. We walk a fine line between a flawless performance and mediocrity. It is why our quality control procedures combined with our automation tools are so important to the success of our firm.

This past year we earned national industry awards for both our quality control program and our use of technology. Particularly satisfying is that both awards value the effort of all of our employees - not single individuals. In each area we enjoy outstanding leadership and training combined with the conscientious performance of our staff, and this creates a powerful customer service engine that runs full throttle every day.

The PAR Excellence Award

Quality control is paramount to us and we have dedicated the resources necessary to create a highly effective quality control program. Our program indoctrinates every staff member in the appropriate protocols to avoid mistakes and has the built-in checks and balances that identify errors or oversights and corrects them before they impact a client.

The underwriter of our E&O insurance is Professional Agencies Reinsurance, Ltd. who insures many of the largest brokers and agents in the United States. Each year, PAR conducts a rigorous scrutiny of all of their brokers' quality control programs and honors the top firms with the PAR Excellence Award. Parker, Smith & Feek was delighted to be a 2004 recipient of the award. The architect of our quality control program, Jeane Maurer, Vice President Agency Operations, has encouraged all of us to celebrate this achievement and use it as a daily reminder that the real beneficiaries of our efforts are our clients.

AMS Automation Excellence Award

The insurance industry has at times been slow to embrace systems technology, with the irony being that insurance is an information intensive business: exchanging communications, financial data, underwriting profiles, and managing claims. While most brokers purchase automation systems, the utilization levels and subsequent benefits achieved vary widely. AMS Services, one of the largest suppliers of insurance agency management software in the nation, recognized this and initiated a program to identify and reward a single agency, from over 9,000, who exemplified the model for using their technology most effectively and who had demonstrated improved efficiency and enhanced customer service. Parker, Smith & Feek, already recognized as a leader in technology innovation, was nominated immediately. A panel of system users evaluated the accomplishment of each broker, and bestowed the first-ever award of its kind on Parker, Smith & Feek.

The award was presented to our Chief Information Officer, Johnmichael Monteith, at the National Convention of AMS Services software users. Mr. Monteith has created a number of proprietary systems that improve client communications, and has earned industry acclaim for his DigitaLINK software suite that allows our clients secure 24/7 access to their insurance information.

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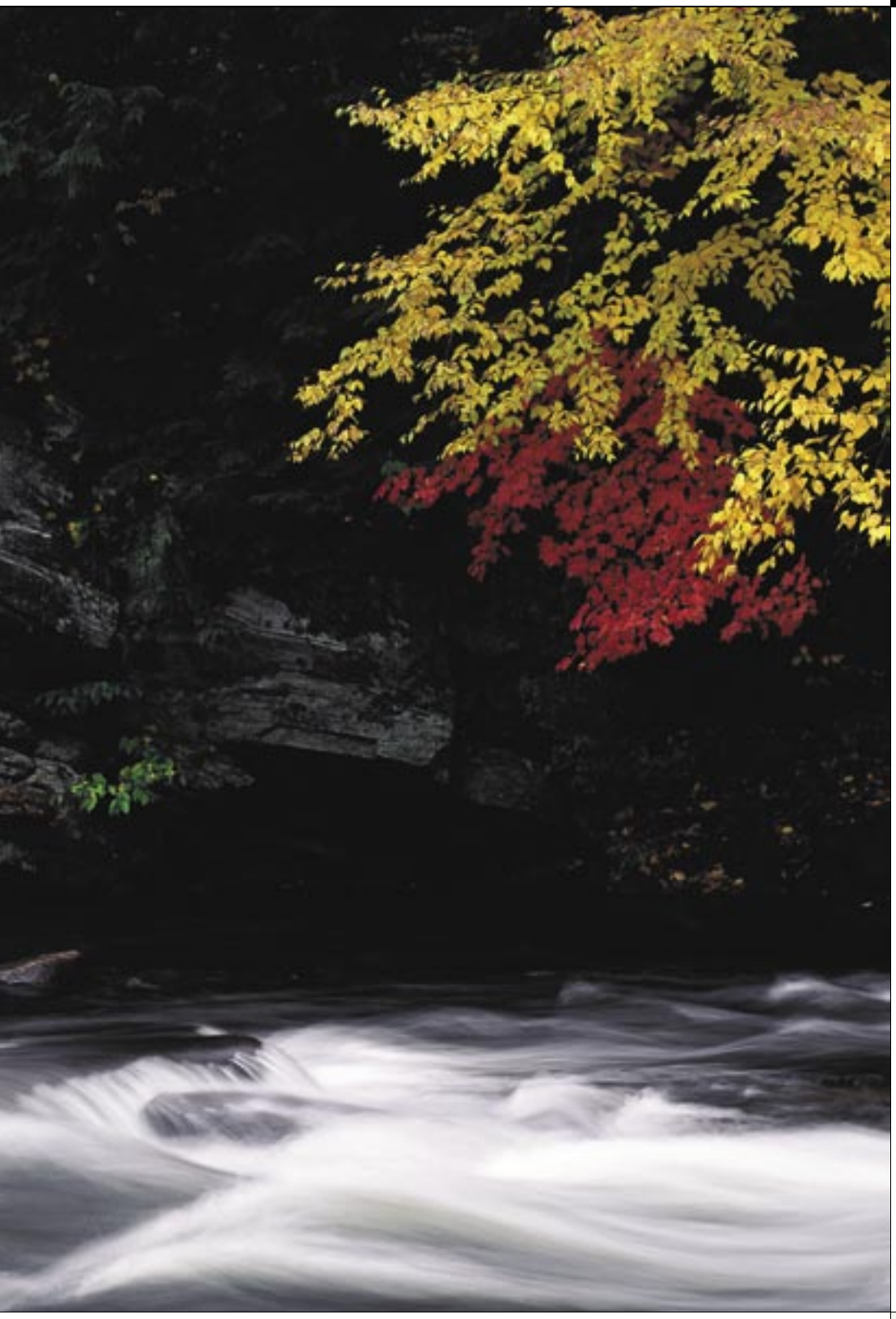

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