

## Commentary on the State of the Insurance Industry

By Michael J. Bemis, President & CEO, TNCRRG

Some of our readers may have already completed their insurance program renewals earlier this year. Some of you will still be embroiled (probably a fair term to employ this year) in the process as you read our summer newsletter. In either case, it is likely that your renewal experience was, or will be, something short of what you really would like to have for your diocese or religious institute.

Three scenarios would be very typical. First, it may be that you couldn't purchase as much limit of coverage as you would prefer—perhaps because it was unavailable, or alternatively, available but too expensive. Next, it may be that your coverage terms and conditions are not as broad as they used to be, and as you would like them to be, in order to really provide you with "sleep insurance." Finally, it is very likely that you paid more for whatever coverage/limit you could get, and it is quite possible that you paid far more than you hoped to (although probably a good deal less than the renewal increase you experienced in 2002).

Why is this happening, particularly after the moderate premium increases of the 2001 renewal season and the massive premium increases of the 2002 renewal season? Aren't the insurers and reinsurers returned to a financially "healthy" state? Or, is it that they are simply greedy and avaricious?

A fair answer would include the following considerations: 1) that the financial health of the industry has improved; 2) that some carriers are taking some advantage of market circumstances (arguably charging more than they need to); and 3) that for much of the industry, more uncertainty remains and much work needs to get done to assure the long-range financial viability and stability of the insurance marketplace.

Why is there such a high level of remaining industry uncertainty and instability? There are several legitimate explanations (note that these factors will not necessarily impact every insurer/reinsurer in an identical fashion or to an identical extent). These explanatory factors are:

- 1) While the industry has significantly increased pricing for a two-year period, the industry had in fact under priced its product for at least the preceding 10-year period (some would argue 12-year period).
- 2) The industry under pricing for 10 to 12 years was substantially offset by excellent investment returns in the same period; industry investment returns for the last three-year period have been poor, and were not nearly high enough to allow the two years of premium increases to really have the positive effect they would have had in the presence of accompanying solid investment returns.
- 3) Actual terrorism losses from the 9/11 tragedy have had a major negative impact on the reinsurance industry; meanwhile the terrorism threat remains as a very frightening, and possibly real, incalculable source of loss to insurers (even in light of the Terrorism Risk Insurance Act of 2002, which provides the industry a very limited federal "backstop" and which requires the insurance industry to eventually repay any amounts the federal government subsidizes after terrorism losses).
- 4) Post Enron, Tyco, WorldCom, Adelphia, etc., D&O (Directors' and Officers') losses have been enormous, and D&O litigation is increasing even though corporate governance issues have been getting very positively addressed by business, industry and nonprofit organizations.
- 5) Asbestos, environmental impairment, and toxic mold claims remain problematic for the industry, and have a long way to go before the industry can begin to "get beyond" these loss producing phenomena.

*The fact is that the insurance market is highly "elastic" (as an economist might say), providing relative ease of entry, a high degree of competitiveness, but also, an essentially uncertain "playing field" for participants, because of the very nature of losses.*

—Michael J. Bemis

- 6) The general pace of litigation continues to expand at an ever-increasing rate, including in the realm of class action suits. This has led to an industry circumstance that in some coverage lines, the average cost of litigation far exceeds the actual amount of the average loss.

### **What can the Church do to respond to industry upheaval?**

As a diocesan or religious institute fiscal officer or director of insurance and risk management, what can you do to protect the Church amidst all this insurance industry upheaval? Four excellent strategies can be employed to protect the Church during insurance marketplace instability (or any other nature of market for that matter). They are: 1) risk control; 2) claims management; 3) increased retention; and 4) use of alternative insuring mechanisms. A few words about each would be helpful.

**Risk control** entails loss prevention (preventing losses before they can occur) and loss control (reducing/mitigating the severity of losses you simply could not prevent). Good risk control will: 1) keep your insurance premiums lower no matter what the state of the market; 2) help your diocese or religious institute avoid all the indirect costs associated with losses (e.g., workplace disruption; loss of employee productivity; time spent with adjusters, contractors, architects, etc., after a property loss; time spent at depositions, answering interrogatories, meeting with attorneys, etc., after a liability loss; interruption of ministries no matter what type of loss); 3) preserve/maintain your organization's ability to earn a dividend based on your loss experience (if your insurer pays dividends); and 4) help your organization to perform its ministries in a fashion that protects the people you serve, protects the property the Lord has entrusted you with, and prevents the disruption of your ministerial work itself.

**Claims management** is the process of resolving your organization's claims in an expeditious, effective, just and moral manner—in other words, as good stewards of the gifts of the Lord. Employing good claims management techniques (like litigation planning and management, alternative dispute resolution, structured settlements, thorough claim/loss investigation, etc.) significantly reduces the ultimate cost of claims, while simultaneously effecting claim resolutions that provide justice for all parties involved. All this results in fewer dollars spent to settle claims, simultaneously producing better loss ratios and lower insurance premiums.

**Increased retentions** will invariably lower your insurance premiums. This strategy makes sense when: 1) you practice quality risk control; 2) you have a sizable body of loss data from which you can project your organization's most frequent nature and size of loss; and 3) you have "free" or available cash flow that you can utilize to establish a loss fund from which you can pay your smaller, more frequent and more predictable claims. The theory is that it makes no sense to "trade dollars" with an insurer, paying the insurer premium dollars for losses that you can reasonably expect will not exceed the premium that you pay. Better to fund those losses internally, allowing you to control your organization's cash flow and invest it to your diocese's/religious institute's benefit (as opposed to the insurer benefiting from investing your organization's premium). A word of caution: do not attempt to retain catastrophic losses or you risk bankrupting your ministries in the event of a very major claim/loss.

**Alternative insuring mechanisms** are entities like captive insurance companies, self-insurance pools, risk retention groups, etc. which allow your organization to participate in an insurance program that is at least partly (perhaps entirely) owned and controlled by your diocese or religious institute. These mechanisms generally offer their owners more stable premiums, better coverage, ability to control underwriting profits, ability to control investment earnings, improved risk control efforts and improved claims management. The good news is that the Catholic Church already owns and operates several of these mechanisms (The National Catholic Risk Retention Group, Inc., is one), so there is an established and successful Catholic market for you to investigate if your diocese or religious institute does not currently participate in an alternative insuring mechanism.

There is one additional strategy that is not as consistently useful or readily adaptable as the four already mentioned; namely, you can always market or "shop" your diocese's or religious institute's insurance program. This is a viable and recommended practice to employ occasionally (perhaps every five years), because you can get "a feel" for the improved products/services/pricing the marketplace has to offer, and also, you can get direct evidence of how seriously your incumbent carrier wants to maintain your business. This strategy is not as adaptable or useful because it sometimes produces meager results. This is usually the case in an extremely unstable market, when carriers are "hurting" and are not so eager to compete for your business via special coverage/limit and/or pricing considerations. In any event, if you choose to market your program, guard against the temptation to opt for the cheapest price (premium), unless you are positive that the new program compares very favorably to your incumbent program on an "apples-to-apples" basis. Otherwise, you may do your diocese or religious organization a major disservice. For example, if you opt for a \$100,000 premium savings and then experience an uncovered claim of \$200,000, in an area of coverage that was included in your old program, you haven't actually saved a penny—in fact, you have cost your organization \$100,000.

Finally, keep in mind that it is folly to expect the insurance market to achieve a permanent fix, offering continual stability and providing easy predictability for insureds. The fact is that the insurance market is highly "elastic" (as an economist might say), providing relative ease of entry, a high degree of competitiveness, but also, an essentially uncertain "playing field" for participants, because of the very nature of losses. All of these factors lead ultimately to occasional market instability and related market "rebalancing." Therefore, your diocese/religious institute will be best served and protected if you learn and consistently employ the strategies discussed herein.

# President's Message



Throughout the year, 2002 presented National Catholic some daunting and adverse challenges. Nonetheless, at year's end, National Catholic could display a broad array of very positive accomplishments and developments. Let's first examine the challenges that confronted National Catholic.

Chief among these was the sexual misconduct scandal and crisis within the Church. This crisis actually produced negative "fallout" for National Catholic in several areas:

- 1) A dramatically increased frequency and magnitude of incident reports and actual claim reports;
- 2) Greatly increased underwriting scrutiny, and some significant underwriting restrictions, placed upon us by our reinsurer;
- 3) A deluge of press/media requests for interviews, information and explanations (note that all claim particulars/data was absolutely kept confidential); and
- 4) Tremendous pressure from dioceses to disseminate and implement our VIRTUS<sup>®</sup> PROTECTING GOD'S CHILDREN<sup>™</sup> program (which was inaugurated very early in February 2002) at a far greater than originally contemplated "delivery rate."

Simultaneously, the insurance marketplace and reinsurance marketplace were deteriorating rapidly and precipitously, with very large premium increases, accompanied concurrently by reductions in available coverage limits and restrictions of important coverage terms and conditions. The crisis in the Church actually exacerbated what was already a highly stressed insurance and reinsurance marketplace. Both our existent insureds, and also, other Catholic entities not currently insured by National Catholic, were coming to us seeking relief from "the storm."

Finally, as with the rest of America, whether commercial, industrial or household, our investments fell far short of their performance in 2001.

Just how did National Catholic respond to all of these challenges, and how ultimately did your company fare? National Catholic provided the rate and premium stability that is part of our mission on behalf of the Church. While the marketplace was typically demanding 20% to 100% rate increases (dependent upon the type of coverage and the insured's specific loss results), National Catholic responded with a 7.8% "across-the-board" rate increase. While the commercial carriers were reducing their available limits of coverage and significantly restricting coverage terms and conditions, National Catholic accelerated issuance of its increased policy limits option, while simultaneously expanding coverage terms and conditions. This "insured-centered" and directed performance benefited National Catholic with the addition of three new shareholders in 2002. We welcome the Archdiocese of Indianapolis; the Archdiocese of Portland, OR; and the Diocese of Birmingham. With the Archdiocese of Portland's membership, National Catholic has now truly become a "coast-to-coast" operation.

Throughout the year, our Investment Committee, with the assistance of outside professionals and involvement of the full Board, reviewed in depth: National Catholic's investment objectives; investment portfolio; investment managers; investment returns; and new investment options. We decided to "stay the course" with continuous monitoring, largely because National Catholic's portfolio was considerably out performing our benchmark portfolio (2002 results for each were negative, but in absolute terms, National Catholic's portfolio performed 1.3 percentage points better than the benchmark portfolio).

Meanwhile, our VIRTUS programs experienced "landmark" performance in 2002. The dissemination and implementation of PROTECTING GOD'S CHILDREN occurred at an extremely rapid pace. By year-end, 92 archdioceses/dioceses were either well exposed to, or already actively involved with, our child sexual abuse prevention program. Nation-wide, well over 2000 PROTECTING GOD'S CHILDREN program facilitators had been trained. Our VIRTUS Online<sup>™</sup> service was fully inaugurated in August as an excellent and comprehensive risk control education, training, monitoring, communication and compliance tool. Our VIRTUS Phase II activities (violence prevention and mitigation) were also augmented substantially in 2002.

Finally, and even in light of the significant challenges and duress circumstances confronting it, through sound underwriting, excellent risk control and high quality claims management, National Catholic was able to post a \$642,980 operating profit in 2002.

We are very thankful that our efforts were so blessed.

In closing, I want to thank all of our shareholders and friends for your support, confidence, and encouragement. Be assured that we will always do our very best to serve you and our Church.

A handwritten signature in cursive script that reads "Michael J. Bemí".

Michael J. Bemí, President and CEO

# Consolidated Balance Sheets

## The National Catholic Risk Retention Group Inc., and Subsidiary

	DECEMBER 31	
	<u>2002</u>	<u>2001</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 3,694,379	\$ 3,899,691
Equity investments, at market value	17,970,916	16,016,747
Fixed maturity securities, at market value	21,457,694	25,085,363
Accounts receivable	663,532	—
Premiums receivable	289,124	193,080
Reinsurance receivable	11,237,646	12,482,932
Prepaid reinsurance premiums	2,876,210	2,108,855
Accrued interest	362,980	442,497
Deferred policy acquisition costs	185,719	125,986
Other assets	124,335	136,453
<b>TOTAL ASSETS</b>	<b>\$58,862,535</b>	<b>\$60,491,604</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Losses and loss adjustment expenses	\$23,018,860	\$23,302,910
Unearned premiums	5,978,574	4,157,592
Reinsurance balances payable	319,789	1,613,529
Premium taxes payable	237,647	172,500
Unearned ceding commissions	287,620	189,901
Other liabilities	525,112	203,521
<b>TOTAL LIABILITIES</b>	<b>30,367,602</b>	<b>29,639,953</b>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock:		
Class A (\$20 par value, 200 shares authorized, 61 and 58 shares issued and outstanding)	1,220	1,160
Class B (\$40 par value, 30,000 shares authorized, 7,453.77 and 7449.88 shares issued and outstanding)	298,153	297,997
Additional paid-in capital – original requirements	408,901	392,987
Additional paid-in-capital – policyholder dividends	8,879,437	8,879,437
Accumulated other comprehensive income	(3,138,978)	(123,150)
Retained earnings	22,046,200	21,403,220
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>28,494,933</b>	<b>30,851,651</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$58,862,535</b>	<b>\$60,491,604</b>

# Consolidated Statements of Operations & Comprehensive Income

## The National Catholic Risk Retention Group Inc., and Subsidiary

	YEAR ENDED DECEMBER 31,	
	<u>2002</u>	<u>2001</u>
<b>REVENUES</b>		
Premiums earned	\$ 4,388,084	\$4,043,618
VIRTUS <sup>®</sup> income earned	891,791	—
Net investment income	1,551,524	2,074,959
Net realized gains on sales of investments	15,659	358,320
Ceding commission income, net of commission expense of \$299,366 and \$261,051, respectively	117,917	17,033
<b>TOTAL REVENUES</b>	<b>6,964,975</b>	<b>6,493,930</b>
<b>EXPENSES</b>		
Losses and loss adjustment expenses	2,507,071	4,049,125
Amortization of policy acquisition costs	295,991	216,600
Management and professional fees	388,569	317,500
VIRTUS <sup>®</sup> expenses	1,803,106	1,094,827
General and administrative expenses	1,327,258	1,347,397
<b>TOTAL EXPENSES</b>	<b>6,321,995</b>	<b>7,025,449</b>
<b>NET INCOME (LOSS)</b>	<b>642,980</b>	<b>(531,519)</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>		
Net unrealized holding gains (losses) arising during the period	(3,000,169)	272,932
Less: reclassification adjustment for gains included in net income (loss)	(15,659)	(358,320)
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>	<b>(3,015,828)</b>	<b>(85,388)</b>
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b>\$(2,372,848)</b>	<b>\$ (616,907)</b>

Note: Johnson Lambert & Co., Certified Public Accountants has audited the financial statements of The National Catholic Risk Retention Group, Inc. for the years ended December 31, 2002 and 2001, prepared in conformity with generally accepted accounting principles in the United States, and issued an unqualified opinion on such financial statements in their report dated January 30, 2003.

These consolidated balance sheets and consolidated statements of operations and comprehensive income of The National Catholic Risk Retention Group, Inc. for the years ended December 31, 2002 and 2001 were derived from the audited financial statements. The complete audited financial statements may be obtained from The National Catholic Risk Retention Group, Inc. at 801 Warrenville Road, Suite 175, Lisle, IL 60532-4334.

### **National Catholic Report**

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# Protecting God's Children™ All Across America

From Maine to Nevada ... from Montana to Florida ... the Protecting God's Children program is making an impact at dioceses all across the country. In the last nine months, 33 dioceses have implemented the program to the point of conducting Protecting God's Children awareness sessions for adults on recognizing, reporting, and preventing child sexual abuse. Fourteen (14) more dioceses have signed contracts and are in the process of scheduling awareness sessions. Plus, another 30 dioceses are taking a serious look at the program and are expected to make a decision within a few weeks. We anticipate that, by the end of the year, close to one-half of the Catholic Church in America will be participating in one or more of the VIRTUS programs.

And, a lot of people are coming to depend on our programs as the best available source for continuing education on the prevention of child sexual abuse. That's why our VIRTUS Online™ system brings so much value to this cause. In May, we had more than a million hits on our website ([www.virtus.org](http://www.virtus.org)), with a steady stream of visitors all hours of the day and night.

We are blessed to have so many shareholders and friends who actively use VIRTUS Online and our other VIRTUS programs and services. Together, we are making the world a safer place for children.

## Understanding the Value of Our VIRTUS Online™ System

VIRTUS Online™ is the brand name that identifies our state-of-the-art, web-based platform that provides best practice resources 24 hours a day, seven days a week. Our system provides a comprehensive menu of functions for churches, religious organizations, and facilities from one convenient web-based resource. Through these functions we can help church organizations prevent wrongdoing, manage risk and improve service to the community through education, training, and best practices.

The home page is provided free of charge to anyone in the world with access to the Internet. The subscriber pages (pages requiring a user name and a password) are intended for users from organizations that subscribe to the VIRTUS® programs.

### How does VIRTUS Online support ongoing training?

The VIRTUS programs provide continuing education via the VIRTUS Online system to empower trainees to modify their own behavior. Every training program, in addition to instructor-led and video awareness sessions, includes ongoing web-based training. These regularly scheduled online bulletins and web-based training courses reinforce the knowledge points made during the awareness sessions and other "live" training sessions. Moreover, every training program is tracked so the organization knows who *has* or *has not* trained. Plus, most of the online training bulletins and modules are interactive allowing trainees to contact and interact with a trainer.

### Specifically, how does VIRTUS Online help in the fight to prevent child sexual abuse?

- **VIRTUS Online provides:**
  - A cost effective, non-intrusive method for providing training to individuals and for tracking each individual's compliance with their individual training requirements.
  - Free information about preventing child sexual abuse.
  - Continuing education through regular monthly (or more frequent) training.
  - Continuous tracking to ensure compliance.
  - Interactive training tools 24 hours a day, seven days a week.
  - Interaction with other peer participants across the nation.

### Why is VIRTUS continuing education conducted online?

- **Greater retention of information for trainees**
  - Studies show that people retain 70 percent more information through online training than through training conducted by a "live" trainer. One reason for this is that online training is interactive—a "hot" medium—and allows the trainee to learn at his or her optimum individual pace, without the distraction and confusion frequently present in a "live" training environment.
- **More efficiency, ease and flexibility for trainees**
  - Your time is valuable. When we ask for your time, we want to get the most out of it, and so should you. Studies show that trainees learn more in less time using the Internet.



- All of us are busy. We don't always have time to do things when others want us to do them. Web-based training allows you to train whenever it's convenient for you—24 hours a day, seven days a week. You get to choose the time and the place. You can train in the comfort of your office or your home ... rain or shine ... day or night.
  - VIRTUS *Online* allows you to complete your training without having to meet at *someone else's* convenience.
  - You also get to ask the questions *you* want to ask and have the answers directed to you in private.
  - If you need to stop during the middle of your online training to handle another matter, there's no problem. The training will be waiting for you upon your return—or the next time you log into the VIRTUS *Online* system.
- **Consistency for all trainees**
    - With live training, training quality varies depending on the knowledge, experience, and methodology of the trainer. The material presented via VIRTUS *Online* is presented in the same way to everyone—all across the nation. *You* read what *everybody else* reads. This allows the VIRTUS programs to maintain a high quality of excellence, and provides you with the best possible opportunity to learn.
- **Tracking and measurability as required by the Church**
    - The United States Conference of Catholic Bishops wants to know if people in your diocese are trained to prevent child sexual abuse. VIRTUS *Online* tracks not only who is expected to complete the training, but also whether those individuals have completed their training. Plus, VIRTUS *Online* tracks training results—to identify whether the training is working. Isn't it important to you to know that your efforts are contributing to a safer environment—for children, yourself, and everyone else?
- **High turnover of Church employees and volunteers**
    - It is estimated that a diocese turns over between 30 and 60 percent of its employees and volunteers each year. Hypothetically, if you were to train all the employees and volunteers at once, in approximately two to three years you would have to train all of them again. VIRTUS *Online* eliminates this problem by allowing all new employees and volunteers to receive training on their first day of service. So, beginning on “day one,” everybody is aware of the importance of preventing child sexual abuse in your parish.
- **Good stewardship for the Church**
    - Conventional “live” training is expensive—and not just the cost of the materials and trainers. There are travel expenses, overnight accommodations, and meals to purchase. Plus, there's the lost work productivity of every trainee.
    - Christian stewardship requires that we use our resources wisely. It's hard to argue with the stewardship of online training versus “live” training. Studies show that online training results in 70 percent more information being retained, at a cost of only 10 cents on the dollar—as compared to “live” training.
    - Dioceses that use VIRTUS *Online* are committed to making every parish a safe environment but, like everyone else, they have limited people resources. Through its automated tracking features, VIRTUS *Online* eliminates the need to hire a department of people to conduct and monitor “live” training.
- **Long-term value**
    - It's affordability makes VIRTUS *Online* a powerful asset for dioceses that are focused on results and willing to make the long-term commitment needed to *really* change community-wide behavior in the fight to prevent child sexual abuse.
- **Availability and convenience**
    - Sixty percent or more of Americans have computers with Internet access.
    - An even larger percentage has access to a computer with a connection to the Internet. For example, public libraries and many workplaces, such as schools, provide Internet access to employees at no cost.
    - “Live” training creates costly logistical and accounting problems. There are staggering costs associated with using expensive printed materials and scarce people resources—not to mention the nightmarish effort needed to track (by hand) everyone's “live” training participation and results. With the broad availability of computers and Internet access, “live” training, by itself, is simply not a viable option.
    - VIRTUS *Online* training access is not restricted to a particular computer. Participants can use someone else's computer and Internet connection to access their own, secured link to the VIRTUS *Online* training resources.
    - All you need is an email address. Email is available at no cost from a variety of sources. Two of the most popular free email services are:
      - Yahoo! Mail—Go to <http://mail.yahoo.com> to sign up.
      - Lycos Mail—Go to <http://login.mail.lycos.com> to sign up.
      - Hundreds of other free email services are available. Enter the keywords “free email” into any major search engine, and you'll be deluged with choices.

#### **How much time and effort is required to use VIRTUS *Online*?**

- **VIRTUS *Online* is fast and easy!** For most people, the Protecting God's Children first-year training curriculum takes between three and six hours spread over an entire year—about 15 to 30 minutes per month. A few minutes a month is a small price to pay to empower yourself to *really* help prevent child sexual abuse.

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## What if a participant doesn't have access to the Internet?

- **They need to call their diocese's VIRTUS Coordinator or the local VIRTUS Coordinator at their parish.** There are other non-Internet mechanisms for completing the training. The diocese will be happy to provide those resources to those who genuinely do not have Internet access.
- **A quick word of caution:** The non-Internet resources are a very costly staff burden to the diocese. Only those without Internet access should call.

## Where can I learn more about VIRTUS Online?

- **Call Jack McCalmon, National Catholic's Director of VIRTUS Programs and Services, at 1-888-847-8870.**

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# Plan Now to Attend National Catholic's 2004 Winter Meeting

*February 1 to 3, 2004, Fort Lauderdale, Florida*

Our 2004 Winter Meeting will be February 1-3 at the Sheraton Yankee Trader Beach Hotel in Fort Lauderdale, Florida. More information about the 2004 Winter Meeting will be sent out later this summer to shareholders and friends. As we have consistently done in the past, we plan on presenting a series of timely and relevant workshops. Detailed information about the meeting will also be available on our company website in the next few months. Keep an eye on our calendar of events at:

[www.nationalcatholic.org](http://www.nationalcatholic.org)

Plus, in a few weeks, you'll be able to download a hotel registration form and a general registration form. To make your reservation, please print all the pages, then complete the two attached forms and return them by mail or fax—each according to their respective instructions. And, please check our online calendar often for the latest information. For details about the hotel and the Fort Lauderdale area, visit the Sheraton Yankee Trader website at:

[www.sheratontrader.com](http://www.sheratontrader.com)

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