COMMERCE GROUP INC /MA
Form ARS
April 11, 2002

2001
annual
report

The
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The Commerce Group, Inc.
211 Main Street, Webster, Massachusetts 01570

INDEX TO 2001 ANNUAL REPORT

FINANCIAL HIGHLIGHTS
(Dollars in Thousands, Except Per Share Amounts)

	2001	2000	1999
Direct premiums written........................	$1,152,407	$1,071,649	$ 948,149
Net premiums written...........................	$1,078,967	$1,008,911	$ 911,993
Earned premiums................................	$1,043,652	$ 954,483	$ 871,830
Net investment income..........................	99,611	96,830	89,789
Premium finance and service fees...............	17,819	15,227	14,774
Amortization of excess of book value of subsidiary interest over cost................	3,389	3,390	3,019
Net realized investment gains (losses)..........	(10,633)	29,550	(16,378)
Total revenues............................	$1,153,838	$1,099,480	$ 963,034
Earnings before income taxes and minority interest....................................	$ 115,425	$ 170,066	$ 104,284
Income taxes...................................	23,194	38,306	16,667
Net earnings before minority interest...........	92,231	131,760	87,617
Minority interest in net loss of subsidiary.....	863	320	1,059
Net earnings..............................	$ 93,094	$ 132,080	$ 88,676
Comprehensive income...........................	$ 93,655	$ 168,570	$ 40,730

Net earnings per common share:			
Basic	$ 2.77	$ 3.87	$ 2.54
Diluted	$ 2.75	$ 3.87	$ 2.54
Operating earnings (1)	$ 98,880	$ 109,631	$ 97,411
Operating earnings per share (1)			
Basic	$ 2.94	$ 3.21	$ 2.79
Diluted	$ 2.93	$ 3.21	$ 2.79
Cash dividends paid per share	$ 1.19	$ 1.15	$ 1.11
Weighted average number of common shares outstanding:			
Basic	33,608,804	34,121,047	34,940,074
Diluted	33,794,938	34,121,047	34,940,074
Total investments at market value and equity value	$1,498,201	$1,472,562	$1,295,995
Total assets	$2,140,082	$2,075,614	$1,878,019
Total liabilities	$1,327,808	$1,292,665	$1,208,650
Minority interest	-	$ 1,068	$ 1,364
Total stockholders' equity	$ 812,274	$ 781,881	$ 668,005
Total stockholders' equity per share	$ 24.52	$ 23.16	$ 19.44
Certain statutory financial ratios (unaudited):			
Loss and LAE ratio	74.7%	71.7%	72.0%
Underwriting expense ratio	24.4	25.1	26.5
Combined ratio	99.1%	96.8%	98.5%
Net premiums written to policyholders' surplus	150.7%	152.6%	175.7%

(1) The above figures are presented to provide information to the reader due to the amount of, and fluctuations in, net realized gains and (losses). The amounts noted, which exclude the after-tax impact of net realized investment gains (losses), are important measures of corporate performance.

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THE COMMERCE GROUP, INC.

March 23, 2002

To Our Stockholders:

In 2001, your Company experienced satisfactory financial results for the 26th consecutive year. From the very first day the funding of The

Commerce Insurance Company was accomplished (April 3, 1972) through December 31, 2001, we have achieved underwriting profit of $293.4 million on total premiums written of $10.0 billion. This underwriting profit represents 2.9% of total premiums written.

In October 2001, the 2002 personal automobile insurance rate decision was announced by the Massachusetts Insurance Commissioner. Despite the industry's request for a 7.8% increase, 2002 rates are to remain unchanged from 2001 rates. Although most companies, including yours, continued to modify safe driver deviations in response to the 2002 rate decision, the Massachusetts marketplace remains highly competitive. Throughout these ongoing competitive times, your Company's share of the Massachusetts personal automobile market has continued to grow, and at year-end, our market share was 23.3% up from 22.3% in 2000.

In 2001, direct premiums written in Massachusetts and earned premiums countrywide surpassed $1 billion for the first time in our history. Your Company will continue to pursue the goals of growing and expanding geographically beyond the borders of Massachusetts. In furtherance of this goal, direct premiums written outside of Massachusetts now represents 12.4% of our total business as compared to 11.3% in 2000.

Your Company has continued to grow and prosper. The Commerce Insurance Company continues to be the largest writer of Massachusetts private passenger automobile insurance, the second largest writer of Massachusetts homeowners insurance, as well as the third largest writer of Massachusetts commercial automobile insurance. The combined insurance companies were also ranked as the 26th largest personal automobile insurance group in the country by A.M. Best Co., based on the most recently available direct premium written information. Additionally, I am very pleased to report that your Company again received a group rating of A+ (Superior) from A.M. Best Co.

Net earnings, written premiums, earned premiums, investment income, total assets, total stockholders' equity and total stockholders' equity per share, as illustrated in the bar graph on the facing page, are all at new highs. For those of you who are interested in the details, I draw your attention to the pages in this report labeled "Management's Discussion and Analysis of Financial Condition and Results of Operations". Behind these numbers are an extremely dedicated group of people: Our policyholders (represented by over 1,042,000 policies in force); Agents (1,236); Employees (1,780); Officers (43); Commerce Group Directors (17); and, of course, our Stockholders (over 5,000, including our Employee Stock Ownership Plan Participants who now number 1,904).

Property-liability insurance remains a good business to be in and The Commerce Group, Inc. will continue its efforts to be one of the most profitable long-term players. Your Company's management continues to believe that owners' interests are its primary constituency.

Our sincere thanks to those who have helped in this building process especially our Agents, Employees, Officers and Board of Directors. This diverse force of committed, ethical and hard working people will continue to build on our past successes and look to the future with excitement and opportunity. Their individual ingenuity, enthusiasm, dedication and professionalism will continue to serve our stockholders well.

Your comments or questions regarding this report, or The Commerce Group, Inc. affairs in general, are solicited as always, at any time.

Arthur J. Remillard, Jr.
President, Chief Executive Officer
and Chairman of the Board

Caring in everything we do.

The bar graph on page 3 illustrates the Company's annual total stockholders' equity per share value and annual total stockholders' equity per share value including cumulative cash dividends paid per share through each December 31, year-end, over the most recent fifteen year period. The X-axis lists the years beginning with 1987 through 2001. The Y-axis lists the dollar values starting at $0.00 and increasing in one-dollar increments to $32.00. The graph depicts a total stockholders' equity per share value in 1987 of $1.40, 1988 of $1.95, 1989 of $2.53, 1990 of $3.36, 1991 of $4.80, 1992 of $7.42, 1993 of $10.09, 1994 of $10.88, 1995 of $14.96, 1996 of $16.28, 1997 of $18.11, 1998 of $19.72, 1999 of $19.44, 2000 of $23.16, and 2001 of $24.52. The graph also depicts the total stockholders' equity per share value adjusted to include cumulative dividends paid per share. The total of these amount to the per share value in 1987 of $1.40, 1988 of $1.95, 1989 of $2.53, 1990 of $3.36, 1991 of $4.80, 1992 of $7.42, 1993 of $10.09, 1994 of $11.03, 1995 of $15.34, 1996 of $17.47, 1997 of $20.33, 1998 of $23.01, 1999 of $23.84, 2000 of $28.71, and 2001 of $31.26.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Thousands of Dollars Except Per Share Data)

General

The property and casualty insurance industry continues to remain highly competitive and inherently volatile in nature. Property and casualty insurance company results have traditionally been impacted by the typical forces unique to the industry such as competi-tion, frequency and severity of losses, the overall economy and the general regulatory environment in those states in which the insurer operates. Additional forces are impacting the industry in the form of deregulation, on-line commerce, price competition, empowered customers and technological advancement. The terrorists' attacks of September 11 have had a significant impact on the insurance industry. According to A.M. Best Co. ("A.M. Best"), "the unprecedented events of September 11 have forever changed the way the insurance industry defines risk. Both property and liability lines have been exposed to catastrophic risks that cannot be priced using traditional actuarial methods". A.M. Best goes on to state, "Against the backdrop of weak financial trends, this new risk environment has accelerated the hardening of the U.S. property/casualty market". Given this increased risk environment, A.M. Best "expects to see a renewed flight to quality that will benefit financially strong insurers". The financial losses due to this tragedy were significant to the insurance industry, however, due to the limited exposure that the Company has outside of Massachusetts, management believes the direct financial impact to the Company will not be material. Additionally, price competition remains quite heavy in many areas of the country, although it has improved in 2001 among independent agency companies in Massachusetts. Beyond Massachusetts, industry-underwriting results are expected to continue to deteriorate in the near future which further emphasizes the importance of competitive advantages gained by affinity marketing and efficient operations. With these issues on the forefront, The Commerce Group, Inc. ("Company") continues to position itself to respond to the prevailing forces and conditions in the market. The Company has utilized its strong agency relationships, a low-cost structure, affinity group alliances and a 1999 joint-venture acquisition all in an effort to keep the Company responsive in today's competitive environment.

The Company, incorporated in 1976, is a holding company for several property and casualty insurers, which, through these insurance subsidiaries, offers predominantly private passenger motor vehicle insurance along with a broad range of other property and casualty insurance products. These products are marketed to affinity groups, individuals, families and businesses through the Company's strong relationships with professional independent insurance agencies. The Company writes insurance primarily in the State of Massachusetts through The Commerce Insurance Company ("Commerce") and Citation Insurance Company ("Citation"), both wholly-owned subsidiaries of Commerce Holdings, Inc. ("CHI").

Additionally, the Company writes insurance in the States of California and Oregon through Commerce West Insurance Company ("Commerce West"), a wholly-owned subsidiary of Commerce, located in Pleasanton, California. The Company also writes insurance through American Commerce Insurance Company ("American Commerce"), which it acquired in January 1999. Located in Columbus, Ohio, American Commerce is a wholly-owned subsidiary of ACIC Holding Co., Inc., with policies in 26 states and licenses in several others.

In November 1998, Commerce formed ACIC Holding Co., Inc., in a joint venture with AAA Southern New England ("AAA SNE") and invested $90,800 to fund the January 29, 1999 acquisi-tion of the Automobile Club Insurance Company whose name was changed to American Commerce upon completion of the acquisition. Commerce invested $90,000 in the form of preferred stock and an additional $800 representing an 80% common stock ownership. AAA SNE invested $200 representing a 20% common stock ownership. The terms of the preferred stock call for Commerce to receive quarterly cash dividends at the rate of 10% per annum from ACIC Holding Co., Inc. In the event cash dividends cannot be paid, additional preferred stock will be issued. Since the January 29, 1999 acquisition, ACIC Holding Co., Inc. and American Commerce's results have been consolidated into the Company's financial statements. Since 1995, Commerce has maintained an affinity group marketing relationship with AAA Insurance Agency, Inc., a subsidiary of AAA SNE. AAA Insurance Agency, Inc. has been a licensed insurance agent of Commerce since 1985.

The Company's business strategy remains focused on activities primarily related to personal automobile insurance. The Company has been the largest writer of personal property and casualty insurance in the State of Massachusetts in terms of market share of direct premiums written since 1990. The Company's share of the Massachusetts personal automobile market increased to 23.3% in 2001, as exhibited in the table below, exceeding our nearest competitor, which maintains a 10.8% market share.

Growth of Massachusetts Personal Automobile Insured Vehicles

Year	Industry	Commerce	Commerce Year-End Market Share
2001	1.7%	6.1%	23.3%
2000	1.9%	6.5%	22.3%
1999	2.0%	0.6%	21.3%

As mentioned, the Company predominantly writes private passenger automobile insurance. The following tables indicate that direct premiums written for private passenger automobile, commercial automobile and homeowners represented 85.2%, 5.2% and 8.0%, respectively, of the Company's total direct premiums written in 2001, as compared to 86.9%, 4.0% and 7.7%, re-spectively, in 2000. Total direct premiums written increased $80,758 or 7.5% in 2001 over 2000. The 2001 increase was primarily attributable to a $32,742 or 4.0% increase in Massachusetts private passenger automobile direct premiums written. This was the result of a 5.8% increase in written exposures offset by a decrease of 1.9% in average premiums per exposure. Private passenger premiums written for all other states increased $18,824 or 18.2%, primarily attributable to an increase in American Commerce premiums of $7,319 or 9.4%, coupled with an increase of $11,505 or 44.5% additional premiums from Commerce West.

Direct Premiums Written, Year Ended December 31, 2001

	Massachusetts	All Other States	Total	% of Total
Personal Automobile......	$ 859,922	$ 122,320	$ 982,242	85.2%
Commercial Automobile....	58,088	1,514	59,602	5.2
Homeowners..............	73,254	18,710	91,964	8.0
Other Lines.............	17,885	714	18,599	1.6
Total..........	$1,009,149	$ 143,258	$1,152,407	100.0%

Direct Premiums Written, Year Ended December 31, 2000

	Massachusetts	All Other States	Total	% of Total
Personal Automobile......	$ 827,180	$ 103,496	$ 930,676	86.9%
Commercial Automobile....	43,243	104	43,347	4.0
Homeowners..............	65,662	16,498	82,160	7.7

Other Lines.............	14,860	606	15,466	1.4
Total..........	$ 950,945	$ 120,704	$1,071,649	100.0%

Massachusetts Automobile Business

In Massachusetts, private passenger automobile insurance is subject to extensive regulation. Owners of registered automobiles are generally required to maintain certain minimum automobile insurance coverages. With very limited exceptions, automobile insurers are required by law to issue a policy to any applicant seeking to obtain such coverages. Companies in Massachusetts are also assigned agents, known as Exclusive Representative Producers ("ERPs"), based primarily on market share, that have been unable to obtain a voluntary contract with an insurance carrier. Marketing and underwriting strategies for companies operating in Massachusetts are limited by maximum premium rates and minimum agency commission levels for personal automobile insurance, both of which are mandated by the

Massachusetts Commissioner of Insurance ("Commissioner"). In Massachusetts, accident rates, bodily injury claims, and medical care costs continue to be among the highest in the nation. According to the Automobile Insurers Bureau of Massachusetts ("A.I.B."), Massachusetts "has higher than average medical costs and liability claims involving attorneys". According to the A.I.B., Massachusetts personal automobile premium per policy, based on 1999 premium information, was 5th highest in the nation.

During the three-year period from 1999 to 2001, average mandated Massachusetts personal automobile insurance premium rates decreased an average of 2.3% per year. The Commissioner approved no rate change in personal automobile premiums for 2002, as compared to an average rate decrease of 8.3% in 2001. Coinciding with the 2002 rate decision, the Commissioner also approved no change in the commission rate agents receive for selling private passenger automobile insurance from 12.3% in 2001.

Year	State Mandated Average Rate Change	Commerce Average Rate Change Per Exposure
2002	0.0%	5.0%(Estimated)
2001	(8.3%)	(1.9%)
2000	0.7%	6.2%
1999	0.7%	9.1%

Although average mandated personal automobile premium rates decreased 8.3% in 2001, the Company's average rate decreased 1.9% per exposure. The 1.9% decrease for 2001 was primarily the result of the state mandated average rate decrease offset by decreases in the Safe Driver Insurance Plan ("SDIP") deviations for Step 9 and Step 10 drivers, the two best driver SDIP classifications in Massachusetts. The smaller Company decrease was also due to the facts that the rate decision did not anticipate purchases of new automobiles in the year to which the rate decision applied and, secondly, the Company's mix of personal automobile business differs from that of the industry.

The 1999 average rate decision was partially driven by corrections for an industry error that had impacted prior year rate decisions. The industry error resulted from a miscalculation of industry expense allowances that had the effect of over-stating rates for 1991 through 1996.

Mandated rates for 1997, 1998 and 1999 included an adjustment to recoup the effects of this error from the industry. The adjustment included in the rate decision to recoup the error was phased in during 1997, 1998 and 1999. The earned premium impact of this, coupled with the impact of a previous year imbalance in the SDIP, was approximately $14.0 million for 1999. The earnings per share after-tax impact resulting from lower earned premiums were estimated at $0.26 for 1999.

The Company's performance in its personal and commercial automobile insurance lines is integrally tied to its participation in Commonwealth Automobile Reinsurers ("C.A.R."), a state-mandated reinsurance mechanism, which permits the Company and most other writers of automobile insurance in Massachusetts to reinsure any automobile risk that the insurer perceives to be under-priced at the premium level permitted by the Commissioner. All companies writing automobile insurance in Massachusetts share in the underwriting results of C.A.R. business for their respective product line or lines. Since its inception, C.A.R. has annually generated multi-million dollar underwriting losses in both its personal and commercial automobile pools. A company's proportionate share of the C.A.R. personal or commercial deficit (its participation ratio) is based upon its market share of the auto-mobile risks for the particular pool, adjusted by a utilization formula such that, in general, its participation ratio is disproportionately and adversely affected if its relative use of C.A.R. exceeds that of the industry, and favorably affected if its relative use of C.A.R. is less than that of the industry. Automobile insurers attempt to develop and implement underwriting strategies that will minimize their relative share of the C.A.R. deficit while maintaining acceptable loss ratios on risks not insured through C.A.R.

Significant changes in the utilization of the C.A.R. private passenger pooling mechanism are not expected for 2002. Various C.A.R. participation formula changes have been fully implemented since 1993 with only minor changes since then. The Company's ERP strategy has been to voluntarily retain more of the types of private passenger automobile business that are factored as credits favorably impacting the utilization formula. These credits primarily result from voluntarily writing business in under-priced territories and for under-priced risks. As a result of increased voluntary retention in excess of the industry,

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the credits impacting the utilization formula have favorably affected the Company's participation ratio. As indicated in the accompanying table, this ratio is several percentage points below the Company's estimated 23.3% share of the Massachusetts personal automobile market. The Company continues to expect the marketplace to make minor annual adjustments to find the optimum balance between voluntary and ceded writings.

Company Private Passenger Participation Ratio for C.A.R. versus Market Share

Year	Company Participation Ratio in C.A.R.	Company Market Share
2001*	16.8%	23.3%
2000	16.9%	22.3%
1999	16.5%	21.3%

*Estimated

The percentage of commercial automobile premiums ceded to C.A.R. by the industry was estimated by the Company to be 24% in 2001. The percentage of commercial automobile business ceded to C.A.R. by the Company was approximately 16.0%. C.A.R. depopulation over the last several years, coupled with C.A.R. rate increases for ceded commercial business, have led to a reduction in the size of the annual commercial automobile deficits. The Company intends to continue to respond to the incentives and disincentives provided by C.A.R. rules as deemed necessary and appropriate.

The Company provides a separate rating tier for preferred Massachusetts commercial automobile business through Citation. Approximately 17% of the Massachusetts commercial automobile premiums produced by voluntary agents in 2001 were written by Citation. The Company expects that this secondary rating tier will continue to assist the Company in retaining its better commercial automobile accounts, while also further increasing the percentage of commercial automobile business that can be retained voluntarily by the Company in 2002 and beyond.

The Company has actively pursued affinity group marketing programs since 1995. The primary purpose of affinity group marketing programs is to provide participating groups with a convenient means of purchasing private passenger automobile insurance through associations and employer groups. Emphasis is placed on writing larger affinity groups, although accounts with as few as 25 participants are considered. Affinity groups are eligible for rate discounts, which must be filed annually with the Division of Insurance. In general, the Company looks for affinity groups with mature/stable membership, favorable driving records and below average turnover ratios. Participants who leave the sponsoring group during the term of the policy are allowed to maintain the policy until expiration. At expiration, a regular Commerce policy may be issued through the agency at the insured's option.

Since the latter part of 1995, Commerce has been a leader in affinity group marketing through agreements with the four American Automobile Association Clubs of Massachusetts ("AAA clubs") offering discounts on private passenger automobile insurance to the clubs' members who reside in Massachusetts. A 6% discount was approved for policies effective January 1, 2002, which is the same as the discount for 2001. Membership in these clubs is estimated to represent approximately one-third of the Massachusetts motoring public, and has been the primary reason for a 62.6% increase in the number of personal automobile exposures written by Commerce since year-end 1995 (the AAA affinity group program incepted in October of 1995). In 2001, total direct premiums written attributable to the AAA group business were $545,496 or 47.3% of the Company's total direct premiums written (63.4% of the Company's total Massachusetts personal automobile premium), an increase of 1.8% over 2000. Total exposures attributable to the AAA clubs group business were 581,455 or 63.3% of total Massachusetts personal automobile exposures in 2001, as compared to 559,696 or 64.5% in 2000. Of the total Massachusetts automobile exposures written through the AAA affinity group program by the Company, approximately 13.0% were written through insurance agencies owned by the AAA clubs (8.7% of total Massachusetts automobile exposures). The remaining 87.0% of the AAA group program was written through the Company's network of independent agents (91.3% of total Massachusetts automobile exposures). For additional details, refer to the table found on page 12 entitled "AAA Affinity Group Discount and SDIP Deviations".

Massachusetts law allows two years to reach the required group penetration level of 35%. Commerce has continued to maintain AAA member participation in excess of 35% through December 31, 2001, when it was estimated at approximately 40%. The two-year penetration requirement was waived by the Massachusetts Legislature for 2000, 2001 and 2002. Waiving the penetration requirements allows insurance companies to continue offering group discounts without reaching the 35% level.

Commerce and the AAA clubs have agreed that Commerce shall be their exclusive under-writer of Massachusetts personal automobile group programs. A rolling three-year contract exists between Commerce and the AAA clubs which renews automatically and may be terminated upon a minimum of three years written notice to either party.

Agreements for the Transfer of Massachusetts Business from Other Companies in 2002

The Company entered into an agreement on September 28, 2001, with Berkshire Mutual Insurance Company ("Berkshire") for the transfer of Massachusetts personal automobile business written by Berkshire to The Commerce Insurance Company, effective January 1, 2002. Under terms of the agreement, Commerce Insurance agreed to offer agency contracts to independent agencies that represent Berkshire for personal automobile insurance in Massachusetts. This will allow agents of Berkshire the opportunity to offer Commerce automobile insurance policies to their customers whose policies renew in 2002. Commerce will assume all of Berkshire's obligations for future policy years beyond 2001 under the Massachusetts residual market system, (commonly known as C.A.R.), including assignment of Berkshire's involuntary agents. The Company received a cash payment of $7,000 from Berkshire in early January, 2002.

The Company announced the formation of a marketing alliance with Horace Mann Educators Corporation on October 18, 2001. Under the terms of an agency agreement between Commerce and Horace Mann Service Corporation ("HMSC"), a licensed brokerage agency in the State of Massachusetts, HMSC will provide its personal automobile customers with Commerce policies. New personal automobile policies sold by HMSC will be insured with Commerce, beginning no later than January 1, 2002. At the policy holders option, Massachusetts personal auto policies currently written by HMSC will convert to Commerce policies upon renewal in 2002.

Other States Business

Direct premiums written in states other than Massachusetts by Commerce West and American Commerce, increased $22,554 or 18.7%. Roughly half of this growth resulted from an increase of $11,505 or 44.5% in personal automobile direct premiums written by Commerce West. The growth from Commerce West is primarily attributable to non-standard automobile business. Commerce West began writing in this segment of the market in late 1999. Commerce West also began writing commercial automobile in late 2000, resulting in writings of $1,514 in 2001. American Commerce direct premiums written increased $9,655 or 10.2%, primarily due to an increase in personal automobile premiums of $7,319 or 9.4%. American Commerce also experienced a 13.4% increase in homeowners business. American Commerce, which writes business in 26 states, wrote greater than 90% of its business in eleven states.

Commerce West premiums and the eleven states with the highest percentages of premiums written by American Commerce are shown in the following table:

Company	State	% of Direct Premiums Written by State 2001	2000
Commerce West	California............	89.8%	99.1%
	Oregon................	10.2%	0.9
	Total............	100.0%	100.0%
American Commerce	Arizona...............	20.9%	21.5%
	Rhode Island..........	14.3%	10.8%
	Ohio..................	12.6%	11.6%
	Oregon................	10.5%	10.2%
	Washington............	8.0%	8.1%
	Oklahoma..............	7.7%	6.4%
	Kentucky..............	5.9%	5.8%
	Indiana...............	4.6%	3.5%
	West Virginia.........	2.5%	2.7%
	Idaho.................	2.5%	2.4%
	Tennessee.............	2.4%	2.2%
	Other states..........	8.1%	14.8%
	Total............	100.0%	100.0%

The decrease in other states for American Commerce is primarily attributable to business in several states being moved to other insurance companies affiliated with the ownership of the agencies representing that business. These and some future moves for business in other states were anticipated at the time the Company negotiated the acquisition of American Commerce.

Insurance Ratios

Underwriting profit margins are reflected by the extent to which the combined ratio is less than 100%. This ratio is considered the best simple index of current underwriting performance of an insurer. During the five-year period ended December 31, 2001, the property and casualty insurance industry's combined ratio, as reported by A.M. Best and weighted to reflect the Company's product mix ("weighted industry average"), has ranged from a low of 100.1% in 1997 to a high of 109.7% in 2000 on a statutory accounting principles basis. During this same period of time, the Company's combined ratio has consistently remained below the weighted industry average, ranging from a low of 96.5% in 1997 to a high of 99.1% in 2001. On an average basis, the Company's combined ratio was 97.8% for the five-year period ended December 31, 2001 compared to a weighted industry average of 105.1%.

Company Statutory Ratios (unaudited)	Year Ended December 31, 2001	2000	1999	1998	1997
Loss and LAE Ratio.................	74.7%	71.7%	72.0%	71.6%	71.4%
Underwriting Expense Ratio.........	24.4	25.1	26.5	26.5	25.1
Combined Ratio.....................	99.1%	96.8%	98.5%	98.1%	96.5%
Industry Combined Ratio (all writers)(1)..................	108.9%	109.7%	104.4%	102.2%	100.1%

(1) Source: Best's Review Preview (2002), as reported by A.M. Best for all property and casualty insurance companies and weighted to reflect the Company's product mix. The 2001 industry information is estimated by A.M. Best.

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Investment Income and Net Realized Investment Gains and Losses

The Company's total revenues were supplemented in fiscal 2001, 2000 and 1999 by net investment income of $99,611, $96,830 and $89,789, respectively. Beginning in the first quarter of 2001, the Company, in the 2001 and prior years' results, classified its undistributed equity in the earnings and losses on investments in closed-end preferred stock mutual funds in net realized investment gains and losses. For the year ended 2000, the undistributed equity in the earnings and losses of these funds was reported in net investment income. The Company believes the current year presentation provides a more appropriate classification for analysis of the on-going operations of the Company. Prior period results previously reflected in investment income, have been reclassified to realized gains and losses to conform with current period presentation. For the years ended December 31, 2001, 2000, and 1999 the Company reflected realized gains (losses) of $4.6 million, $26.6 million and ($22.4) million, respectively, as a result of this change. These investments are valued at original cost plus the cumulative undistributed equity in earnings and losses of the funds and adjusted over time by the premium or discount at the time of purchase to the applicable underlying net asset value of the funds. Also in 2001, the Company began to account for venture capital fund investments on an equity basis. The equity in the operating results of these funds has been reflected in realized gains and losses. Prior to this change, the operating results were not material and were therefore reflected in accumulated other comprehensive income and loss. For 2001, the Company had a net realized loss of $10.6 million, of which the largest component, $9.1 million, was attributable to venture capital fund investments.

Regulatory Matters

General

Although the U.S. federal government does not directly regulate the insurance industry, federal initiatives often have an impact on the business. Congress and certain federal agencies continue to investigate the current condition of the insurance industry (encompassing both life and health and property and casualty insurance) in the United States in order to decide whether some form of federal role in the regulation of insurance companies would be appropriate. Congress conducts hearings relating, in general, to the solvency of insurers and has proposed federal legislation from time to time on this and other subjects.

In November 1999, the Gramm-Leach-Bliley Act was signed into law. The Act (1) repealed the Glass-Steagall Act of 1933, which had prohibited the merger of banks and securities firms, and (2) substantially modified the Bank Holding Company Act of 1956, which had the effect of separating banking and insurance underwriting business. The law contains pro-visions that govern competition, created safe-harbor protections for specific state laws and established consumer protections that govern bank-insurance sales.

At the state level, various forms of automobile insurance reform are continuously debated. New regulations and legislation are often proposed with the goal of reducing the need for premium increases. For further details, please refer to the general discussion on insurance regulation and premium rates beginning on page 5.

Personal Automobile Insurance

As previously mentioned, since 1995, the Company has been a leader in affinity group marketing in Massachusetts by providing discounts to members of the AAA clubs. Membership in these clubs is estimated to represent approximately one-third of the Massachusetts motoring public. The Company increased its Massachusetts private passenger automobile insurance exposures by 5.8%, ending the year with approximately 23.3% of the Massachusetts private passenger automobile market.

Through 2000, the Company offered its Massachusetts customers safe driver deviations to drivers with SDIP classifications of either Steps 9 or 10 and to only Step 9 drivers in 2001. Safe driver deviations are rate discounts based on the customer's driving record and resulting SDIP classification and must be approved annually by the Commissioner. Steps 9 and 10 are the two best driver SDIP classifications in Massachusetts, representing drivers with no at-fault accidents and not more than one minor moving vehicle violation in the last six years. The accompanying table depicts the AAA Affinity Group Discount, SDIP Deviations and their combined reduction from Massachusetts average mandated rates:

AAA Affinity Group Discount and SDIP Deviations	2002*	2001	2000	1999
AAA Affinity Group Discount................	6.0%	6.0%	6.0%	6.0%
SDIP Step 9 Deviation......................	0.0%	2.0%	6.0%	8.0%
SDIP Step 10 Deviation.....................	0.0%	0.0%	2.0%	3.0%
Combined AAA Affinity Group Discount and Step 9 Deviation.........................	6.0%	7.9%	11.6%	13.5%
Combined AAA Affinity Group Discount and Step 10 Deviation........................	6.0%	6.0%	7.9%	8.8%

*For policies with effective dates as of January 1, 2002 or thereafter.

In 2002, in response to the average personal automobile rate decisions over the last several years, the Company did not file for SDIP Step 9 or Step 10 deviations, for policies incepting in the 2002 calendar year. During 2001, 55.0% of the Company's exposures were eligible for Step 9 deviations, versus 55.1% and 14.0%, eligible for Step 9 and Step 10 deviations in 2000.

Risk-Based Capital

In order to enhance the regulation of insurer insolvency, the National Association of Insurance Commissioners ("NAIC") developed a formula and model law to provide for Risk-Based Capital ("RBC") requirements for property and casualty insurance companies. RBC require-ments are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholder obligations. The RBC model for property and casualty insurance companies measures three major areas of risk facing property and casualty insurers: (i) underwriting, which encompasses the risk of adverse loss development and inadequate pricing; (ii) declines in asset values arising from credit risk; and, (iii) other business risks from investments. Insurers having less statutory surplus than required by the RBC calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy.

The RBC model formula proposes four levels of regulatory action. The extent of regulatory intervention and action increases as the percentage of surplus to RBC falls. The first level, the Company Action Level (as defined by the NAIC), requires an insurer to submit a plan of corrective actions to the regulator if surplus falls below 200% of the RBC amount. The Regulatory Action Level (as defined by the NAIC) requires an insurer to submit a plan containing corrective actions and permits the Commissioner to perform an examination or other analysis and issue a corrective order if surplus falls below 150% of the RBC amount. The Authorized Control Level (as defined by the NAIC) allows the regulator to rehabilitate or liquidate an insurer in addition to the aforementioned actions if surplus falls below 100% of the RBC amount. The fourth action level is the Mandatory Control Level (as defined by the NAIC), which requires the regulator to rehabilitate or liquidate the insurer if surplus falls below 70% of the RBC amount.

The following table provides the key RBC information for the Company's insurance subsidiaries, Commerce, Citation, Commerce West, and American Commerce:

(Dollars in millions) At December 31, 2001	Commerce	Citation	Commerce West	American Commerce
Statutory surplus............	$ 609	$ 107	$ 28	$ 84
200% RBC Company action level.	184	4	7	20
Statutory surplus in excess of RBC Company action level.	$ 425	$ 103	$ 21	$ 64
RBC amounts..................	$ 92	$ 2	$ 4	$ 10
% of surplus to RBC amounts...	662.0%	5,350.0%	700.0%	840.0%

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Premiums

The following table compares direct premiums written, net premiums written and earned premiums for the years ended December 31, 2001 and 2000:

	Years Ended December 31, 2001	2000	$ Change	% Change
Direct Premiums Written:				
Personal Automobile in Massachusetts......	$ 859,922	$ 827,180	$ 32,742	4.0%
Personal Automobile in All Other States...	122,320	103,496	18,824	18.2%
Commercial Automobile in Massachusetts....	58,088	43,243	14,845	34.3%
Commercial Automobile in All Other States.	1,514	104	1,410	*
Homeowners in Massachusetts..............	73,254	65,662	7,592	11.6%
Homeowners in All Other States...........	18,710	16,498	2,212	13.4%
Other Lines in Massachusetts.............	17,885	14,860	3,025	20.4%
Other Lines in All Other States..........	714	606	108	17.8%
Total Direct Premiums Written..........	$1,152,407	$1,071,649	$ 80,758	7.5%
Net Premiums Written:				
Personal Automobile in Massachusetts......	$ 864,900	$ 839,394	$ 25,506	3.0%
Personal Automobile in All Other States...	122,256	103,719	18,537	17.9%
Commercial Automobile in Massachusetts....	60,986	44,848	16,138	36.0%
Commercial Automobile in All Other States.	1,477	104	1,373	*
Homeowners in Massachusetts..............	20,364	17,547	2,817	16.1%
Homeowners in All Other States...........	4,576	(1,658)	6,234	*
Other Lines in Massachusetts.............	4,236	4,916	(680)	(13.8%)
Other Lines in All Other States..........	172	41	131	319.5%
Total Net Premiums Written............	$1,078,967	$1,008,911	$ 70,056	6.9%
Earned Premiums:				
Personal Automobile in Massachusetts......	$ 776,552	$ 714,972	$ 61,580	8.6%
Personal Automobile in All Other States...	116,479	100,101	16,378	16.4%
Commercial Automobile in Massachusetts .	43,008	32,548	10,460	32.1%
Commercial Automobile in All Other States.	711	19	692	*
Homeowners in Massachusetts..............	19,119	17,364	1,755	10.1%
Homeowners in All Other States...........	3,731	4,186	(455)	(10.9%)
Other Lines in Massachusetts.............	3,290	3,434	(144)	(4.2%)
Other Lines in All Other States..........	158	162	(4)	(2.5%)
Assumed Premiums from C.A.R..............	80,176	81,300	(1,124)	(1.4%)
Assumed Premiums from Other than C.A.R....	428	397	31	7.8%
Total Earned Premiums.................	$1,043,652	$ 954,483	$ 89,169	9.3%
Earned Premiums in Massachusetts..........	$ 841,969	$ 768,318	$ 73,651	9.6%
Earned Premiums-Assumed...................	80,604	81,697	(1,093)	(1.3%)
Earned Premiums in All Other States.......	121,079	104,468	16,611	15.9%
Total Earned Premiums.................	$1,043,652	$ 954,483	$ 89,169	9.3%

*Calculation is not meaningful.

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The $32,742 or 4.0% increase in Massachusetts personal automobile direct premiums written resulted primarily from increases of 5.8% and 7.1% in the number of Massachusetts personal automobile exposures for liability and physical damage coverage, respectively, offset in 2001 by decreases in rates for the coverage types noted below. The components of these changes from the previous year for 2001 and 2000 were as follows:

Coverage Type	2001 Rate Change (1)	2000 Rate Change (1)
Liability:		
Bodily Injury................	(2.1%)	1.0%
Personal Injury Protection....	(12.9%)	6.4%
Property Damage to Others.....	1.0%	20.8%
Physical Damage:		
Collision.....................	(0.1%)	1.7%
Comprehensive.................	(7.6%)	2.4%
Total (2)................	(1.9%)	6.2%

(1) Represents change in the Company's average rate per exposure from the Company's prior year average rate for Massachusetts private passenger automobile premiums.
(2) The total rate change depicted is the result of the weighted average of premiums written for all coverages divided by liability exposures only, due to the fact that all exposures are required to carry liability coverage.

The above percentage changes were primarily the result of rate modifications in the individual coverage components in the 2001 state mandated rates, offset by changes in the Company's safe driver rate deviations. The combination of these factors resulted in a 1.9% decrease in the average personal automobile premium per exposure in 2001. Despite the 2001 state mandated average rate decrease of 8.3%, the smaller Company decrease in the average personal automobile premium per exposure was primarily due to the above noted changes coupled with the fact that the rate decision does not anticipate purchases of new auto-mobiles in the year to which the rate decision applies and the Company's mix of personal automobile business differs from that of the industry. In 2001, the Company offered its customers safe driver deviations of 2.0% to drivers with SDIP classifications of Step 9 and 0.0% for Step 10 (6.0% for Step 9 and 2.0% for Step 10 in 2000).

As shown in the table found on page 12, the AAA affinity group discount for 2001 was established at 6.0%, which was unchanged from 2000. In 2001, for drivers who qualified, the Company's AAA affinity group discount and safe driver deviations could be combined for up to a 7.9% reduction (11.6% in 2000) from state mandated rates.

Other states personal automobile direct premiums written increased $18,824 or 18.2%, however, an overall depressed rate environment resulted in diminished underwriting profits. The Company continues to evaluate a number of its other than Massachusetts state rating structures, has filed for increases in several states and will seek additional rate increases where appropriate. Personal automobile direct premiums written by American Commerce increased $7,319 or 9.4% to $85,124 as compared to $77,805 due primarily to book rollovers of business from existing agents, partially offset by decreases in states where the Company is not actively pursuing writings. Personal automobile direct premiums written from Commerce West increased $11,505 or 44.5% to $37,196 as compared to $25,691. Both companies target preferred insurance risks, however Commerce West's recent growth is attributable to the introduction of a non-standard auto product in late 2000. Both American Commerce and Commerce West write predominantly personal automobile insurance. American Commerce writes personal automobile insurance in 26 states while Commerce West writes personal automobile insurance in the states of California and Oregon. Personal automobile policies for both companies are written primarily for a policy term of six months. Homeowner and other policies in all states are written primarily for a policy term of one year.

Direct premiums written for Massachusetts commercial automobile insurance increased by $14,845 or 34.3%, due primarily to an increase of approximately 9.0% in the number of policies written, combined with a 23.5% increase in the average commercial automobile premium per policy. The increase in premium per policy was attributable to a hardening of the commercial automobile market, primarily in larger commercial accounts. The Company experienced an increase of approximately $3,700 from policies in excess of $50. In addition, rates for other voluntary commercial automobile policies have increased moderately, combined with an approximate 10% increase in rates for policies written through C.A.R. The increased business was attributable to the Company's initiative to expand writings.

Direct premiums written for Massachusetts homeowners insurance increased by $7,592 or 11.6% due primarily to a 6.4% increase in the number of Massachusetts policies written coupled with a 5.0% increase in the average Massachusetts premium per policy. The increase in business was primarily attributable to existing and newly appointed agents. Other states homeowners insurance written by American Commerce increased $2,212 or 13.4% to $18,710 due primarily to book rollovers of business from existing agents.

The $70,056 or 6.9% increase in net premiums written was primarily due to the growth in direct premiums written as described above offset by an increase in premiums ceded to C.A.R. coupled with an increase in premiums ceded to reinsurers other than C.A.R. Net premiums written for homeowners in all other states increased $6,234, with net premiums written of $4,576 in 2001, as compared to ($1,658) in 2000. The reason for negative written premium in 2000 was due to American Commerce joining the quota share reinsurance agreement effective January 1, 2000. An unearned premium transfer of $6,033 occurred effective January 1, 2000, which has a direct impact to net written premium.

The $89,169 or 9.3% increase in earned premiums during 2001, as compared to 2000, was primarily due to increases in written exposures for Massachusetts personal automobile liability and physical damage, coupled with an increase in earned premium per exposure. The increase in earned premium per exposure occurs (versus a decrease in written premium per exposure) because of the time lag in earning the premium once it is written. This resulted in a $61,580 or 8.6% increase for Massachusetts personal automobile earned premium.

Investment Income

Net investment income is affected primarily by the composition of the Company's investment portfolio and yield thereon. The following table summarizes the composition of the Company's investment portfolio, at cost, at December 31, 2001 and 2000 (the Company's investment portfolio, at market and equity is shown in the table on page 25):

Investments, at cost

	December 31,			
	2001	% of Invest.	2000	% of Invest.
GNMA & FNMA mortgage-backed bonds......	$ 98,198	6.7%	$ 67,274	4.7%
Corporate bonds......................	133,506	9.1	130,775	9.1
U.S. Treasury bonds and notes..........	104	-	3,428	0.2
Tax exempt state and municipal bonds...	386,967	26.2	464,404	32.1
Total fixed maturities............	618,775	42.0	665,881	46.1
Preferred stocks......................	256,582	17.4	215,823	14.9
Common stocks.........................	87,704	5.9	87,704	6.1
Closed-end preferred stock mutual funds	294,948	20.0	327,980	22.7
Mortgages and collateral loans (net of allowance for possible loan losses)..	39,505	2.7	51,661	3.6
Cash and cash equivalents.............	148,630	10.1	70,521	4.9
Other investments.....................	28,291	1.9	25,475	1.7
Total investments.................	$1,474,435	100.0%	$1,445,045	100.0%

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The Company's investment strategy is to maximize after-tax investment income through investing in high quality securities coupled with acquiring equity investments, which may forgo current investment yield in favor of potential higher yielding capital appreciation in the future.

As depicted in the following table, 2001 net investment income increased $2,781 or 2.9%, compared to 2000, principally as a result of an increase in average invested assets (at cost), offset by a decrease in yield. The decrease in yield is primarily due to lower short-term yields on larger cash and cash equivalent balances, coupled with an environment of higher yielding fixed maturities being called. The Company continues to monitor interest rates on long-term securities and intends to maintain its high cash position until such time as the Company believes long-term rates have appropriately firmed. Net investment income as a percentage of total average investments was 6.6% in 2001 compared to 6.9% for 2000. Net investment income after tax as a percentage of total average investments was 5.3% and 5.7% for 2001 and 2000, respectively.

Investment Return

	Years Ended December 31,	
	2001	2000
Average month-end investments (at cost)...	$1,506,485	$1,395,159
Net investment income before tax..........	99,611	96,830
Net investment income after-tax...........	79,172	79,547
Net investment income as a percentage of average net investments (at cost)....	6.6%	6.9%
Net investment income after-tax as a percentage of average net investments (at cost)..................	5.3%	5.7%

Premium Finance and Service Fees

Premium finance and service fees increased $2,592 or 17.0% during 2001, as a result of increased premiums as discussed earlier.

Amortization of Excess of Book Value of Subsidiary Interest over Cost

As a result of the acquisition of American Commerce (see "Management's Discussion and Analysis of Financial Condition and Results of Operations - General" and "Notes to Consoli-dated Financial Statements - NOTES A12 and A17"), the amount representing the excess of the fair value of the net assets acquired over the purchase price at January 29, 1999 was $16,947. This amount is being amortized into revenue on a straight-line basis over a five-year period. The amount amortized into revenue in 2001 was $3,389, compared to $3,390 in 2000.

Investment Gains and Losses

Net realized investment losses totaled $10,633 during 2001 as compared to gains of $29,550 in 2000. Of the net realized losses during 2001, $9,071 was a result of the Company's venture capital fund investments. These investments primarily provide seed capital for start-up companies with emerging high technology initiatives in the financial services industry. These investments are made in limited partnerships and the Company's exposure to loss is limited to its actual investment. In 2001, the Company began to account for these investments on an equity basis. The equity in the operating results of these funds has been reflected in realized gains and losses. Prior to this change, the operating results were not material and were therefore reflected in accumulated other comprehensive income and loss.

Also during 2001, the undistributed operating results of closed-end preferred stock mutual funds have been reflected in realized gains and losses. Year-end December 31, 2000 period results previously reflected in investment income, have been reclassified to realized gains and losses to conform with current period presentation. During 2001 and 2000, the Company reflected realized gains of $4,582 and $26,575, respectively, as a result of this change.

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Gross realized gains and losses for the years ended December 31, 2001 and December 31, 2000 were as follows:

	2001		2000	
	Gross Realized Gains	Gross Realized Losses	Gross Realized Gains	Gross Realized Losses
Fixed maturities.........	$ 957	$ (3,773)	$ 223	$ (3,995)
Preferred stocks.........	128	(3,820)	1,748	(462)
Common stocks............	1,526	(923)	4,370	-
Closed-end preferred stock mutual funds*....	5,197	(615)	26,641	(66)
Venture capital fund				

investments............	-	(9,071)	460	-
Other investments........	-	(239)	631	-
Total..............	$ 7,808	$ (18,441)	$ 34,073	$ (4,523)

* Includes $3,215 in 2001 and $9,260 in 2000, respectively, relating to the amortization of the net discount, at the time of purchase, of these securities.

Gross accumulated other comprehensive income and losses at December 31, 2001 and December 31, 2000 were as follows:

	December 31, 2001		December 31, 2000	
	Gross Accumulated Other Comprehensive Income	Gross Accumulated Other Comprehensive Losses	Gross Accumulated Other Comprehensive Income	Gross Accumulated Other Comprehensive Losses
Fixed maturities.........	$ 17,994	$ (10,287)	$ 16,247	$ (12,193)
Preferred stocks.........	6,289	(14,770)	999	(16,739)
Common stocks............	21,590	(1,836)	28,126	(3)
Other investments........	-	-	1,327	-
Total..............	$ 45,873	$ (26,893)	$ 46,699	$ (28,935)

Loss and Loss Adjustment Expenses

Losses and loss adjustment expenses ("LAE") incurred increased $91,386 or 13.3% in 2001. Massachusetts operations experienced declining underwriting results primarily due to increased losses in the homeowners property business and in comprehensive personal automobile, due to more adverse weather conditions compared to last year. The ratio of net incurred losses, excluding LAE, to premiums earned ("pure loss ratio") on Massachusetts personal automobile was 65.4% in 2001 compared to 63.1% in 2000. The commercial automobile pure loss ratio increased to 61.8% in 2001 compared to 59.7% in 2000. This increase was primarily due to higher bodily injury losses and to higher physical damage losses coupled with worse experience in the business assumed from C.A.R. during this period. For Massachusetts homeowners (gross of reinsurance), the pure loss ratio was 47.6% in 2001 compared to 40.0% in 2000. This increase was the result of more claims for Massachusetts homeowner business due to less favorable weather conditions, as compared to last year, primarily during the first six months of 2001. Pure loss ratios of subsidiaries in other states increased to 67.5% in 2001 compared to 62.9% in 2000. The loss ratio (on a statutory basis) for Commerce West and American Commerce was 85.1% and 84.4%, respectively, in 2001, compared to 69.3% and 84.5% respectively, in 2000. The increase in the loss ratio for Commerce West was primarily attributable to a substantial increase in non-standard automobile writings with loss ratios that are significantly higher than their regular business.

Policy Acquisition Costs

Policy acquisition costs expensed increased by $17,613 or 7.2% in 2001. As a per-centage of net premiums written, the Company's statutory underwriting expense ratio for 2001 was 24.4% compared to 25.1% in 2000. The decreased 2001 underwriting expense ratio resulted primarily from a lower provision for accrued contingent commissions, lower insolvency assessments and lower expenses due to the continued effects of certain cost reduction programs. The 2000 underwriting ratio includes a $4,900 charge versus $1,244 in 2001, representing the Company's allocation from the Massachusetts Insurers Insolvency Fund. The underwriting expense ratio (on a statutory basis) for Commerce West was 32.7% for 2001 as compared to 35.8% for 2000. The underwriting expense ratio (on a statutory basis) for American Commerce, was 32.6% for 2001 compared to 29.3% for 2000.

Income Taxes

The Company's effective tax rate was 20.1% and 22.5% for the years ended December 31, 2001 and 2000, respectively. In both years the effective rate was lower than the statutory rate of 35% primarily due to tax-exempt interest income and the corporate dividends received deduction.

Minority Interest in Net Loss of Subsidiary

As a result of the joint venture with AAA SNE and acquisition of American Commerce (see "Management's Discussion and Analysis of Financial Condition and Results of Operations - General" and "Notes to Consolidated Financial Statements - NOTES A13 and A17"), the Company's interest in ACIC Holding Co., Inc., through Commerce, a wholly-owned subsidiary of CHI, is represented by ownership of 80% of the outstanding shares of common stock at December 31, 2001. AAA SNE maintains a 20% common stock ownership. The minority interest of $863 included in the consolidated statement of earnings for 2001 represents 20% of the net loss for ACIC Holding Co., Inc., calculated after the $9,582 preferred stock dividend paid to Commerce, to the extent of the minority interest. This compares to $320 minority interest in net loss of subsidiary after $9,178 in preferred stock dividends paid to Commerce in 2000. During the third quarter of 2001, the net losses of ACIC Holding Co., Inc. exceeded the minority interest balance sheet component.

Net Earnings

Net earnings decreased $38,986 or 29.5% to $93,094 during 2001 as compared to $132,080 in 2000. Operating earnings, which exclude the after-tax impact of net realized investment gains and losses, decreased $10,751 or 9.8% to $98,880 ($2.94 per share basic and $2.93 per share diluted) during 2001 as compared to $109,631 ($3.21 per share basic and diluted) in 2000, as a result of the factors previously mentioned.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Premiums

The following table compares direct premiums, net premiums written and earned premiums for the years ended December 31, 2000 and 1999:

	Years Ended December 31,			
	2000	1999	Change	% Change
Direct Premiums Written:				
Personal Automobile in Massachusetts......	$ 827,180	$731,329	$ 95,851	13.1%
Personal Automobile in All Other States...	103,496	92,297*	11,199	12.1%
Commercial Automobile in Massachusetts....	43,243	36,616	6,627	18.1%
Commercial Automobile in All Other States.	104	-	104	-
Homeowners in Massachusetts..............	65,662	59,981	5,681	9.5%
Homeowners in All Other States...........	16,498	14,378*	2,120	14.7%
Other Lines in Massachusetts.............	14,860	13,027	1,833	14.1%
Other Lines in All Other States..........	606	521*	85	16.3%
Total Direct Premiums Written..........	$1,071,649	$948,149	$123,500	13.0%
Net Premiums Written:				
Personal Automobile in Massachusetts......	$ 839,394	$747,402	$ 91,992	12.3%
Personal Automobile in All Other States...	103,719	91,640*	12,079	13.2%
Commercial Automobile in Massachusetts....	44,848	38,593	6,255	16.2%
Commercial Automobile in All Other States.	104	-	104	-
Homeowners in Massachusetts..............	17,547	16,304	1,243	7.6%
Homeowners in All Other States...........	(1,658)	13,543*	(15,201)	(112.2%)
Other Lines in Massachusetts.............	4,916	4,193	723	17.2%
Other Lines in All Other States..........	41	318*	(277)	(87.1%)
Total Net Premiums Written............	$1,008,911	$911,993	$ 96,918	10.6%
Earned Premiums:				
Personal Automobile in Massachusetts......	$ 714,972	$633,746	$ 81,226	12.8%
Personal Automobile in All Other States...	100,101	91,357*	8,744	9.6%
Commercial Automobile in Massachusetts....	32,548	29,219	3,329	11.4%
Commercial Automobile in All Other States.	19	-	19	-
Homeowners in Massachusetts..............	17,364	16,830	534	3.2%
Homeowners in All Other States...........	4,186	12,032*	(7,846)	(65.2%)
Other Lines in Massachusetts.............	3,434	3,190	244	7.6%)
Other Lines in All Other States..........	162	755*	(593)	(78.5%)
Assumed Premiums from C.A.R..............	81,300	84,356	(3,056)	(3.6%)
Assumed Premiums from Other than C.A.R....	397	345	52	15.1%
Total Earned Premiums.................	$ 954,483	$871,830	$ 82,653	9.5%
Earned Premiums in Massachusetts..........	$ 768,301	$682,985	$ 85,316	12.5%
Earned Premiums-Assumed..................	81,697	84,701	(3,004)	(3.5%)
Earned Premiums in All Other States.......	104,485	104,144*	341	0.3%
Total Earned Premiums.................	$ 954,483	$871,830	$ 82,653	9.5%

*Includes eleven-month results of American Commerce since the January 29, 1999 acquisition.

The $95,851 or 13.1% increase in Massachusetts personal automobile direct premiums written resulted primarily from increases of 6.4% and 8.5% in the number of Massachusetts personal automobile exposures for liability and physical damage coverage, respectively, coupled in 2000 with increases in rates for the coverage types noted below. The components of these changes from the previous year for 2000 and 1999 were as follows:

Coverage Type	2000 Rate Change (1)	1999 Rate Change (1)
Liability:		
Bodily Injury.................	1.0%	(1.9%)
Personal Injury Protection....	6.4%	11.0%
Property Damage to Others.....	20.8%	9.1%
Physical Damage:		
Collision.....................	1.7%	25.2%
Comprehensive.................	2.4%	11.7%
Total (2).................	6.2%	9.1%

(1) Represents change in the Company's average rate per exposure from the Company's prior year average rate charged for Massachusetts private passenger automobile premiums.
(2) The total rate change depicted is the result of the weighted average of premiums written for all coverages divided by liability exposures only, due to the fact that all exposures are required to carry liability coverage.

The above percentage changes were primarily the result of rate modifications in the individual coverage components in the 2000 state mandated average rate increase, combined with changes in the Company's safe driver rate deviations. The combination of these factors resulted in a 6.2% increase in the average personal automobile premium per exposure in 2000. Despite the 2000 state mandated average rate increase of only 0.7%, the Company's increase in the average personal automobile premium per exposure was primarily due to the above noted changes coupled with the fact that the rate decision does not anticipate purchases of new automobiles in the year to which the rate decision applies and the Company's mix of personal automobile business differs from that of the industry. In 2000, the Company offered its customers safe driver deviations of 6.0% to drivers with SDIP classifications of Step 9 and 2.0% for Step 10 (8.0% for Step 9 and 3.0% for Step 10 in 1999).

As shown in the table found on page 12, the AAA affinity group discount for 2000 was established at 6.0%, which was unchanged from 1999. In 2000, for drivers who qualified, the Company's AAA affinity group discount and safe driver deviations could be combined for up to a 11.6% reduction (13.5% in 1999) from state mandated rates.

Direct premiums written for commercial automobile insurance increased by $6,627 or 18.1%, due primarily to an increase of approximately 10.1% in the number of policies written, combined with a 6.9% increase in the average commercial automobile premium per policy. The increased business was attributable to the Company's intention to expand writings coupled with increased business due to the insolvency of Trust Insurance Company ("Trust"), a former Massachusetts insurance company that was placed in receivership in 2000. Direct premiums written for homeowners insurance increased by $7,801 or 10.5% due primarily to a 13.5% increase in the number of Massachusetts policies written offset by a 3.0% decrease in the average Massachusetts premium per policy, coupled with an additional month premium from American Commerce. The increased business was primarily attributable to the previously mentioned Trust insolvency.

The $96,918 or 10.6% increase in net premiums written was due to the growth in direct premiums written as described above, offset by a decrease of premiums assumed from C.A.R. The decrease in premiums assumed from C.A.R. was the result of fewer premiums ceded to C.A.R. by the servicing carriers in 2000 as compared to 1999. Premiums ceded to reinsurers other than C.A.R. increased $22,289 or 40.8% as compared to 1999 as a result of American Commerce joining the quota-share reinsurance program effective January 1, 2000 and increases in Massachusetts homeowners premiums.

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The $82,653 or 9.5% increase in earned premiums during 2000 as compared to 1999 was primarily due to increases to the average rates per exposure for Massachusetts personal automobile liability and physical damage, and the increased business due to the insolvency of Trust mentioned previously. This resulted in an $85,316 or 12.5% increase for Massachusetts earned premiums. The remaining changes were attributable to a $3,004 or 3.5% decrease in earned premiums assumed from C.A.R. offset by $341, or 0.3% increase in earned premiums from all other states, primarily attributable to American Commerce whose year to date 2000 results reflect a full twelve months as compared to eleven months in 1999, offset by the effect of ceded earned premium to the quota share treaty.

Investment Income

Net investment income is affected primarily by the composition of the Company's investment portfolio and yield thereon. The following table summarizes the composition of the Company's investment portfolio, at cost, at December 31, 2000 and 1999:

Investments, at cost	December 31,			
	2000	% of Invest.	1999	% of Invest.
GNMA & FNMA mortgage-backed bonds......	$ 67,274	4.7%	$ 82,349	6.1%
Corporate bonds.......................	130,775	9.1	45,147	3.3
U.S.Treasury bonds and notes...........	3,428	0.2	3,616	0.3
Tax exempt state and municipal bonds...	464,404	32.1	530,333	39.2
Total fixed maturities............	665,881	46.1	661,445	48.9
Preferred stocks......................	215,823	14.9	230,934	17.1
Common stocks.........................	87,704	6.1	83,984	6.2
Closed-end preferred stock mutual funds	327,980	22.7	267,956	19.8
Mortgages and collateral loans (net of				

allowance for possible loan losses)..	51,661	3.6	72,451	5.4
Cash and cash equivalents.............	70,521	4.9	22,535	1.7
Other investments.....................	25,475	1.7	13,130	0.9
Total investments.................	$1,445,045	100.0%	$1,352,435	100.0%

The Company's investment strategy is to maximize after-tax investment income through high quality securities coupled with acquiring equity investments, which may forgo current investment yield in favor of potential higher yielding capital appreciation in the future.

As depicted in the accompanying table, net investment income before taxes increased $7,041 or 7.8%, compared to 1999, principally as a result of an increase in average invested assets (at cost). Net investment income as a percentage of total average investments was 6.9% in 2000, compared to 6.8% in 1999. Net investment income after tax as a percentage of total average investments was 5.6% in 2000 and 6.3% in 1999.

Investment Return	Years Ended December 31, 2000	1999
Average month-end investments (at cost)...	$1,395,159	$1,326,098
Net investment income before tax..........	96,830	89,789
Net investment income after-tax...........	79,547	74,970
Net investment income as a percentage of average net investments (at cost)....	6.9%	6.8%
Net investment income after-tax as a percentage of average net investments (at cost)..................	5.7%	5.7%

Premium Finance and Service Fees

Premium finance and service fees increased $453 or 3.1% during 2000.

Amortization of Excess of Book Value of Subsidiary Interest over Cost

As a result of the acquisition of American Commerce (see "Management's Discussion and Analysis of Financial Condition and Results of Operations - General" and "Notes to Consolidated Financial Statements - NOTES A12 and A17"), the amount representing the excess of the fair value of the net assets acquired over the purchase price at January 29, 1999 was $16,947. The amount is being amortized into revenues on a straight-line basis over a five-year period. The amount amortized into revenues in 2000 was $3,390, compared to $3,019 in 1999.

Investment Gains and Losses

During the fourth quarter of 2000, the Company changed its policy in regard to its investments in certain closed-end preferred stock mutual funds. On a forward going basis, the Company intends to take a proactive posture to affect the overall investment performance of these funds. The Company's ownership position of these various funds at December 31, 2000 range from 23% to 48% of outstanding shares. The level of ownership and new investment policy requires the company to account for these investments on an equity basis. The equity method requires that the investments are to be valued at original cost plus the cumulative equity in the earnings and losses of the funds and adjusted over time by the premium or discount at the time of purchase to the applicable underlying net asset value of the funds. Prior to the policy change, the Company reported the income on a cash basis, valued the investments at quoted market prices and recorded the change in quoted market prices through comprehensive income. The results of prior accounting periods impacted by this change have been restated.

During 2001, the undistributed operating results of closed-end preferred stock mutual funds have been reflected in realized gains and losses. Year-end December 31, 2000 period results previously reflected in investment income, have been reclassified to realized gains and losses to conform with current period presentation. During 2000 the Company reflected a realized gain of $26,575 versus a loss in 1999 of $22,401, as a result of this change.

Gross realized gains and losses for the years ended December 31, 2000 and December 31, 1999 were as follows:

	2000		1999	
	Gross Realized Gains	Gross Realized Losses	Gross Realized Gains	Gross Realized Losses
Fixed maturities....................	$ 223	$ (3,995)	$ 458	$ (6,449)
Preferred stocks....................	1,748	(462)	207	(451)
Closed-end preferred stock mutual funds............................	26,641	(66)	1,900	(24,301)
Common stocks.......................	4,370	-	16,080	(5,057)
Venture capital fund investments....	460	-	888	-
Other investments...................	631	-	347	-
Total.........................	$ 34,073	$ (4,523)	$ 19,880	$(36,258)

Gross accumulated other comprehensive income and losses for December 31, 2000 and December 31, 1999 were as follows:

	December 31, 2000		December 31, 1999	
	Gross Accumulated Other Comprehensive Income	Gross Accumulated Other Comprehensive Losses	Gross Accumulated Other Comprehensive Income	Gross Accumulated Other Comprehensive Losses
Fixed maturities..........	$ 16,247	$ (12,193)	$ 5,221	$ (19,328)
Preferred stocks..........	999	(16,739)	782	(20,667)
Common stocks.............	28,126	(3)	1,305	(7,941)
Other investments.........	1,327	-	1,009	-

Total....................	$ 46,699	$ (28,935)	$ 8,317	$ (47,936)

The accumulated other comprehensive income on fixed maturities increased significantly as a result of the favorable performance in the bond market due to lower interest rates in 2000. Long-term interest rates (30-year Treasury Bond) decreased to 5.46% at December 31, 2000 from 6.48% at December 31, 1999.

Loss and Loss Adjustment Expenses

Losses and loss adjustment expenses ("LAE") incurred increased $61,067 or 9.8% in 2000. As a percentage of premiums earned, losses and LAE incurred for 2000 was 71.7% compared to 72.0% in 1999. The Company experienced higher assumed residual market losses during 2000, which were offset by improved voluntary loss ratios in Massachusetts. Additionally in 2000, the loss ratio was adversely impacted by approximately $8,000 of expense (0.8% of the loss ratio) attributable to the Trust insolvency. Also included in the 2000 increase in incurred expense is approximately $6,300 in higher corporate expenses which are allocated to losses and LAE for book value appreciation rights, director retirement compensation and state income taxes on non-insurance subsidiaries. The ratio of net incurred losses, excluding LAE, to premiums earned ("pure loss ratio") on personal automobile was 63.2% in 2000 compared to 65.1% in 1999. The decrease to the personal automobile pure loss ratio was primarily due to an increase in redundancies arising from prior accident years, and decreases in the cost of adjusting losses. The commercial automobile pure loss ratio decreased to 59.7% in 2000 compared to 60.3% in 1999. For homeowners, the pure loss ratio was 40.0% in 2000 compared to 35.9% in 1999. The increase was primarily due to fewer liability redundancies in 2000 compared to 1999. The loss ratio (on a statutory basis) for Commerce West was 69.3% for 2000 as compared to 71.2% in 1999. The loss ratio (on a statutory basis) for American Commerce was 84.5% for 2000 as compared to its eleven-month loss ratio of 75.8% in 1999.

Policy Acquisition Costs

Policy acquisition costs expensed increased by $9,597 or 4.1% in 2000. As a percentage of net premiums written, the Company's statutory underwriting expense ratio for 2000 was 25.1% compared to 26.5% in 1999. The decreased 2000 underwriting expense ratio resulted primarily from lower Massachusetts direct automobile commissions associated with a decrease in the state mandated minimum commissions, a lower provision for accrued contingent commissions, and lower expenses due to the continued effects of certain cost reduction programs, partially offset by the Trust insolvency assessment. The 2000 underwriting ratio includes a $4,900 charge (0.5% of the underwriting expense ratio) representing the Company's allocation from the Massachusetts Insurers Insolvency Fund for this insolvency. Also included in the 2000 increase in policy acquisition costs expensed is approximately $5,800 in higher corporate expenses which are allocated to policy acquisition costs for book value appreciation rights, director retirement compensation and state income taxes on non-insurance subsidiaries. The underwriting expense ratio (on a statutory basis) for Commerce West was 35.8% for 2000 as compared to 40.9% for 1999. The underwriting expense ratio (on a statutory basis) for American Commerce, was 29.3% for 2000 compared to its eleven-month expense ratio of 31.4% for 1999.

Income Taxes

The Company's effective tax rate was 22.5% and 16.0% for the years ended December 31, 2000 and 1999, respectively. In both years the effective rate was lower than the statutory rate of 35% primarily due to tax-exempt interest income and the corporate dividends received deduction. The higher effective tax rate for 2000 was the result of both the tax-exempt interest and the dividends received deduction comprising a lesser portion of earnings before taxes.

Minority Interest in Net Loss of Subsidiary

As a result of the joint venture with AAA SNE and acquisition of American Commerce (see "Management's Discussion and Analysis of Financial Condition and Results of Operations - General" and "Notes to Consolidated Financial Statements - NOTES A13 and A17"), the Company's interest in ACIC Holding Co., Inc., through Commerce, a wholly-owned subsidiary of CHI, is represented by ownership of 80% of the outstanding shares of common stock at December 31, 2000. AAA SNE maintains a 20% common stock ownership. The minority interest in net loss of subsidiary of $320 included in the consolidated statement of earnings for 2000 represents 20% of the net loss for ACIC Holding Co., Inc. calculated after the $9,178 preferred stock dividend paid to Commerce. This compares to $1,059 minority interest in net loss of subsidiary after $8,300 in preferred stock dividends paid to Commerce in 1999.

Net Earnings

Net earnings increased $43,404 or 48.9% to $132,080 during 2000 as compared to $88,676 in 1999. The net earnings for 2000 were increased by $20,514, or $0.60 per share and decreased $14,020 or $0.40 per share in 1999 as a result of the Company's change in its policy in regard to its investment in closed-end preferred stock mutual funds mentioned previously. Operating earnings, which exclude the after-tax impact of net realized investment gains, increased $12,220 or 12.5% to $109,631 ($3.21 per share basic and diluted) during 2000 as compared to $97,411 ($2.79 per share basic and diluted) in 1999, as a result of the factors previously mentioned.

Liquidity and Capital Resources

The focus of the discussion of liquidity and capital resources is on the Consolidated Balance Sheets on page 35 and the Consolidated Statements of Cash Flows on pages 38 and 39. Stockholders' equity increased by $30,393, or 3.9%, in 2001 as compared to 2000. The increase resulted from $93,094 in net earnings, and by net increases in other comprehensive income, net of income tax benefits, on fixed maturities and preferred and common stocks of $561, offset by dividends paid to stockholders of $39,951 and Treasury Stock purchased of $23,311. Total assets at December 31, 2001 increased $64,468, or 3.1% to $2,140,082 as compared to total assets of $2,075,614 at December 31, 2000. Invested assets, at market value and equity, increased $25,639 or 1.7%. Premiums receivable increased $15,641 or 6.8%. The increase in premiums receivable from December 31, 2000, was primarily attributable to increases in Massachusetts automobile business. Deferred policy acquisition costs increased $5,252 or 4.7%. Receivable from reinsurers increased $8,896 or 14.5%, primarily attributable to the increase in other than automobile business previously discussed. The deferred income tax asset increased $4,952, mainly as a result of accounting for certain investments on an equity basis. All other remaining assets increased $4,088 or 2.2%.

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The Company's investment portfolio, at market and equity, is shown on the following table as of December 31, 2001 and 2000 (for investments, at cost, refer to the table found on page 15):

Investments, at market and equity	December 31, 2001	% of Invest.	2000	% of Invest.
GNMA & FNMA mortgage-backed bonds......	$ 98,985	6.6%	$ 67,261	4.6%
Corporate bonds.......................	136,506	9.1	126,255	8.6
U.S.Treasury bonds and notes...........	105	-	3,377	0.2
Tax exempt state and municipal bonds...	390,886	26.1	473,042	32.1
Total fixed maturities............	626,482	41.8	669,935	45.5
Preferred stocks......................	248,101	16.6	200,083	13.6
Common stocks.........................	107,458	7.2	115,827	7.9
Closed-end preferred stock mutual funds at equity..............	309,282	20.6	337,733	22.9
Mortgages and collateral loans (net of allowance for possible loan losses)..	39,505	2.6	51,661	3.5
Cash and cash equivalents.............	148,630	9.9	70,521	4.8
Other investments.....................	18,743	1.3	26,802	1.8
Total investments.................	$1,498,201	100.0%	$1,472,562	100.0%

Comparison of Cost/Market Value of Fixed Maturities for the years ended December 31,

2001

	Market	Cost	Difference	% of Total Based on Cost
GNMA & FNMA mortgage-backed bonds.....	$ 98,985	$ 98,198	$ 787	15.9%
Corporate bonds......................	136,506	133,506	3,000	21.6%
U.S. Treasury bonds and notes.........	105	104	1	0.0%
Tax exempt state and municipal bonds..	390,886	386,967	3,919	62.5%
Total fixed maturities.............	$ 626,482	$ 618,775	$ 7,707	100.0%

2000

	Market	Cost	Difference	% of Total Based on Cost
GNMA & FNMA mortgage-backed bonds.....	$ 67,261	$ 67,274	$ (13)	10.0%
Corporate bonds......................	126,255	130,775	(4,520)	20.0%
U.S. Treasury bonds and notes.........	3,377	3,428	(51)	1.0%
Tax exempt state and municipal bonds..	473,042	464,404	8,638	70.0%
Total fixed maturities.............	$ 669,935	$ 665,881	$ 4,054	100.0%

Of the Company's bonds, 97.9% are rated in either of the two highest quality categories provided by the NAIC.

Comparison of Carrying Value for the years ended December 31,

	2001 Market/Equity Value	2000 Market/Equity Value	Variance	% of Variance
Fixed maturities......................	$ 626,482	$ 669,935	$ (43,453)	(6.5%)
Preferred stocks......................	248,101	200,083	48,018	24.0%
Common stocks.........................	107,458	115,827	(8,369)	(7.2%)
Closed-end preferred stock mutual funds at equity.............	309,282	337,733	(28,451)	(8.4%)
Mortgages and collateral loans (net of allowance for possible loan losses)......................	39,505	51,661	(12,156)	(23.5%)
Cash and cash equivalents.............	148,630	70,521	78,109	110.8%
Other investments.....................	18,743	26,802	(8,059)	(30.1%)
Total investments..................	$1,498,201	$1,472,562	$ 25,639	1.7%

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Preferred stocks increased $48,018, or 24.0% and common stocks decreased $8,369, or 7.2%, during 2001. Preferred stock mutual funds at equity, decreased $28,541 or 8.4% in 2001 compared to 2000. The majority of the increase in preferred stocks and the corresponding decrease in preferred stock mutual funds was primarily the result of a newly created trust fund. In 2001, the trustees of Putnam Dividend Income Fund ("PDI") liquidated the fund. The Company's pro-rata share of the portfolio securities and cash of PDI was transferred to a new fund created by the PDI trustees whose ownership was conveyed to the Company. At December 31, 2001 the fund was consolidated into the Company's financial statements, totaling $60,869. The majority of the fund represents investments valued at $59,019 and is included in preferred stocks and $1,332 in cash and cash equivalents. Other investments at equity, comprised of venture capital fund investments, decreased $8,059 or 30.1% during 2001 as a result of equity accounting changes mentioned previously. The Company's strategy continues to focus on maximizing after-tax investment income through investing in high quality securities coupled with acquiring equity investments, which may forgo current investment yield in favor of potential higher yielding capital appreciation in the future. The Company continues to monitor interest rates on long-term securities and intends to maintain its high cash position until such time as the Company believes the long-term rates have appropriately firmed.

The Company's liabilities increased $35,143 or 2.7% to $1,327,808 at December 31, 2001 as compared to $1,292,665 at December 31, 2000. Loss and loss adjustment expense reserves comprised 51.3% of the Company's liabilities at December 31, 2001 compared with 52.2% at December 31, 2000. Unearned premiums comprised 42.4% of the Company's liabilities at December 31, 2001 compared with 40.2% at December 31, 2000. All other liabilities comprised 6.3% of the Company's liabilities at December 31, 2001, compared with 7.6% at December 31, 2000. Loss and loss adjustment expense reserves increased $7,484 or 1.1%. Unearned premiums increased $43,571 or 8.4%, due primarily to increased business in 2001. Current income taxes decreased $13,988 or 80.4%. The net effect of all other liabilities decreased $4,659 or 5.5%.

Liabilities for unpaid losses and loss adjustment expenses at December 31, 2001 and 2000 consist of:

	2001	2000
Net voluntary unpaid loss and LAE reserves................	$558,635	$544,585
Voluntary salvage and subrogation recoverable.............	(73,393)	(65,505)
Assumed unpaid loss and LAE reserves from C.A.R...........	125,787	127,631
Assumed salvage and subrogation recoverable from C.A.R....	(20,695)	(20,844)
Total voluntary and assumed unpaid loss and LAE reserves	590,334	585,867
Adjustment for ceded unpaid loss and LAE reserves.........	100,290	97,273
Adjustment for ceded salvage and subrogation recoverable..	(9,000)	(9,000)
Total unpaid loss and LAE reserves......................	$681,624	$674,140

The primary sources of the Company's liquidity are funds generated from insurance premiums, net investment income, premium finance and service fees and the maturing and sale of investments as reflected in the Consolidated Statements of Cash Flows on pages 38 and 39. The discussion of these items can be found under "Year Ended December 31, 2001 Compared to Year Ended December 31, 2000", herein.

The Company's operating activities provided cash of $106,172 in 2001, as compared to $147,906 in 2000, representing a decrease of $41,734 or 28.2% in 2000. The primary reason for this decrease is that the increase in premiums collected was outpaced by the increase in losses and LAE paid. Federal income tax payments increased $10,439 or 35.7% in 2001. Of the $39,703 in federal tax payments in 2001, $13,985 related to 2000, due to significant income in the fourth quarter of 2000. Net investment income received and premium and service fees received increased 8.9% and 17.0%, respectively.

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For 2001 net cash flows from investing activities provided cash of $35,199, as compared to net cash flows used in investing activities of $45,226 in 2000. The majority of the $80,425 difference was a $54,142 decrease in purchases of fixed maturities, a $38,824 decrease in the purchase of preferred stock mutual funds, a $5,164 increase from proceeds from sale of equity securities, a $3,811 decrease in purchases of other assets, and a $4,974 increase in proceeds from maturity of fixed maturities. These were offset by a $12,787 increase in the purchase of equity securities coupled with a $6,790 increase in the purchase of property and equipment. Investing activities were funded by accumulated cash and cash provided by operating activities in 2001 and 2000. The decreased purchases of longer term investments coupled with the significant increase in cash and cash equivalents were primarily the result of the low interest rate environment in 2001.

During 2001, Commerce purchased a 160,000 square foot building. Costs for this building including the land and improvements to date at December 31, 2001, are $4,932. The Company anticipates expending an additional $13 million renovating this building, primarily in 2002.

Cash flows used in financing activities totaled $63,262 during 2001 compared to $54,694 during 2000. The 2001 cash flows used in financing activities consisted of $39,951 in dividends paid to stockholders and $23,311 used to purchase 622,900 shares of Treasury Stock. The 2000 cash flows used in financing activities consisted of $39,201 in dividends paid to stockholders and $15,493 used to purchase 606,200 shares of Treasury Stock.

The Company's funds are generally invested in securities with maturities intended to provide adequate funds to pay claims without the forced sale of investments. The carrying value (at market and equity) of total investments at December 31, 2001 was $1,498,201. At December 31, 2001, the Company held cash and cash equivalents of $148,630. These funds provide sufficient liquidity for the payment of claims and other short-term cash needs. The Company continues to monitor interest rates on long-term securities and intends to maintain its high cash position until such time as the Company believes long-term rates have appropriately firmed. The Company also relies upon dividends from its subsidiaries for its cash requirements. Every Massachusetts insurance company seeking to make any dividend or other distributions to its stockholders may, within certain limitations, pay such dividends and then file a report with the Commissioner. Dividends in excess of these limitations are called extraordinary dividends. An extraordinary dividend is any dividend or other property, whose fair value together with other dividends or distributions made within the preceding twelve months exceeds the greater of ten percent of the insurer's surplus as regards to policyholders as of the end of the preceding year, or the net income of a non-life insurance company for the preceding year. No pro-rata distribution of any class of the insurer's own securities is to be included. No Massachusetts insurance company shall pay an extraordinary dividend or other extraordinary distribution until thirty days after the Commissioner has received notice of the intended distribution and has not objected. No extraordinary dividends were paid in 2001, 2000 or 1999. Similar laws exist in California and Ohio. No extraordinary dividend was paid by American Commerce in 2001 or 2000 and no dividends were paid by Commerce West since its acquisition.

Periodically, sales have been made from the Company's fixed maturity investment port-folio to actively manage portfolio risks, including credit-related concerns, to optimize tax planning and to realize gains. This practice will continue in the future.

Industry and regulatory guidelines suggest that the ratio of a property and casualty insurer's annual net premiums written to statutory policyholders' surplus should not exceed 3.00 to 1.00. The Company's statutory premiums to surplus ratio was 1.51 to 1.00, 1.53 to 1.00, and 1.76 to 1.00 for the years ended December 31, 2001, 2000 and 1999, respectively.

In early 1999, Commerce, invested $90,800 in the joint venture (ACIC Holding Co., Inc.) to fund the American Commerce acquisition and to capitalize the joint venture that is owned together with AAA SNE. Of this $90,800, Commerce invested $90,000 in the form of preferred stock and an additional $800 representing its 80% common stock ownership. The terms of the preferred stock call for quarterly cash dividends at the rate of 10% per annum. In the event cash dividends cannot be paid, additional preferred stock will be issued. AAA SNE invested $200 representing its 20% common stock ownership. Commerce consolidates ACIC Holding Co., Inc. and its wholly-owned subsidiary, American Commerce, for financial reporting and tax purposes. Since 1995, Commerce has maintained an affinity group marketing relationship with AAA Insurance Agency, Inc., a subsidiary of AAA SNE. AAA Insurance Agency, Inc. has been an agent of Commerce since 1985.

In addition to the real estate commitment mentioned earlier, Commerce has commitments in two venture capital fund investments. These investments are made in limited partnerships and the Company's exposure to loss is limited to its actual investment.

In 2000, Commerce entered into a Limited Partnership Agreement with Conning Partners VI, L.P., a Delaware Limited Partnership. This partnership agreement required a commitment by the Company to invest up to $50,000 into the partnership. To date the Company has invested $15,091 into the partnership leaving a balance for funds still committed but not paid into the partnership of $34,909. The partnership was formed to operate as an investment fund principally for the purpose of making investments primarily in equity, equity-related and other securities issued in expansion financing, start-ups, buy-outs and recapitalization transactions relating to companies in the areas of insurance, financial services, e-commerce, healthcare, and related businesses, including, without limitation, service and technology enterprises supporting such businesses, in order to realize long-term capital returns, all as determined and managed by the General Partner for the benefit of the Partners.

Also in 2000, Commerce entered into a Limited Partnership Agreement with Distribution Partners Investment Capital, L.P. a Delaware Limited Partnership. This partnership agreement required a commitment by the Company to invest up to $3,500 into the partnership. To date the Company has invested $2,258 into the partnership leaving a balance of $1,242 for funds still committed. The partnership was formed to operate as an investment fund principally for the purpose of making investments primarily in equity and equity-related securities of companies operating in the area of insurance distribution and distribution related activities, all as determined and managed by the General Partner for the benefit of the Partners.

Market Risk: Interest Rate Sensitivity and Equity Price Risk

The Company's investment strategy emphasizes investment yield while maintaining investment quality. The Company's investment objective continues to focus on maximizing after-tax investment income through investing in high quality diversified investments structured to maximize after-tax investment income while minimizing risk. The Company's funds are generally invested in securities with maturities intended to provide adequate funds to pay claims and meet other operating needs without the forced sale of investments. Periodically, sales have been made from the Company's fixed maturity portfolio to actively manage portfolio risks, including credit-related concerns, to optimize tax planning and to realize gains. This practice will continue in the future.

In conducting investing activities, the Company is subject to, and assumes, market risk. Market risk is the risk of an adverse financial impact from changes in interest rates and market prices. The level of risk assumed by the Company is a function of the Company's overall objectives, liquidity needs and market volatility.

The Company manages its market risk by focusing on higher quality equity and fixed income investments, by periodically monitoring the credit strength of companies in which investments are made, by limiting exposure in any one investment and by monitoring the quality of the investment portfolio by taking into account credit ratings assigned by recognized rating organizations. Although the Company has significant holdings of various closed-end preferred stock mutual funds, these funds are comprised primarily of preferred stocks traded on national stock exchanges, thus limiting exposure to any one investment.

As part of its investing activities, the Company assumes positions in fixed maturity, equity, short-term and cash equivalents markets. The Company is, therefore, exposed to the impacts of interest rate changes in the market value of investments. At December 31, 2001, the Company's exposure to interest rate changes and equity price risk has been estimated using sensitivity analysis. The interest rate impact is defined as the effect of a hypothetical interest rate change of plus-or-minus 200 basis points on the market value of fixed maturities and preferred stocks. The equity price risk is defined as a hypothetical change of plus-or-minus 10% in the fair value of common stocks. Changes in interest rates would result in unrealized gains or losses in the market value of the fixed maturity and preferred stock portfolio due to differences between current market rates and the stated rates for these investments. Based on the results of the sensitivity analysis at December 31, 2001, the Company's estimated market exposure for a 200 basis point increase (decrease) in interest rates was calculated. A 200 basis point increase results in an $83,611 decrease in the market value of the fixed maturities and preferred stocks. A 200 basis point decrease results in a $47,436 increase in the market value of the same securities. The equity price risk impact at December 31, 2001, based upon a 10% increase in the fair value of common stocks and preferred stock mutual funds, would be an increase of $10,746 and $31,567, respectively. Based upon a 10% decrease, common stocks and preferred stock mutual funds would decrease $10,746 and $31,567, respectively. Long-term interest rates (30-year Treasury Bond) increased slightly to 5.47% at December 31, 2001 from 5.46% at December 31, 2000. The preceding sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions such as the nature and timing of interest rate levels including the yield curve shape, prepayments on loans and securities, reinvestment and replacement of asset and liability cash flows and others. While assumptions are developed based upon current economic conditions, the Company cannot provide any assurance as to the predictive nature of these assumptions. Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will also differ due to prepayment and refinancing levels likely deviating from those assumed and other internal and external variables. Furthermore, the sensitivity analysis does not reflect actions that management might take in responding to or anticipating changes in interest rates.

Recent Accounting Developments

The NAIC revised the Accounting Practices and Procedures Manual in a process referred to as Codification. The revised manual became effective January 1, 2001 for all insurance companies. The domiciliary states of the Company's insurance subsidiaries have adopted the provisions of the revised manual. The revised manual has changed certain prescribed statutory accounting practices and has resulted in changes to the accounting practices that the Company's insurance subsidiaries use to prepare their statutory-basis financial statements. The impact of these changes to the Company's insurance subsidiaries statutory-basis capital and surplus as of January 1, 2001 had a significant beneficial effect of approximately $38,737 primarily due to the inclusion of deferred taxes as an admitted asset. The codification changes had no impact on the Company's GAAP financial statements.

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Certain Derivative Instruments and Hedging Activities", as amended in June 2000 by Statement of Financial Accounting Standards No. 138 ("SFAS 138"), "Accounting for Certain Derivative Instruments and Certain Hedging Activities", which requires companies to recognize all derivatives as either assets or liabilities in the balance sheet and measure such instruments at fair value. SFAS 138 also amended Statement of Financial Accounting Standards No. 137 ("SFAS 137"), "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133". The provisions of SFAS 133 require adoption for fiscal year beginning after June 15, 2000. The Company had no derivative or hedging activity in 2001, 2000, or 1999. The adoption of these FASBs had no material impact on the Company's consolidated financial statements.

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140 ("SFAS 140"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", which replaced Statement of Financial Accounting Standards No. 125 ("SFAS 125"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". The Statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a "financial components" approach that focuses on control. Under that approach, after a transfer of financial assets, a company recognizes the financial and servicing assets it controls and the liabilities it has

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incurred, does not recognize financial assets when control has been surrendered, and does not recognize liabilities when extinguished. The Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. The Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Adoption of SFAS 140 did not have a material impact on the Company's consolidated financial statements.

In July 2001, the FASB issued Statements of Financial Accounting Standards No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141, effective for business combinations initiated after June 30, 2001, requires that all business combinations be accounted for under a single method - the purchase method. Use of the pooling-of-interests method is no longer permitted. SFAS No. 141 also clarifies the criteria to recognize intangible assets separately from goodwill. SFAS No. 142 requires that goodwill and intangible assets deemed to have indefinite lives no longer be amortized to earnings, but instead be reviewed at least annually for impairment. Other intangible assets will continue to be amortized over their useful lives. SFAS No. 142 will be effective January 1, 2002.

The Company has evaluated the impact of adopting the provisions of SFAS No. 142 on earnings and financial position for the year ended December 31, 2002. Effective January 1, 2002, in accordance with SFAS No. 142, the Company will cease amortizing the balance sheet item "excess of book value of subsidiary interest over cost" which is $5.7 million at year end 2001. The 2001 impact of the amortization of this resulted in approximately $0.10

per share of annual operating earnings. Additionally, the Company will no longer amortize the negative goodwill resulting from the purchase of preferred stock mutual funds effective January 1, 2002. The amount of unamortized negative goodwill at year-end is $6.4 million. The 2001 impact of the amortization of this was $0.10 per share of earnings classified as capital gains. Both the excess of book value of subsidiary interest over cost and the negative goodwill on preferred stock mutual funds will be recognized as income in the first quarter of 2002 and classified as an extraordinary item. The estimated per share income impact of this change is $0.34 per share.

Critical Accounting Policies

The preparation of 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 could differ from those estimates. The following accounting policies, which are derived based on management's judgments and estimates, are considered critical to the preparation of the Company's financial statements.

1. Investments

The focus of management's judgments and estimates relating to investments involves the potential impairment of investments for other than temporary declines in market values. The carrying value of investments in fixed maturities, which include taxable and non-taxable bonds, and investments in common and preferred stocks, are derived from market prices supplied by the Company's investment custodian. Unrealized investment gains and losses on common and preferred stocks and fixed maturities, to the extent that there is no other than temporary impairment of value, are credited or charged to a separate component of stockholders' equity, known as "net accumulated other comprehensive income (loss)", until realized, net of any tax effect. An impairment in an investment is deemed to be other than temporary, when a security's market value has diminished to less than 75% of cost for two consecutive quarters. If the security is deemed impaired the Company adjusts the securities cost to market value through realized loss based on publicly available prices or, in the absence of such, to a value based on cash flow modeling. During 2001, the Company wrote down $2,665 in bonds and preferred stock investments with impairment as determined by management to be other than temporary. Given the makeup and quality of the Company's investments, management does not believe that a more stringent policy would have a material effect on the carrying value of its investments.

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2. Unpaid Loss and Loss Adjustment Expenses ("LAE")

Unpaid Loss and LAE by their nature are inherently uncertain as to the ultimate outcome of the estimated amounts. The liability for unpaid losses and LAE represents Management's best estimate of the ultimate net cost of all losses and LAE incurred through the balance sheet date. The estimate for ultimate net cost of all losses incurred through the balance sheet date includes the adjusted case estimates for losses, incurred but not reported ("IBNR") losses, salvage and subrogation recoverable and a reserve for LAE.

In arriving at its best estimate, management begins with the aggregate of individual case reserves and then makes adjustments to these amounts on a line of business basis. These adjustments to the aggregate case reserves by line of business are made based on analysis performed by Management as further described below. The entire liability for unpaid losses and LAE is also reviewed quarterly and annually by the Company's Actuarial Department. Liability estimates are continually analyzed and updated, and therefore, the ultimate liability may be more or less than the current estimate. The effects of changes in the estimates are included in the results of operations in the period in which the estimates are revised.

The claim cycle begins when a claim is reported to the Company and claims personnel establish a "case reserve" for the estimated amount of the ultimate exposure to the Company. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding the claim and the policy provisions relating to the loss. This estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims personnel adjusting the claim. During the loss adjustment period, these case basis estimates are revised as deemed necessary by the Company's claims department personnel based on subsequent developments and periodic reviews of the claim.

In accordance with industry practice, the Company also maintains reserves for estimated IBNR, salvage and subrogation recoverable and LAE. These reserves are determined on the basis of historical information and the experience of the Company. Adjustments to these reserves are made periodically to take into account changes in the volume of business written, claims frequency and severity, the mix of business, claims processing and other items that can be expected to affect the Company's liability for losses and LAE over time.

When reviewing the liability for unpaid losses and LAE, the Company analyzes historical data and estimates the impact of various factors such as: (i) payment trends; (ii) loss expense per exposure; (iii) the historical loss experience of the Company and industry; (iv) frequency and severity trends; and, (v) legislative enactments, judicial decisions, legal developments in the imposition of damages, changes and trends in general economic conditions, including the effects of inflation and recession. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method, however, for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

By using individual estimates of reported claims adjusted for managements best estimate by line of business and generally accepted actuarial reserving techniques, the Company estimates the ultimate net liability for losses and LAE. After taking into account all relevant factors, management believes that, based on existing information, the provision for losses and LAE at December 31, 2001 is adequate to cover the ultimate net cost of losses and claims incurred as of that date. The ultimate liability, however, may be greater or lower than established reserves. If the ultimate exposure is greater than (or less than) management's estimated liability for losses and LAE, based on any of the factors noted previously, the Company will incur additional expense (income) which may have a material impact.

Forward - Looking Statements

This annual report contains some statements that are not historical facts and are considered "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve opinions, assumptions and predictions, and no assurance can be given that the future results will be achieved since events or results may differ materially as a result of risks facing the Company. These include, but are not limited to, those risks and uncertainties in our business, some of which are beyond the control of the Company, that are described in the Company's Forms 10-K and 10-Q, Schedules 13D and 13G, and other documents filed with the SEC, including the

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possibility of adverse catastrophe experience and severe weather, adverse trends in claim severity or frequency, adverse state and federal regulation and legislation, adverse state judicial decisions, litigation risks, interest rate risk, rate making decisions for private passenger automobile policies in Massachusetts, potential rate filings outside of Massachusetts, adverse impacts related to consolidation activities, heightened competition, as well as the economic, market or regulatory conditions and risks associated with entry into new markets and diversification.

Effects of Inflation and Recession

The Company generally is unable to recover the costs of inflation in its personal automobile insurance line since the premiums it charges are subject to state regulation. Additionally, the premium rates charged by the Company for personal automobile insurance are adjusted by the Commissioner only at annual intervals. Such annual adjustments in premium rates may lag behind related cost increases. Economic recessions can have an impact upon the Company, primarily through the policyholder's election to decrease non-compulsory coverages afforded by the policy and increased driving, each of which tends to decrease claims.

To the extent inflation and economic recession influence yields on investments, the Company is also affected. As each of these environments affect current market rates of return, previously committed investments may rise or decline in value depending on the type and maturity of investment.

Inflation and recession must also be considered by the Company in the creation and review of loss and LAE reserves since portions of these reserves are expected to be paid over extended periods of time. The anticipated effect of economic conditions is implicitly considered when estimating liabilities for losses and LAE. The importance of continually adjusting reserves is even more pronounced in periods of changing economic circumstances.

COMMON STOCK PRICE AND DIVIDEND INFORMATION

The Company's common stock trades on the NYSE under the symbol "CGI". The high, low and close prices for shares, as quoted in The Boston Globe, of the Company's Common Stock for 2001 and 2000 were as follows:

	2001			2000		
	High	Low	Close	High	Low	Close
First Quarter......	$32.1000	$24.5500	$32.0000	$31.0000	$23.0000	$29.5000
Second Quarter.....	36.9900	30.7500	36.7900	30.8750	26.1250	29.5000
Third Quarter......	38.3500	33.5500	38.0000	29.4375	25.0625	28.9375
Fourth Quarter.....	40.3500	35.8000	37.6900	29.2500	22.8750	27.1800

As of March 1, 2002, there were 1,053 stockholders of record of the Company's Common Stock, not including stock held in "Street Name" or held in accounts for participants of the Company's Employee Stock Ownership Plan ("E.S.O.P.").

The Board of Directors of the Company voted to declare four quarterly dividends to stockholders of record totaling $1.19 per share and $1.15 per share in 2001 and 2000, respectively. On May 19, 2001, the Board voted to increase the quarterly stockholder dividend from $0.29 to $0.30 per share to stockholders of record as of June 4, 2001. Prior to that declaration, the Company had paid quarterly dividends of $0.29 per share dating back to May 15, 2000 when the Board voted to increase the dividend from $0.28 to $0.29 per share.

In May 1999, the Board of Directors of the Company authorized a stock buy-back program of up to 2,000,000 shares of common stock of the Company. At December 31, 2001, there are 273,700 shares of common stock authorized to be purchased under this program. In November 2001, the Board of Directors approved another stock buy-back program authorizing the purchase of up to an additional 2,000,000 shares. During the period from January 1, 2001 through December 31, 2001, the Company purchased 622,900 shares of its own common stock. During 2000, the Company purchased 606,200 shares of its own common stock under the May 1999 buy-back program. At December 31, 2001, the Company had authority to purchase a total of 2,273,700 additional shares of its common stock under the May 1999 and November 2001 buy-back programs. As of December 31, 2001, the Company holds a total of 4,869,548 shares of treasury stock.

REPORT OF MANAGEMENT

The management of the Company is responsible for the consolidated financial statements and all other information presented in this Annual Report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States determined by management to be appropriate in the circumstances and include amounts based on management's informed estimates and judgments. Financial information presented elsewhere in this Annual Report is consistent with the financial statements. The appropriateness of data underlying such financial information is monitored through internal accounting controls, an internal audit department, independent auditors and the Board of Directors through its audit committee.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance to management and the Board of Directors that assets are safeguarded and that transactions are executed in accordance with management's authorization and recorded properly. The system of internal accounting controls is supported by the selection and training of qualified personnel combined with the appropriate division of responsibilities.

Management recognizes its responsibility for fostering a strong ethical climate so that the Company's affairs are conducted according to the highest standards of personal and corporate conduct. The Board of Directors has adopted a formal Code of Conduct and Corporate Compliance Program governing employees and directors. Management encourages open communication within the Company and requires the confidential treatment of proprietary information and compliance with all domestic laws, including those relating to financial disclosure.

The 2001 consolidated financial statements were audited by the Company's independent auditors, Ernst & Young LLP, in accordance with auditing standards generally accepted in the United States. In addition, Ernst & Young LLP performs reviews of the unaudited quarterly financial statements, prior to the announcement of quarterly earnings. Management has made available to Ernst & Young LLP all of the Company's financial records and related data, including reports prepared by the Internal Audit Department as well as the minutes of stockholders' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP were valid and appropriate.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of
The Commerce Group, Inc.

We have audited the accompanying consolidated balance sheets of The Commerce Group, Inc. and Subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Commerce Group, Inc. and Subsidiaries at December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

ERNST & YOUNG LLP

Boston, Massachusetts
January 29, 2002

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THE COMMERCE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31,
(Thousands of Dollars)

	2001	2000
ASSETS		
Investments (notes A2, A3, and B)		
Fixed maturities, at market (cost: $618,775 in 2001 and $665,881 in 2000)	$ 626,482	$ 669,935
Preferred stocks, at market (cost: $256,582 in 2001 and $215,823 in 2000)	248,101	200,083
Common stocks, at market (cost: $87,704 in 2001 and 2000)	107,458	115,827
Preferred stock mutual funds, at equity (cost: $294,948 in 2001 and $327,980 in 2000)	309,282	337,733
Mortgage loans on real estate and collateral notes receivable (less allowance for possible loan losses of $660 in 2001		

and $858 in 2000)	39,505	51,661
Cash and cash equivalents	148,630	70,521
Other investments (cost: $28,291 in 2001 and $25,475 in 2000)	18,743	26,802
Total investments	1,498,201	1,472,562
Accrued investment income	15,539	18,218
Premiums receivable (less allowance for doubtful receivables of $1,565 in 2001 and $1,487 in 2000)	246,221	230,580
Deferred policy acquisition costs (notes A4 and C)	116,557	111,305
Property and equipment, net of accumulated depreciation (notes A5 and D)	40,014	34,823
Residual market receivable (note F)		
Losses and loss adjustment expenses	81,433	82,450
Unearned premiums	44,399	44,791
Due from reinsurers (note F)	70,450	61,554
Deferred income taxes (notes A9 and G)	16,993	12,041
Receivable for investments sold	838	-
Non-compete agreement, net of accumulated amortization (note A6)	2,479	2,829
Other assets	6,958	4,461
Total assets	$2,140,082	$2,075,614

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities		
Unpaid losses and loss adjustment expenses (notes A7, E and F)	$ 681,624	$ 674,140
Unearned premiums (note A8)	563,456	519,885
Current income taxes (notes A9 and G)	2,735	13,988
Deferred income (notes A10 and F)	7,015	7,703
Contingent commissions accrued (note A11)	29,724	35,346
Payable for securities purchased	-	524
Excess of book value of subsidiary interest over cost (note A12)	5,719	8,431
Other liabilities and accrued expenses	37,535	32,648
Total liabilities	1,327,808	1,292,665
Minority interest (note A13)	-	1,068
Stockholders' Equity (notes B, L, M and N)		
Preferred stock, authorized 5,000,000 shares at $1.00 par value; none issued in 2001 and 2000	-	-
Common stock, authorized 100,000,000 shares at $.50 par value; 38,000,000 shares issued in 2001 and 2000	19,000	19,000
Paid-in capital	29,621	29,621
Net accumulated other comprehensive income, net of income taxes of $6,674 in 2001 and $6,371 in 2000	12,394	11,833
Retained earnings	873,671	820,528
	934,686	880,982
Treasury stock, 4,869,548 shares in 2001 and 4,246,648 shares in 2000, at cost (note A14)	(122,412)	(99,101)
Total stockholders' equity	812,274	781,881
Total liabilities, minority interest and stockholders' equity	$2,140,082	$2,075,614

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

THE COMMERCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS
For the years ended December 31,
(Thousands of Dollars Except Per Share Data)

	2001	2000	1999
Revenues			
Earned premiums (notes A8 and F)	$1,043,652	$ 954,483	$ 871,830
Net investment income (note B)	99,611	96,830	89,789
Premium finance and service fees	17,819	15,227	14,774
Amortization of excess of book value of subsidiary interest over cost (note A12)	3,389	3,390	3,019
Net realized investment gains (losses) (note B)	(10,633)	29,550	(16,378)
Total revenues	1,153,838	1,099,480	963,034
Expenses			
Losses and loss adjustment expenses (notes A7, E and F)	777,543	686,157	625,090
Policy acquisition costs (notes A4 and C)	260,870	243,257	233,660
Total expenses	1,038,413	929,414	858,750
Earnings before income taxes and minority interest	115,425	170,066	104,284
Income taxes (notes A9 and G)	23,194	38,306	16,667
Net earnings before minority interest	92,231	131,760	87,617
Minority interest in net loss of subsidiary (note A13)	863	320	1,059
NET EARNINGS	$ 93,094	$ 132,080	$ 88,676
COMPREHENSIVE INCOME	$ 93,655	$ 168,570	$ 40,730
NET EARNINGS PER COMMON SHARE: (note A15)			
BASIC	$ 2.77	$ 3.87	$ 2.54
DILUTED	$ 2.75	$ 3.87	$ 2.54
CASH DIVIDENDS PAID PER SHARE	$ 1.19	$ 1.15	$ 1.11
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:			
BASIC	33,608,804	34,121,047	34,940,074
DILUTED	33,794,938	34,121,047	34,940,074

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the years ended December 31,
(Thousands of Dollars)

	Common Stock	Paid-in Capital	Net Accumulated Other Comprehensive Income/(Loss)	Retained Earnings	Treasury Stock	Total
Balance January 1, 1999......	$19,000	$29,621	$ 23,289	$677,629	$ (38,687)	$710,852
Net earnings................				88,676		88,676
Other comprehensive income (loss):						
Unrealized holding losses arising during the period, net of tax benefits of $18,833.................			(34,976)			(34,976)
Reclassification adjustment, net of tax benefits of $6,984...................			(12,970)			(12,970)
Other comprehensive(loss)..			(47,946)			(47,946)
Comprehensive income........						40,730
Stockholder dividends.......				(38,656)		(38,656)
Treasury stock purchased....					(44,921)	(44,921)
Balance December 31, 1999....	19,000	29,621	(24,657)	727,649	(83,608)	668,005
Net earnings................				132,080		132,080
Other comprehensive income:						
Unrealized holding gains arising during the period, net of taxes of $18,218..			33,833			33,833
Reclassification adjustment, net of taxes of $1,431....			2,657			2,657
Other comprehensive income.			36,490			36,490
Comprehensive income........						168,570
Stockholder dividends.......				(39,201)		(39,201)
Treasury stock purchased....					(15,493)	(15,493)
Balance December 31, 2000....	19,000	29,621	11,833	820,528	(99,101)	781,881
Net earnings................				93,094		93,094
Other comprehensive income (loss):						
Unrealized holding losses arising during the period, net of tax benefits of $634....................			(1,178)			(1,178)
Reclassification adjustment, net of taxes of $936......			1,739			1,739
Other comprehensive income.			561			561
Comprehensive income........						93,655
Stockholder dividends.......				(39,951)		(39,951)
Treasury stock purchased....					(23,311)	(23,311)
Balance December 31, 2001....	$19,000	$29,621	$ 12,394	$873,671	$(122,412)	$812,274

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

THE COMMERCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31,
(Thousands of Dollars)

	2001	2000	1999
Cash flows from operating activities			
Premiums collected................................	$1,066,544	$ 977,413	$ 881,472
Net investment income received.....................	101,216	92,962	90,558
Premium finance and service fees received..........	17,819	15,227	14,774
Losses and loss adjustment expenses paid...........	(770,841)	(660,665)	(611,136)
Policy acquisition costs paid......................	(268,863)	(247,767)	(225,587)
Federal income tax payments........................	(39,703)	(29,264)	(25,404)
Net cash provided by operating activities.........	106,172	147,906	124,677
Cash flows from investing activities			
Proceeds from maturity of fixed maturities.........	25,779	20,805	46,565
Proceeds from sale of fixed maturities.............	89,712	97,180	142,562
Proceeds from sale of equity securities............	50,768	45,604	76,485
Proceeds from sale of preferred stock mutual funds..	2,945	-	-
Proceeds from sale of other investments............	5,735	-	-
Proceeds from sale of mortgages....................	-	20,042	-
Purchase of fixed maturities.......................	(71,702)	(125,844)	(107,664)
Purchase of equity securities......................	(42,774)	(29,987)	(72,536)
Purchase of preferred stock mutual funds...........	(21,200)	(60,024)	(98,564)
Purchase of other investments......................	(8,074)	(11,885)	(4,875)
Purchase of subsidiary, net of cash acquired........	-	-	(77,056)
Payments received on mortgage loans and collateral notes receivable................................	14,506	9,141	11,800
Mortgage loans and collateral notes originated......	(2,152)	(7,896)	(10,911)
Purchase of property and equipment.................	(10,206)	(3,416)	(2,910)
Other proceeds from investing activities...........	1,862	1,054	2,627
Net cash provided by (used in) investing activities....................................	35,199	(45,226)	(94,477)
Cash flows from financing activities			
Dividends paid to stockholders.....................	(39,951)	(39,201)	(38,656)
Purchase of treasury stock.........................	(23,311)	(15,493)	(44,921)
Net cash used in financing activities............	(63,262)	(54,694)	(83,577)
Increase (decrease) in cash and cash equivalents......	78,109	47,986	(53,377)
Cash and cash equivalents at beginning of year........	70,521	22,535	75,912
Cash and cash equivalents at end of year.............	$ 148,630	$ 70,521	$ 22,535

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

THE COMMERCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Reconciliation of Net Earnings to Net Cash Provided by Operating Activities
For the years ended December 31,
(Thousands of Dollars)

	2001	2000	1999
Cash flows from operating activities			
Net earnings..	$ 93,094	$ 132,080	$ 88,676
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Premiums receivable..............................	(15,641)	(35,420)	(22,399)
Deferred policy acquisition costs.................	(5,252)	(12,805)	(3,374)
Residual market receivable........................	1,409	14,419	(1,440)
Due from reinsurers..............................	(8,896)	(13,189)	(4,116)
Losses and loss adjustment expenses...............	7,484	14,299	12,733
Unearned premiums................................	43,571	62,790	38,796
Current income taxes.............................	(11,253)	3,149	6,909
Deferred income taxes............................	(5,255)	5,893	(15,647)
Deferred income..................................	(688)	239	516
Contingent commissions...........................	(5,622)	1,878	11,401
Other assets, liabilities and accrued expenses.....	(323)	6,708	(8,273)
Net realized investment (gains) losses............	10,633	(29,550)	16,378
Other - net......................................	2,911	(2,585)	4,517
Net cash provided by operating activities.......	$ 106,172	$ 147,906	$ 124,677

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

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2000 and 1999
(Thousands of Dollars)

NOTE A - Summary of Significant Accounting Policies

1. Basis of Presentation

The consolidated financial statements of The Commerce Group, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

The consolidated financial statements include The Commerce Group, Inc. and its wholly-owned subsidiaries, Bay Finance Company, Inc., Clark-Prout Insurance Agency, Inc. and Commerce Holdings, Inc. ("CHI"). The Commerce Insurance Company ("Commerce") and Citation Insurance Company ("Citation") are wholly-owned subsidiaries of CHI. Commerce West Insurance Company ("Commerce West") is a wholly-owned subsidiary of Commerce. American Commerce Insurance Company ("American Commerce") is a wholly-owned subsidiary of ACIC Holding Co., Inc. ACIC Holding Co., Inc. is owned jointly with AAA Southern New England ("AAA SNE") with Commerce maintaining an 80% common stock interest and AAA SNE maintaining a 20% common stock interest (see NOTE A17). All inter-company transactions and balances have been eliminated in consolidation. Certain prior year account balances have been reclassified to conform to the 2001 presentation. During the fourth quarter of 2000, the Company changed its policy in regard to its investments in certain closed-end preferred stock mutual funds. The level of ownership and new investment policy requires the Company to account for these investments on an equity basis. The results of prior accounting periods impacted by this change have been restated.

The insurance subsidiaries, Commerce, Citation, Commerce West and American Commerce, prepare statutory financial statements in accordance with accounting practices prescribed by the National Association of Insurance Commissioners ("NAIC"), the Commonwealth of Massachusetts, the State of California, and the State of Ohio.

The preparation of 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 could differ from those estimates.

2. Investments

All investment transactions have credit exposure to the extent that a counter party may default on an obligation to the Company. Credit risk is a consequence of carrying investment positions. To manage credit risk, the Company focuses on higher quality fixed-income securities and preferred stocks, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment category and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.

The focus of management's judgments and estimates relating to investments involves the potential impairment of investments for other than temporary declines in market values. Carrying values of investments in fixed maturities, which include taxable and non-taxable bonds, and investments in common and preferred stocks, are derived from market prices supplied by the Company's investment custodian. Unrealized investment gains and losses on common and preferred stocks and fixed maturities, to the extent that there is no other than temporary impairment of value, are credited or charged to a separate component of stockholders' equity, known as "net accumulated other comprehensive income (loss)", until realized, net of any tax effect. An impairment in an investment is deemed to be other than temporary when a security's market value has diminished to less than 75% of cost for two consecutive quarters. If the contractual terms of the security are being complied with, management performs a cash flow valuation to determine the potential impairment of the security. If the security is deemed impaired the Company adjusts the securities cost to market value through realized loss based on publicly available or, in the absence of such, to a value based on cash flow modeling. During 2001, the Company wrote down $2,665 in bonds and preferred stock investments with impairment as determined by management to be other than temporary. Given the makeup and quality of the Company's investments, management does not

NOTE A - Summary of Significant Accounting Policies (continued)

believe that a more stringent policy would have a material effect on the carrying value of its investments. When investment securities are sold, the realized gain or loss is determined based upon specific identification. Fair market value of fixed maturities and common and preferred stocks are based on quoted market prices. For other securities held as investments, fair market value equals quoted market price, if available. If a quoted market price is not available, fair market value is estimated using quoted market prices for similar securities. The Company has not invested more than 5% of fixed maturities in any one state or political subdivision.

During 2001, as required by the Emerging Issues Task Force ("EITF") D-46, the Company began accounting for venture capital fund investments in which it owns more than a 5% interest on the equity method. The operating results of these venture capital fund investments have been reflected in realized gains and losses. Prior to this change, the operating results were not material and were therefore reflected in accumulated other comprehensive income and loss.

During the fourth quarter of 2000 the Company changed its policy in regard to investments in certain closed-end preferred stock mutual funds. From that point forward the Company intends to take a proactive posture to affect the overall investment performance of these funds. The Company's level of ownership and new investment policy required the Company to account for these investments from that point forward on the equity method. Under the equity method the Company recorded it's share of the changes in the mutual funds' undistributed net assets in net investment income. Prior to the fourth quarter of 2000 these investments were recorded at their fair market value with the changes in value reflected in accumulated other comprehensive income. With the adoption of the equity method in the fourth quarter of 2000 all prior periods were restated to reflect equity method accounting. Beginning in the first quarter of 2001 the Company began recording their equity in the changes in net assets of closed-end preferred stock mutual funds as a component of realized gains and losses. All prior periods have been reclassified to permit comparison with the current year presentation. The Company believes the current year presentation provides a more appropriate classification for analysis of ongoing operations of the Company. These investments are valued at original cost plus the cumulative undistributed equity in earnings and losses of the funds and adjusted over time by the premium or discount at the time of purchase to the applicable underlying net asset value of the funds.

The Company originates and holds mortgage loans on real estate on properties located in the Commonwealth of Massachusetts and the State of Connecticut. The Company controls credit risk through credit approvals, credit limits and monitoring procedures. The Company performs in-depth credit evaluations on all new mortgage customers. Bad debt expenses have not been material in recent years.

Mortgage loans on real estate and collateral notes receivable are stated at the amount of unpaid principal, less an allowance for possible loan losses. The adequacy of the allowance for possible loan losses is evaluated on a regular basis by management. Factors considered in evaluating the adequacy of the allowance include previous loss experience, current economic conditions and their effect on borrowers and the performance of individual loans in relation to contract terms. The provision for possible loan losses charged to operating expenses is based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb possible losses. Loan losses are charged against the allowance when management believes the collectibility of the principal is unlikely and recoveries are credited to the allowance when received.

Interest on mortgage loans is included in income as earned based upon rates applied to principal amounts outstanding. Accrual of interest on mortgage loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal, or when a loan becomes contractually past due more than ninety days. When a loan is placed on non-accrual status, all unpaid interest previously accrued is reversed against current period earnings.

NOTE A - Summary of Significant Accounting Policies (continued)

3. Cash and Cash Equivalents

Cash and cash equivalents includes cash currently on hand to cover operating expenses. The Company invested $82,856 with Fidelity Investment Government Fund and $59,281 with Provident Institutional Fund. These are short-term money market investments in government backed securities. Money is invested on a daily basis. The Company held $17,210 and $13,775 in U.S. Government Repurchase Agreements at various financial institutions in 2001 and 2000, respectively. The amount of collateral, maintained by the seller, at the time of purchase and each subsequent business day, is required to have a market value that is equal to 102% of the resale price.

4. Deferred Policy Acquisition Costs

Policy acquisition costs are calculated by line of business as a percentage of unearned premiums by multiplying the sum of current commission rates plus current premium tax rates plus an estimate of the percentage of other underwriting expenses incurred at the policy issuance. These costs are deferred and amortized over the period in which the related premiums are earned, the amount being reduced by any potential premium deficiency. If any potential premium deficiency exists, it represents future estimated losses, loss adjustment expenses and amortization of deferred acquisition costs in excess of the related unearned premiums. There was no premium deficiency in 2001, 2000 and 1999. In determining whether a premium deficiency exists, the Company considers anticipated investment income.

(Thousands of Dollars)

5. Property and Equipment

Property and equipment are stated at cost and are depreciated on the straight-line method over the estimated useful lives of the assets using the following rates:

Asset Classification	Percent Per Annum
Buildings....................................	2.5
Building improvements (prior to 1992).........	2.5
Building improvements (1992 and subsequent)...	5.0
Equipment and office furniture................	10.0
EDP equipment and copiers.....................	20.0
Automobiles..................................	33.3

Maintenance and repairs are charged to operations; betterments are capitalized. The cost of property sold or otherwise disposed of and the accumulated depreciation thereon is eliminated from the related property and accumulated depreciation accounts and any resulting gain or loss is credited or charged to income.

6. Non-Compete Agreement

The non-compete agreement of $2,479 represents the unamortized portion of the purchase price associated with the acquisition of American Commerce allocated to the arrangement whereby the American Automobile Association, Inc. ("AAA National") agreed not to compete with American Commerce prior to February 2009. The cost of $3,500 is being amortized on a straight-line basis over the term of the arrangement. The amount of accumulated amortization at December 31, 2001 and 2000 was $1,021 and $671, respectively.

7. Unpaid Loss and Loss Adjustment Expenses

Loss and LAE reserves by their nature are inherently uncertain as to the ultimate outcome of the estimated amounts. The liability for unpaid losses and loss adjustment expenses ("LAE") represents the accumulation of individual case estimates for reported losses, adjustments to this amount on a line of business basis and estimates for incurred but not reported ("IBNR") losses and LAE net of, salvage and subrogation recoverable. The liability for losses and LAE is intended to cover the ultimate net cost of all losses and LAE incurred through the balance sheet date. Liability estimates are continually reviewed and updated, and therefore, the ultimate liability may be more or less than the current

NOTE A - Summary of Significant Accounting Policies (continued)

estimate. The effects of changes in the estimates are included in the results of operations in the period in which the estimates are revised.

8. Premiums

Insurance premiums are recognized as income ratably over the terms of the policies. Unearned premiums are determined by prorating written premiums on a daily basis over the terms of the policies. A significant portion of the Company's Massachusetts premiums written is derived through the American Automobile Association Clubs of Massachusetts ("AAA clubs") affinity group marketing program. Of the Company's total direct premiums written, the portion attributable to the AAA affinity group marketing program in Massachusetts was $545,496 or 47.3% in 2001, $535,766 or 50.0% in 2000 and $495,962 or 52.3% in 1999. Of these amounts, 13.0% were written through insurance agencies owned by the AAA clubs and 87.0% were written through the Company's network of independent agents in 2001.

9. Income Taxes

The Company uses an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, the Company generally considers all expected future events other than changes in the tax law or rates, unless enacted. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. No valuation allowance was established in 2001, 2000 or 1999.

10. Deferred Income

Income consisting of expense reimbursements, which include servicing carrier fees from Commonwealth Automobile Reinsurers ("C.A.R."), a state-mandated reinsurance mechanism, on policies written for C.A.R., are deferred and amortized over the term of the related insurance policies (see "Notes to Consolidated Financial Statements - NOTE F").

11. Contingent Commissions

In addition to state mandated minimum and other commissions on policies written, the Company pays certain of its agencies compensation in the form of profit sharing. This is based, in part, on the underwriting profits of an individual agent's business written with the Company. The arrangement for Massachusetts business utilizes a three-year rolling plan, with one third of the agent's profit or loss for each of the current and the two prior years' calculations summed to a single amount. This amount, if positive, is multiplied by the profit sharing commission rate and paid to the agent. Outside of Massachusetts, Commerce West and American Commerce each have contingent commission plans tailored to their specific markets.

12. Excess of Book Value of Subsidiary Interest Over Cost

As a result of the acquisition of American Commerce, the amount representing the excess of the fair value of the net assets acquired over the purchase price at the January 29, 1999 acquisition date was $16,947. The amount is being amortized into revenue on the straight-line basis over a five year period. The amount amortized into income in 2001, 2000 and 1999 was $3,389, $3,390 and $3,019, respectively. See "Notes to Consolidated Financial Statements - NOTE A17" for treatment of excess of book value of subsidiary interest over cost ("negative goodwill") subsequent to December 31, 2001.

NOTE A - Summary of Significant Accounting Policies (continued)

13. Minority Interest in Net Loss of Subsidiary

As a result of the joint venture with AAA SNE and acquisition of American Commerce, the Company's interest in ACIC Holding Co., Inc., through Commerce, a wholly-owned subsidiary of CHI, is represented by ownership of 80% of the outstanding shares of common stock at December 31, 2001. AAA SNE maintains a 20% common stock ownership. The minority interest of $863 included in the consolidated statement of earnings for 2001 represents 20% of the net loss for ACIC Holding Co., Inc., calculated after the $9,582 preferred stock dividend paid to Commerce, to the extent of the minority interest. This compares to $320 minority interest in the net loss of ACIC Holding Co., Inc. after $9,178 in preferred stock dividends paid to Commerce in 2000. During the third quarter of 2001, the net losses of ACIC Holding Co., Inc. exceeded the minority interest balance sheet component.

14. Treasury Stock

In May 1999, the Board of Directors of the Company authorized a stock buy-back program of up to 2,000,000 shares of common stock of the Company. At December 31, 2001, there are 273,700 shares of common stock authorized to be purchased under this program. In November 2001, the Board of Directors approved another stock buy-back program authorizing the purchase of up to an additional 2,000,000 shares. During the period from January 1, 2001 through December 31, 2001, the Company purchased 622,900 shares of its own common stock. During 2000, the Company purchased 606,200 shares of its own common stock under the May 1999 buy-back program. At December 31, 2001, the Company had authority to purchase a total of 2,273,700 additional shares of its common stock under the May 1999 and November 2001 buy-back programs. As of December 31, 2001, the Company holds a total of 4,869,548 shares of treasury stock.

15. Net Earnings Per Common Share

Net earnings per basic common share is computed by dividing net earnings by the weighted average number of basic common shares outstanding. The weighted average number of basic common shares outstanding for the years ended December 31, 2001, 2000 and 1999 were 33,608,804, 34,121,047 and 34,940,074, respectively. Weighted average number of basic common shares outstanding is determined by taking the average of the following calculation for a specified period of time: The daily amount of (1) the total issued outstanding common shares minus (2) the total Treasury Stock purchased.

Earnings per diluted common share is based on the weighted average number of diluted common shares outstanding during each period. The weighted average number of diluted common shares outstanding for the years ended December 31, 2001, 2000 and 1999 were 33,794,938, 34,121,047 and 34,940,074, respectively. The Company's only potentially dilutive instruments are stock options outstanding and dilution from these is not significant.

16. New Accounting Pronouncements

The NAIC revised the Accounting Practices and Procedures Manual in a process referred to as Codification. The revised manual became effective January 1, 2001 for all insurance companies. The domiciliary states of the Company's insurance subsidiaries have adopted the provisions of the revised manual. The revised manual has changed certain prescribed statutory accounting practices and has resulted in changes to the accounting practices that the Company's insurance subsidiaries use to prepare their statutory-basis financial statements. The impact of these changes to the Company's insurance subsidiaries statutory-basis capital and surplus as of January 1, 2001 had a significant beneficial effect of approximately $38,737 primarily due to the inclusion of deferred taxes as an admitted asset. The codification changes had no impact on the Company's GAAP financial statements.

NOTE A - Summary of Significant Accounting Policies (continued)

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Certain Derivative Instruments and Hedging Activities", as amended in June 2000 by Statement of Financial Accounting Standards No. 138 ("SFAS 138"), "Accounting for Certain Derivative Instruments and Certain Hedging Activities", which requires companies to recognize all derivatives as either assets or liabilities in the balance sheet and measure such instruments at fair value. SFAS 138 also amended Statement of Financial Accounting Standards No. 137 ("SFAS 137"), "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133". The provisions of SFAS 133 require adoption for fiscal years beginning after June 15, 2000. The Company had no derivative or hedging activity in 2001, 2000 or 1999. The adoption of these SFASs had no material impact on the Company's consolidated financial statements.

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140 ("SFAS 140"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", which replaced Statement of Financial Accounting Standards No. 125 ("SFAS 125"), "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". The Statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a "financial components" approach that focuses on control. Under that approach, after a transfer of financial assets, a company recognizes the financial and servicing assets it controls and the liabilities it has incurred, does not recognize financial assets when control has been surrendered, and does not recognize liabilities when extinguished. The Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. The Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Adoption of SFAS 140 did not have a material impact on the Company's consolidated financial statements.

In July 2001, the FASB issued Statements of Financial Accounting Standards No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141, effective for business combinations initiated after June 30, 2001, requires that all business combinations be accounted for under a single method - the purchase method. Use of the pooling-of-interests method is no longer permitted. SFAS No. 141 also clarifies the criteria to recognize intangible assets separately from goodwill. SFAS No. 142 requires that goodwill and intangible assets deemed to have indefinite lives no longer be amortized to earnings, but instead be reviewed at least annually for impairment. Other intangible assets will continue to be amortized over their useful lives. SFAS No. 142 will be effective January 1, 2002.

The Company has evaluated the impact of adopting the provisions of SFAS No. 142 on earnings and financial position for the year ended December 31, 2002. Effective January 1, 2002, in accordance with SFAS No. 142, the Company will cease amortizing the balance sheet item "excess of book value of subsidiary interest over cost" which is $5.7 million at year end 2001. The 2001 impact of the amortization of this resulted in approximately $0.10 per share of annual operating earnings. Additionally, the Company will no longer amortize the negative goodwill resulting from the purchase of preferred stock mutual funds effective January 1, 2002. The amount of unamortized negative goodwill at year-end is $6.4 million. The 2001 impact of the amortization of this was $0.10 per share of earnings classified as capital gains. Both the excess of book value of subsidiary interest over cost and the negative goodwill on preferred stock mutual funds will be recognized as income in the first quarter of 2002 and classified as an extraordinary item. The estimated per share income impact for this change is $0.34 per share.

17. Acquisition

In November 1998, Commerce formed ACIC Holding Co., Inc., in a joint venture with AAA SNE and invested $90,800 to fund the January 29, 1999 acquisition of the Automobile Club Insurance Company, whose name was changed to American Commerce upon completion of the acquisition. Commerce invested $90,000 in the form of preferred stock and an additional $800 representing an 80% common stock ownership. AAA SNE invested $200 representing a 20% common stock ownership. The terms of the preferred stock call for Commerce to receive quarterly cash dividends at the rate of 10% per annum from ACIC Holding, Co., Inc. In the event cash dividends cannot be paid, additional preferred stock will be issued. During 2001, 96 shares of Class B preferred stock were issued in lieu of the cash payment of dividends. The acquisition was accounted for as a purchase. Since the January 29, 1999 acquisition, American Commerce's results have been consolidated into the Company's financial statements. Since 1995, Commerce has maintained an exclusive affinity group marketing relationship with AAA Insurance Agency, Inc., a subsidiary of AAA SNE. AAA Insurance Agency, Inc. has been a licensed insurance agent of Commerce since 1985.

(Thousands of Dollars)

NOTE B - Investments and Investment Income

1. Fixed Maturities

The amortized cost and estimated fair market value of investments in fixed maturities are as follows:

	Amortized Cost	Gross Accumulated Other Comprehensive Income	Gross Accumulated Other Comprehensive Losses	Estimated Fair Market Value
At December 31, 2001:				
Corporate bonds....................	$ 133,506	$ 7,497	$ (4,497)	$ 136,506
U.S. Treasury bonds and notes.......	104	1	-	105
GNMA & FNMA mortgage-backed bonds...	98,198	1,602	(815)	98,985
Obligations of states and political subdivisions............	386,967	8,890	(4,971)	390,886
Total.........................	$ 618,775	$ 17,990	$ (10,283)	$ 626,482
At December 31, 2000:				
Corporate Bonds....................	$ 130,775	$ 1,263	$ (5,783)	$ 126,255
U.S. Treasury bonds and notes.......	3,428	86	(137)	3,377
GNMA & FNMA mortgage-backed bonds...	67,274	444	(457)	67,261
Obligations of states and political subdivisions............	464,404	14,454	(5,816)	473,042
Total.........................	$ 665,881	$ 16,247	$ (12,193)	$ 669,935

NOTE B - Investments and Investment Income (continued)

Proceeds from sales of investments in fixed maturities, gross gains and gross losses realized on those sales were as follows:

	Proceeds From Sales	Gross Realized Gains	Gross Realized Losses
For the year ended December 31, 2001:			
Corporate bonds................................	$ 7,343	$ 129	$ (151)
U.S. Treasury bonds and notes...................	-	-	-
GNMA mortgage-backed bonds......................	-	-	-
Obligations of states and political subdivisions..	82,369	694	(1,820)
Total	$ 89,712	$ 823	$ (1,971)
For the year ended December 31, 2000:			
Corporate bonds................................	$ 1,167	$ -	$ -
U.S. Treasury bonds and notes...................	-	-	-
GNMA mortgage-backed bonds......................	-	-	-
Obligations of states and political subdivisions..	96,013	198	(2,749)
Total	$ 97,180	$ 198	$ (2,749)
For the year ended December 31, 1999:			
Corporate bonds................................	$ 17,516	$ 102	$ (941)
U.S. Treasury bonds and notes...................	27,096	8	(842)
GNMA mortgage-backed bonds......................	-	-	-
Obligations of states and political subdivisions..	97,950	298	(2,606)
Total	$142,562	$ 408	$ (4,389)

The amortized cost and approximate fair market value of fixed maturities at December 31, 2001 and 2000, by contractual maturity, are as follows:

	2001		2000	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
Obligations of states, political subdivisions, corporate bonds and U.S. Treasury bonds and notes:				
Due in one year or less...................	$ 1,398	$ 1,417	$ 1,201	$ 1,214
Due after one year through five years......	2,860	3,001	7,650	7,882
Due after five years through ten years.....	5,256	5,378	9,162	9,431
Due after ten years.......................	511,063	517,701	580,594	584,147
	520,577	527,497	598,607	602,674
GNMA & FNMA mortgage-backed bonds..........	98,198	98,985	67,274	67,261
Total fixed maturities..............	$618,775	$626,482	$665,881	$669,935

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2000 and 1999
(Thousands of Dollars)

NOTE B - Investments and Investment Income (continued)

2. Closed-end Preferred Stock Mutual Funds

The following table reflects the shares held, percentage of ownership, carrying value at equity, book value, market value, and value of shares at net asset value, by fund at December 31, 2001 and 2000:

December 31, 2001

Fund Symbol(1)	Fund Shares Held	% of Ownership	Carrying Value at Equity	Book Value	Quoted Market Value	Value of Shares at Net Asset Value
PGD	2,361,500	28.3%	$ 30,225	$ 25,713	$ 29,873	$ 32,258
PPF	2,370,400	32.7%	30,168	26,256	29,275	31,076
PDF	4,685,500	31.3%	44,900	42,400	45,121	45,731
PDT	5,289,700	35.3%	63,035	57,175	58,451	64,111
DIV	3,579,500	36.2%	51,991	49,687	52,798	53,335
PFD	2,981,500	30.3%	42,904	44,803	43,828	42,904
PFO	4,050,043	36.3%	46,059	48,914	47,993	46,251
Total			$309,282	$294,948	$307,339	$315,666

December 31, 2000

Fund Symbol(1)	Fund Shares Held	% of Ownership	Carrying Value at Equity	Book Value	Quoted Market Value	Value of Shares at Net Asset Value
PGD	1,877,300	22.5%	$ 23,478	$ 19,666	$ 22,528	$ 26,695
PPF	2,352,900	32.4%	28,322	26,048	25,882	30,470
PDF	4,638,800	31.0%	46,003	41,966	40,589	47,594
PDT	4,925,100	32.8%	60,453	53,144	52,021	63,091
DIV	3,080,500	31.2%	46,314	42,500	40,239	48,918
PDI(2)	5,253,400	48.5%	52,207	52,583	52,534	54,110
PFD	2,981,500	30.3%	39,834	44,803	36,151	40,012
PFO	3,892,543	34.9%	41,122	47,270	40,385	41,533
Total			$337,733	$327,980	$310,329	$352,423

(1) John Hancock Patriot Global Dividend Fund ("PGD"), John Hancock Patriot Preferred Dividend Fu
John Hancock Patriot Premium Dividend I Fund ("PDF"), John Hancock Patriot Premium Dividend I
John Hancock Patriot Select Dividend Fund ("DIV"), Putnam Dividend Income Fund ("PDI"), Prefe
("PFD"), Preferred Income Opportunity Fund ("PFO").

(2) In 2001, the Trustees of PDI liquidated the fund. The Company's pro-rata share of the portfo
cash of PDI was transferred to a new fund created by the PDI Trustees whose ownership was con
Company. At December 31, 2001 the fund, totaling $60,869, was consolidated into the Company'
statements. The majority of the fund represents investments valued at $59,019 and is include
stocks and $1,332 in cash and cash equivalents.

The difference between the carrying value at equity and the value of shares at net asset value is negative goodwill created at the time of the purchase of the shares. SFAS 141, which was implemented on July 1, 2001, specifically addresses the manner in which to account for negative goodwill. For purchases prior to July 1, 2001, that created negative goodwill, the Company continued to amortize the negative goodwill on these securities through the end of 2001. This negative goodwill was amortized into realized gains over various periods ranging from 1.25 years to 4 years based on the turnover ratios of the funds. In accordance with SFAS 141, for purchases subsequent to June 30, 2001, the difference between the cost and net asset value at the time of purchase was recognized as a realized gain, totaling $614 for 2001.

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THE COMMERCE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2000 and 1999
(Thousands of Dollars)

NOTE B - Investments and Investment Income (continued)

3. Mortgage Loans on Real Estate and Collateral Notes Receivable

At December 31, 2001 and 2000, mortgage loans on real estate and collateral notes receivable consisted of the following:

	December 31, 2001	December 31, 2000
Residential (1st Mortgages)............	$28,696	$36,496
Residential (2nd Mortgages)............	83	209
Commercial (1st Mortgages).............	8,210	12,542
Commercial (2nd Mortgages).............	33	50
	37,022	49,297
Collateral notes receivable............	3,143	3,222
	40,165	52,519
Allowance for possible loan losses.....	(660)	(858)
Mortgage loans on real estate and collateral notes receivable.......	$39,505	$51,661

Fair value of the Company's mortgage loans on real estate and collateral notes receivable is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit and for the same remaining maturities. The future cash flows associated with certain non-performing loans are estimated based on expected payments from borrowers either through work out arrangements or the disposition of collateral. The estimated fair value of mortgage loans on real estate and collateral notes receivable at December 31, 2001 and 2000, prior to the allowance for possible loan losses, was $41,391 and $54,141, respectively.

At December 31, 2001 and 2000 mortgage loans which were on non-accrual status amounted to $1,118 and $1,357, respectively. The reduction in interest income associated with non-accrual loans was $99, $118 and $129 for the years ended December 31, 2001, 2000 and 1999, respectively.

The Company originates and services residential and commercial mortgages in Massachusetts and Connecticut. The Company's exposure is generally 80% or less of the appraised value of any collateralized real property at the time of the loan origination. The ability and willingness of residential and commercial borrowers to honor their repayment commitments is generally dependent upon the level of overall economic activity and real estate values. The Company sold $20,042 of residential mortgages in 2000 without recourse to an unrelated third party.

A summary of the changes in the allowance for possible loan losses follows:

	Years ended December 31, 2001	2000
Balance, beginning of year........................	$ 858	$ 2,127
Decrease in provision for possible loan losses...	(198)	(1,269)
Balance, end of year.............................	$ 660	$ 858

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THE COMMERCE GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2000 and 1999
(Thousands of Dollars)

NOTE B - Investments and Investment Income (continued)

The following table describes mortgage principal balances by maturity, total mortgages over 90 days past due and total mortgages in foreclosure:

	2001	2000
Fixed rate mortgages maturing:		
One year or less..............................	$ 90	$ 141
More than one year to five years...............	861	742
More than five years to ten years..............	3,366	5,331
Over ten years.................................	23,375	31,810
Total fixed mortgages......................	$ 27,692	$ 38,024
Adjustable rate mortgages maturing:		
One year or less..............................	$ -	$ -
More than one year to five years...............	87	61
More than five years to ten years..............	419	283
Over ten years.................................	8,824	10,929
Total adjustable mortgages.................	$ 9,330	$ 11,273
Past due over 90 days...........................	$ 1,118	$ 1,357
Mortgages in foreclosure, included in past due over 90 days.................................	$ 184	$ 808

4. Net Investment Income

The components of net investment income were as follows:

(Thousands of Dollars)

	Years ended December 31, 2001	2000	1999
Interest on fixed maturities..................	$ 45,542	$ 44,766	$ 45,957
Dividends on common and preferred stocks.......	23,768	23,177	23,148
Dividends on preferred stock mutual funds......	23,165	22,158	15,483
Interest on cash and cash equivalents..........	5,729	3,555	2,596
Interest on mortgage loans.....................	4,026	5,677	5,908
Other..	356	84	118
Total investment income..............	102,586	99,417	93,210
Investment expenses............................	2,975	2,587	3,421
Net investment income................	$ 99,611	$ 96,830	$ 89,789

5. Net Realized Investment Gains (Losses)

Net realized investment gains (losses) were as follows:

	Years ended December 31, 2001	2000	1999
Net realized investment gains (losses):			
Fixed maturities..............................	$ (2,816)	$ (3,772)	$ (5,991)
Preferred stocks..............................	(3,692)	1,286	(244)
Common stocks.................................	603	4,370	11,023
Closed-end preferred stock mutual funds*........	4,582	26,575	(22,401)
Venture capital fund investments...............	(9,071)	460	888
Other...	(239)	631	347
Total....................................	$(10,633)	$ 29,550	$(16,378)

*Includes $3,215 in 2001 and $9,260 in 2000, respectively, relating to the amortization of negative goodwill, at the time of purchase, of these securities.

NOTE B - Investments and Investment Income (continued)

6. Other Comprehensive Income (Loss)

Net increases (decreases) in other comprehensive income (loss), less applicable income tax (expense) benefit, were as follows:

	Years ended December 31, 2001	2000	1999
Other comprehensive income (loss):			
Fixed maturities..............................	$ 3,653	$ 18,161	$(32,892)
Preferred stocks..............................	7,259	4,145	(17,040)
Common stocks.................................	(8,369)	34,759	(26,587)
Other...	(1,327)	318	634

(Thousands of Dollars)

Impact of minority interest....................	(352)	(1,244)	2,122
Total.......................................	864	56,139	(73,763)
Tax benefit (expense)..........................	(272)	(19,495)	26,560
Impact of minority interest....................	(31)	(154)	(743)
Total tax benefit (expense)................	(303)	(19,649)	25,817
Total other comprehensive income (loss).....	$ 561	$ 36,490	$(47,946)

A summary of net accumulated other comprehensive income (loss) on stocks and fixed maturity investments in 2001, 2000 and 1999 follows:

	Years ended December 31,		
	2001	2000	1999
Accumulated other comprehensive income.........	$ 45,873	$ 46,699	$ 8,317
Accumulated other comprehensive losses.........	(26,893)	(28,935)	(47,936)
Impact of minority interest...................	88	440	1,685
Total unrealized gains (losses)...........	19,068	18,204	(37,934)
Tax benefit (expense).........................	(6,643)	(6,217)	13,867
Impact of minority interest...................	(31)	(154)	(590)
Total benefit (expense)..................	(6,674)	(6,371)	13,277
Total....................................	$ 12,394	$ 11,833	$(24,657)

NOTE C - Deferred Policy Acquisition Costs

Policy acquisition costs incurred and amortized to income are as follows:

	Years ended December 31,		
	2001	2000	1999
Balance, beginning of year............	$111,305	$ 98,500	$ 88,759
Costs deferred during the year.........	266,122	256,062	243,401
Amortization charged to expense........	(260,870)	(243,257)	(233,660)
Balance, end of year..................	$116,557	$111,305	$ 98,500

NOTE D - Property and Equipment

A summary of property and equipment at December 31, is as follows:

	2001	2000
Buildings................................	$ 33,013	$ 32,916
Equipment and office furniture............	36,609	35,185
Building improvements.....................	850	850
	70,472	68,951
Less accumulated depreciation.......	(38,473)	(35,456)

	31,999	33,495
Land....................................	3,476	1,253
Construction in progress.................	4,539	75
	$ 40,014	$ 34,823

Depreciation expense was $4,280, $4,270 and $4,243 for the years ended December 31, 2001, 2000 and 1999, respectively. Depreciation expense is allocated evenly between losses and loss adjustment expenses and policy acquisition costs.

NOTE E - Unpaid Losses and Loss Adjustment Expenses

Liabilities for unpaid losses and loss adjustment expenses at December 31, consist of:

	2001	2000
Net voluntary unpaid loss and LAE reserves................	$558,635	$544,585
Voluntary salvage and subrogation recoverable.............	(73,393)	(65,505)
Assumed unpaid loss and LAE reserves from C.A.R...........	125,787	127,631
Assumed salvage and subrogation recoverable from C.A.R....	(20,695)	(20,844)
Total voluntary and assumed unpaid loss and LAE reserves	590,334	585,867
Adjustment for ceded unpaid loss and LAE reserves.........	100,290	97,273
Adjustment for ceded salvage and subrogation recoverable..	(9,000)	(9,000)
Total unpaid loss and LAE reserves......................	$681,624	$674,140

Unpaid Loss and LAE by their nature are inherently uncertain as to the ultimate outcome of the estimated amounts. The liability for unpaid losses and LAE represents Management's best estimate of the ultimate net cost of all losses and LAE incurred through the balance sheet date. The estimate for ultimate net cost of all losses incurred through the balance sheet date includes the adjusted case estimates for losses, incurred but not reported ("IBNR") losses, salvage and subrogation recoverable and a reserve for LAE. In arriving at its best estimate, management begins with the aggregate of individual case reserves and then makes adjustments to these amounts on a line of business basis. These adjustments to the aggregate case reserves by line of business are made based on analysis performed by Management as further described below. The entire liability for unpaid losses and LAE is also reviewed quarterly and annually by the Company's Actuarial Department. Liability estimates are continually analyzed and updated, and therefore, the ultimate liability may be more or less than the current estimate. The effects of changes in the estimates are included in the results of operations in the period in which the estimates are revised.

(Thousands of Dollars)

NOTE E - Unpaid losses and Loss Adjustment Expenses (continued)

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. To recognize liabilities for unpaid losses, insurers establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and LAE. Quarterly, the Company reviews these reserves internally. Regulations of the Division of Insurance require the Company to annually obtain a certification from either a qualified actuary or an approved loss reserve specialist that its loss and LAE reserves are reasonable.

When a claim is reported to the Company, claims personnel establish a "case reserve" for the estimated amount of the ultimate exposure to the Company. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding the claim and the policy provisions relating to the loss. This estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims personnel adjusting the claim. During the loss adjustment period, these estimates are revised as deemed necessary by the Company's claims department personnel based on subsequent developments and periodic reviews of the cases.

In accordance with industry practice, the Company also maintains reserves for estimated IBNR and LAE net of salvage and subrogation recoverable. These reserves are determined on the basis of historical information and the experience of the Company. Adjustments to these reserves are made periodically to take into account changes in the volume of business written, claims frequency and severity, the mix of business, claims processing and other items that can be expected to affect the Company's liability for losses and LAE over time.

When reviewing the liability for unpaid losses and LAE, the Company analyzes historical data and estimates the impact of various factors such as (i) payment trends; (ii) loss expense per exposure; (iii) the historical loss experience of the Company and industry; (iv) frequency and security trends; and, (v) legislative enactments, judicial decisions, legal developments in the imposition of damages, changes and trends in general economic conditions, including the effects of inflation and recession. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method, however, for subsequently evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

By using both individual estimates of reported claims and generally accepted actuarial reserving techniques, the Company estimates the ultimate net liability for losses and LAE. After taking into account all relevant factors, management believes that, based on existing information, the provision for losses and LAE at December 31, 2001 is adequate to cover the ultimate net cost of losses and claims incurred as of that date. The ultimate liability, however, may be greater or lower than established reserves. If the ultimate exposure is greater than (or less than) management's estimated liability for losses and LAE, based on any of the factors noted previously, the Company will incur additional expense (income) which may have a material impact. The Company does not discount to present value that portion of its loss reserves expected to be paid in future periods.

Included in the loss reserve methodologies described above, are liabilities for unpaid claims and claim adjustment expenses for environmental related claims such as oil spills, mold and lead paint. Reserves have been established to cover these claims for known losses. Because of the Company's limited exposure to these types of claims, management believes they will not have a material impact on the consolidated financial position of the Company in the future. Loss reserves on environmental related claims amounted to $4,281 and $3,712 at December 31, 2001 and 2000, respectively.

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NOTE E - Unpaid losses and Loss Adjustment Expenses (continued)

The following table sets forth a reconciliation of beginning and ending reserves for losses and loss adjustment expense, net of reinsurance deductions from all reinsurers including C.A.R., as shown in the Company's consolidated financial statements for the periods indicated.

	Years ended December 31,		
	2001	2000	1999
Loss and loss adjustment expense reserves, beginning of year, prior to effect of ceded reinsurance recoverable............................	$585,867	$558,779	$498,127
January 29, 1999 American Commerce loss and loss adjustment expense reserves..................	-	-	63,112
Incurred losses and loss adjustment expenses:			
Provision for insured events of the current year..	812,863	728,582	664,978
Decrease in provision for insured events of prior years....................................	(35,320)	(42,425)	(39,888)
Total incurred losses and loss adjustment expenses.....................................	777,543	686,157	625,090
Payments:			
Losses and loss adjustment expenses attributable to insured events of the current year............	487,918	402,040	383,707
Losses and loss adjustment expenses attributable to insured events of prior years................	285,158	257,029	243,843
Total payments.................................	773,076	659,069	627,550
Loss and loss adjustment expense reserves prior to effect of ceded reinsurance recoverable..........	590,334	585,867	558,779
Ceded reinsurance recoverable....................	91,290	88,273	101,062
Reserves for losses and loss adjustment expenses at the end of year per financial statements.........	$681,624	$674,140	$659,841

(Thousands of Dollars)

The decrease in provision for insured events of prior years represents redundancies for reserves established for prior year. This decrease in provision was principally the result of re-estimation of unpaid losses and loss adjustment expenses principally on the personal automobile, commercial automobile and homeowners lines of business.

The Company's loss and LAE reserves reflect its share of the aggregate C.A.R. loss and LAE reserves of the Company and the 38 other writers of automobile insurance in Massachusetts that participate in C.A.R. ("Servicing Carriers"). The Company is a defendant in various legal actions arising from the normal course of its business. These proceedings are considered to be ordinary to operations or without foundation in fact. Management is of the opinion that these actions will not have a materially adverse effect on the consolidated financial statements of the Company. (See NOTE S - Legal Proceedings.)

NOTE F - Reinsurance Activity

The Company has reinsurance contracts for casualty and catastrophe coverages. These reinsurance arrangements minimize the Company's losses arising from large risks and protect the Company against numerous losses from a single occurrence or event. The Company also has a quota share reinsurance contract on its other than automobile business.

NOTE F - Reinsurance Activity (continued)

Property, Catastrophe and Quota Share Reinsurance

The Company maintains a 75% quota share reinsurance program, covering all non-automobile property and liability business, except umbrella policies. The program is split between American Re-Insurance Company, Employers Reinsurance Corporation, Hartford Fire Insurance Company and Swiss Reinsurance America Corporation. The maximum per occurrence dollar recovery is equal to 250% of the net premiums ceded to the quota share arrangement in a contract year. The maximum aggregate per year dollar recovery under the quota share contract is equal to 350% of the net premium ceded to the quota share arrangement in a contract year. A sliding scale commission, based on loss ratio, is utilized under this program. This program provides the Company with sufficient protection for catastrophe coverage so as to enable the Company to forego pure catastrophe reinsurance coverage, which was previously tailored in conjunction with the former quota share arrangement.

The table below provides information depicting the approximate recovery under the quota share contract (described below) at various loss scenarios, if a single catastrophe were to strike:

Total Loss	Reinsurance Recovery	Net Loss Retained by the Company
$ 50,000	$ 37,500	$12,500
100,000	75,000	25,000

(Thousands of Dollars)

150,000	112,500	37,500
200,000	150,000	50,000
250,000	187,500	62,500

Under the above scenario and based on the business subject to the quota share reinsurance contract for 2001, the Company has no reinsurance recoveries for a single event catastrophe in excess of a total loss of approximately $262.0 million. The level of reinsurance protection increases (decreases) when the company cedes more (less) premium to the reinsurers. The Company's estimated total losses on its other than automobile business for 100 and 250-year hurricanes (including American Commerce) are approximately $176.0 million and $295.8 million, respectively. The Company estimates were derived through the services of Swiss Reinsurance America Corporation who utilized the RMS (Risk Management Solutions) risk assessment system. Most property and casualty insurance companies establish their catastrophe reinsurance programs up to the 100 year storm estimate.

Written premiums ceded in 2001, 2000 and 1999 under the above referenced program were $78.6 million, $69.4 million and $51.5 million, respectively. The 13.3% increase in written premiums ceded in 2001 versus 2000 in this program was primarily the result of a $7,592 or 11.6% increase in Massachusetts homeowner direct written premium, coupled with a $2,212 or 13.4% increase in direct homeowner writings in states other than Massachusetts, as previously mentioned. Ceding commission income is calculated on a ceded earned premium basis.

Casualty Reinsurance

Casualty reinsurance is on an excess of loss basis for any one event or occurrence with a maximum recovery of $9.0 million over a net retention of $1.0 million. This coverage is placed with Swiss Reinsurance America Corporation (rated A++ by A.M. Best).

Personal and commercial liability umbrella policies are reinsured on a 95% quota share basis in regard to limits up to $1.0 million and 100% quota share basis for limits in excess of $1.0 million but not exceeding $5.0 million for policies with underlying automobile coverage of $250/$500 or more. The Company also has personal liability umbrella reinsurance coverage for policies with underlying automobile coverage of $100/$300, on a 65% quota share basis in regard to limits up to $1.0 million and 100% quota share basis for limits in excess of $1.0 million but not exceeding $3.0 million. These coverages are placed with American Re-Insurance Company (rated A++ by A.M. Best).

NOTE F - Reinsurance Activity (continued)

Earned premiums and losses and loss adjustment expenses are stated in the accompanying consolidated financial statements after deductions for ceded reinsurance. Those deductions for reinsurance other than C.A.R. are as follows:

	Years ended December 31, 2001	2000	1999
Income Statement			
Written premiums ceded...........................	$81,827	$76,946	$ 54,657
Earned premiums ceded............................	77,226	73,354	55,557
Losses and loss adjustment expenses ceded.........	40,514	30,797	24,240
Balance Sheet			
Unpaid losses and loss adjustment expenses........	28,192	24,726	21,552
Unearned premiums................................	42,258	36,828	26,813

The Company, as primary insurer, would be required to pay losses in their entirety in the event that the reinsurers were unable to discharge their obligations under the reinsurance agreements.

C.A.R.

C.A.R., a state-mandated reinsurance mechanism, enables the Company and the other Servicing Carriers to reinsure any automobile risk that the insurer perceives to be under-priced at the premium level permitted by the Commissioner. Servicing Carriers, who are responsible for over 99.0% of total direct premiums written for personal automobile insurance in Massachusetts, are required to offer automobile insurance coverage to all eligible applicants pursuant to "take-all-comers" regulations, but may reinsure business with C.A.R.

Since its inception, C.A.R. has annually generated multi-million dollar underwriting losses in both the personal and commercial pools. The Company is required to share in the underwriting results of C.A.R. business for its respective product lines. Under current regulations, the Company's share of the C.A.R. personal or commercial deficit is based upon its market share for retained automobile risks for the particular pool, adjusted by a "utilization" concept, such that, in general, the Company is disproportionately and adversely affected if its relative use of C.A.R. reinsurance exceeds that of the industry, and favorably affected if its relative use of C.A.R. reinsurance is less than that of the industry. The Company's strategy has been to voluntarily retain more types of private passenger automobile business that are factored as credits, thereby favorably impacting the utilization formula. These credits result from voluntarily writing business in under priced territories and for under priced risks. As a result of increased voluntary retention, in excess of the industry, the credits impacting the utilization formula have favorably affected the Company's participation ratio compared to its market share. During 2001, 2000 and 1999, the Company's net participation in the C.A.R. personal automobile pool approximated 16.8%, 16.9% and 16.5%, respectively, as reported by C.A.R., compared to the Company's estimated market share in those years of 23.3%, 22.3% and 21.3%.

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Written premiums, earned premiums, losses and LAE incurred, underwriting expenses incurred and the liabilities for unearned premiums, unpaid losses and LAE ceded to and assumed from C.A.R. were as follows:

	Years ended December 31,					
	2001		2000		1999	
	Ceded	Assumed	Ceded	Assumed	Ceded	Assumed
Income Statement						
Written premiums...	$ 70,973	$ 79,360	$ 67,451	$ 81,659	$ 68,740	$ 87,241
Earned premiums....	72,648	80,176	69,120	81,300	68,902	84,356
Losses and LAE. incurred.........	80,053	108,353	67,987	109,788	81,853	104,273
Underwriting expenses.........	-	28,270	-	28,753	-	28,569
Balance Sheet						
Unearned premiums..	44,399	41,699	44,791	42,515	50,084	42,156
Unpaid losses and LAE.............	81,433	105,092	82,450	106,787	91,576	100,680

The Company pays to C.A.R. all of the premiums generated by the policies it has ceded and C.A.R. reimburses the Company for all losses incurred on account of ceded policies. In addition, the Company receives a fee for servicing ceded policies based on the expense structure established by C.A.R. For the years ended December 31, 2001, 2000 and 1999, these servicing fees amounted to $17,161, $16,783 and $17,235, respectively.

The Company presents assets and liabilities gross of reinsurance. The Residual Market Receivable represents the gross amount of reinsurance recoverable from C.A.R. including unpaid losses, unearned premiums, paid losses recoverable and unpaid ceded and assumed premiums.

The current C.A.R. utilization-based participation ratio has been in place for the personal automobile market since 1993. During 2001, 2000 and 1999 the Company's amount of personal automobile exposures it reinsured through C.A.R. approximated 4.9%, 4.9% and 5.6%, respectively, as compared to industry averages of 7.7%, 8.4% and 9.6%, respectively.

NOTE G - Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return.

The federal income tax expense (benefit) consisted of the following:

	Years ended December 31,		
	2001	2000	1999
Current...........................	$ 28,571	$ 32,849	$ 26,481
Deferred..........................	(5,377)	5,457	(9,814)
	$ 23,194	$ 38,306	$ 16,667

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NOTE G - Income Taxes (continued)

Deferred taxes arise from temporary differences in the basis of assets and liabilities for tax and financial statement purposes. The sources of these differences and the related tax effects of the activities that occurred consisted of the following:

	Years ended December 31, 2001	2000	1999
Unearned premiums	$ (2,428)	$ (3,835)	$ (2,785)
Discounting of loss reserves	809	(381)	(928)
Deferred policy acquisition costs	1,303	4,015	1,251
Salvage and subrogation recoverable	81	(116)	272
Tax depreciation in excess of book depreciation	180	239	639
Pension liability	-	1,145	(440)
Post-retirement benefits liability	(246)	(424)	120
Equity in earnings (losses) of preferred stock mutual funds	264	6,060	(10,487)
Equity in losses of venture capital fund investments	(3,342)	-	-
Other	(1,998)	(1,246)	2,544
Deferred income tax	(5,377)	5,457	(9,814)
Other comprehensive income (loss)	425	20,084	(26,407)
Deferred taxes at acquisition of American Commerce	-	-	(4,662)
Change in deferred tax asset	$ (4,952)	$ 25,541	$(40,883)

Realization of a deferred tax asset is dependent on generating sufficient taxable income in future years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets 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 or unrealized gains are reduced.

Deferred tax liabilities (assets) were comprised of the following at December 31, 2001 and 2000:

	2001	2000
Unearned premiums	$(31,477)	$(29,049)
Discounting of loss reserves	(20,850)	(21,659)
Equity in losses of preferred stock mutual funds	(3,551)	(3,815)
Equity in losses of venture capital fund investments	(3,342)	-
Post-retirement benefits liability of American Commerce	(1,267)	(1,021)
Other	(4,915)	(3,355)
Deferred tax assets	(65,402)	(58,899)

Deferred policy acquisition costs	33,847	32,544
Salvage and subrogation recoverable	2,109	2,028
Tax depreciation in excess of book depreciation	2,157	1,977
Net accumulated comprehensive income	6,643	6,217
Other	3,653	4,092
Deferred tax liabilities	48,409	46,858
Net deferred tax asset	$(16,993)	$(12,041)

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THE COMMERCE GROUP, INC. AND SUBSIDIARIES

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NOTE G - Income Taxes (continued)

Federal income tax on income is less than the amount computed by applying the statutory rate of 35% for the years ended 2001, 2000 and 1999 for the following reasons:

	Years ended December 31, 2001		2000		1999	
Tax at statutory rate	$ 40,399	35.0%	$ 59,523	35.0%	$ 36,499	35.0%
Tax exempt interest	(7,123)	(6.2)	(8,314)	(4.9)	(9,157)	(8.8)
Dividends paid to ESOP participants	(848)	(0.7)	(899)	(0.5)	(785)	(0.8)
Dividends received deduction	(7,510)	(6.5)	(8,123)	(4.8)	(7,560)	(7.2)
Amortization of preferred stock mutual fund negative goodwill	(1,043)	(0.9)	(3,242)	(1.9)	(1,909)	(1.8)
Other	(681)	(0.6)	(639)	(0.4)	(421)	(0.4)
Tax at effective rate	$ 23,194	20.1%	$ 38,306	22.5%	$ 16,667	16.0%

NOTE H - Related-Party Transactions

The Company has made loans to insurance agencies with which Commerce transacts business on a regular basis. At December 31, 2001, eleven loans with an aggregate outstanding principal balance of $3,476, were collateralized by the assets of the agencies, one of these loans with an outstanding balance of $313 was collateralized by real estate as the primary collateral and the assets of the agency as secondary collateral. There were no loans to insurance agencies collateralized solely by real estate. At December 31, 2000, ten loans with an aggregate outstanding balance of $3,556 were collateralized by the assets of the agencies and one of these loans with an outstanding balance of $328 was collateralized by real estate as the primary collateral and the assets of the agency as secondary collateral.

The immediate family of Raymond J. Lauring, a Director of the

Company, owns more than a 10% equity interest in Lauring Construction Company. Mr. Lauring has no ownership interest in Lauring Construction Company. During 2001, Lauring Construction Company provided construction and construction management services in connection with a contract for the estimated $13 million renovation of a 160,000 square foot building purchased by the Company. Terms of the contract provide for a fixed fee of $650 for supervision and management of the project over the term of the contract. There were no payments made on the supervision or management services portion of the contract in 2001. Payments to Lauring Construction Company in 2001 for actual materials used and construction work performed on this project were $405 and payments for other work unrelated to the project were $31.

NOTE I - Employee Stock Ownership Plan and 401(k) Plan

The Company offers an Employee Stock Ownership Plan ("E.S.O.P.") and 401(k) Plan for the benefit of substantially all employees, including those of the Company's subsidiaries. The E.S.O.P. is noncontributory on the part of Participants and contributions are made at the discretion of the Board of Directors. The company is under no obligation to make contributions or maintain the E.S.O.P. for any length of time, and may completely discontinue or terminate the E.S.O.P. at any time without liability. Contributions by the Company and subsidiaries to the E.S.O.P. for the years ended December 31, 2001, 2000 and 1999 were $7,502, $5,702 and $5,744, respectively. The increase in the contribution in 2001 over 2000 was primarily due to the inclusion of American Commerce employees into the plan. The E.S.O.P. held 2,989,046 and 3,143,076 shares of the Company's common stock at December 31, 2001 and 2000, respectively. E.S.O.P. Participants who are current employees of the Company or its subsidiaries and who are 100% vested in their E.S.O.P. accounts can annually elect to transfer

NOTE I - Employee Stock Ownership Plan and 401(k) Plan (continued)

out of the E.S.O.P. up to 100% of their allocated Company stock in the form of an eligible rollover distribution into another eligible retirement plan, such as a qualified individual retirement arrangement. Approximately 2,191,000 shares owned by Participants in the E.S.O.P. at December 31, 2001 are allocated to the E.S.O.P. accounts of these individuals. E.S.O.P. Participants who are former employees of the Company may generally elect to withdraw from the E.S.O.P. the total amount of shares allocated to their accounts at any time. Approximately 580,000 shares held by the E.S.O.P. at December 31, 2001 are allocated to the E.S.O.P. accounts of these individuals. The remaining approximately 219,000 shares held by the E.S.O.P. at December 31, 2001 are allocated to the E.S.O.P. accounts of Participants who have not yet reached 100% vesting in their account balances. Disposition of these unvested shares is restricted under the E.S.O.P. The Company pays for administration of the E.S.O.P.

The 401(k) Plan, implemented in September 1998, enables eligible employees to contribute up to 15% of eligible compensation on a pre-tax basis up to the annual maximum limits under federal tax law. The Company incurs no expenses in the form of matching contributions but does pay for administration of the Plan.

NOTE J - American Commerce Pension and Post-Retirement Benefits

Effective June 1, 2000, the Directors of American Commerce voted to terminate the American Commerce noncontributory defined benefit pension plan (the "pension plan") and transition on January 1, 2001 to the E.S.O.P. The payment of the termination liability to participants from previously funded assets of the pension plan amounted to $4,558 in 2000. All participants of the pension plan were eligible to retire with full retirement benefits upon attainment of age 65 with 5 years of participation. Retirement benefits were payable for the life of the participant with guaranteed payments for 10 years. All retirees had taken lump-sum payments. American Commerce made contributions to a deposit administration contract, which provided the pension plan with assets sufficient to fund pension benefits to pension plan participants. The deposit administration contract was carried at contract value, which represented the cost of contributions plus interest and experience refunds. The pension plan was subject to and exceeded the minimum funding requirements of ERISA.

Effective January 1, 2001, the Directors of American Commerce voted to merge the 401(k) Plan with the Company's Plan. Previously, American Commerce maintained a separate 401(k) Plan for the benefit of substantially all of its employees. American Commerce matched 50% of all employee contributions up to 6% of pay. Both American Commerce and its employees shared in administration expenses of the plan. American Commerce did not contribute to the plan in 2001 due to the aforementioned merger. Commerce contributed $181 and $165 to the plan in 2000 and 1999, respectively.

American Commerce maintains a noncontributory post-retirement benefit plan (the "post-retirement plan") for retirees that includes medical, dental and life insurance coverages. All participants of the post-retirement plan are eligible upon attainment of age 55 with 10 years of service or age 65 with 5 years of service. Dental coverage ceases at age 65 and life insurance coverage decreases based upon the age of the retiree until the attainment of age 70, at which time retirees are provided a nominal amount of coverage from age 70 and thereafter. Participants' spouses are also covered under the post-retirement plan. The cost of post-retirement medical, dental and life insurance benefits is accrued over the active service periods of employees to the date they attain full eligibility for such benefits. It is the policy of American Commerce to pay for post-retirement benefits as incurred.

NOTE J - American Commerce Pension and Post-Retirement Benefits (continued)

The following table shows, as of December 31, 2001 and 2000, the American Commerce post-retirement benefit plan funded status reconciled with amounts reported in the consolidated balance sheet and the assumptions used in determining the actuarial present value of the benefit obligation:

	2001	2000
Plan assets at fair value..........................	$ -	$ -
Accumulated benefit obligation:		
Retirees...	1,448	1,168
Active participants, fully eligible..............	790	893
Active participants, not eligible................	1,812	2,225
Projected benefit obligation.......................	4,050	4,286
Unfunded status of plan............................	(4,050)	(4,286)
Unrecognized prior service costs...................	(17)	(20)
Unrecognized net transition obligation.............	1,087	1,186
Unrecognized net loss (gain).......................	(641)	20
Accrued benefit cost.........................	$(3,621)	$(3,100)
Assumptions:		
Weighted average discount rate...................	7.0%	7.0%

Net periodic cost of the American Commerce post-retirement benefit plan for the period ended December 31, 2001, 2000 and 1999 includes the following components:

	2001	2000	1999
Service cost-benefits earned.......................	$ 250	$ 246	$ 238
Interest cost on projected benefit obligation.......	248	265	246
Actual return on plan assets.......................	-	-	-
Amortization of unrecognized net transition obligation......................................	99	99	99
Amortization of unrecognized prior service cost.....	(3)	(3)	(3)
Amortization of unrecognized loss (gain)............	(25)	-	-
Net asset loss deferred for later recognition.......	-	-	-
Net periodic cost................................	$ 569	$ 607	$ 580

The assumed health care cost trend rate for 2001 was 8.5% and 7.25% for medical and dental, respectively. These rates grade down until the final trend rates of 6.0% and 5.0% for medical and dental, respectively, are reached in 2010. A one percentage point increase in the assumed health and dental cost trend rates increases the sum of the service and interest costs components of the 2001, 2000 and 1999 periodic post-retirement benefit cost by 16.3%, 20.4% and 13.0% respectively, and the accumulated post-retirement benefit obligation as of December 31, 2001, 2000 and 1999 by 16.6%, 17.7% and 14.0%, respectively.

Subsequent to December 31, 2001, the Directors of American Commerce voted to terminate that portion of the post-retirement plan applicable to future retirees of American Commerce. Termination will be effective May 1, 2002. Current retirees and employees who retire prior to May 1, 2002 will remain eligible for post-retirement benefits.

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(Thousands of Dollars)

NOTE K - Directors' Retirement Compensation Plan

During 2000, the Company's Directors approved a Directors' Retirement Compensation Plan (the "Retirement Plan"). The Retirement Plan becomes effective for each Company Director upon terminating service on the Company's Board of Directors (the "Board") providing that such termination was not made under conditions adverse to the Company's interest. Effective with the annual meeting wherein the Director is not reappointed to the Board, and provided benefits are not paid until such time as the Director has attained the age of 65, the Company will pay an annual retirement benefit equal to 50% of the average annual total compensation of the Director for the immediately preceding three full years ("the three year average compensation"). The annual retirement benefit of 50% of the three year average compensation vests at the rate of 4.0% for each year of Board (or subsidiary) service up to a maximum of 100% vesting through termination of service. Payments continue for a maximum of ten years over the remaining life of the terminated Director, or his or her then spouse, if the Director pre-deceases the spouse. No payments are to be made after the death of the Director and spouse. Expenses related to the Retirement Plan in 2001 and 2000 amounted to $178 and $2,364, respectively. A total of $19 was paid under the Retirement Plan in 2001 and 2000.

NOTE L - Stockholders' Equity

Book Value Awards, Stock Appreciation Rights and Stock Options Program

The Management Incentive Plan approved by the Company's stockholders in May, 1994 provides for the award of incentive stock options, non-qualified stock options, book value awards, stock appreciation rights, restricted stock and performance stock units. Up to 2,500,000 shares of common stock (subject to increase for anti-dilution adjustments) may be issued under the Plan, including shares that may be issued pursuant to awards of restricted stock or upon the exercise of common stock equivalent awards such as stock options and stock appreciation rights payable in the form of common stock (not in the form of cash). At the discretion of the compensation committee all directors, officers and other senior management employees of the Company or any of its subsidiaries are eligible to participate in this Management Incentive Plan.

Book value awards issued relating to this Plan totaled 474,541, 496,685 and 447,185 in 2001, 2000 and 1999, respectively. Expenses relating to book value awards were $1,577, $3,081 and $438 in 2001, 2000 and 1999, respectively. Grants under the SAR plan ceased in 1999 and were replaced with the stock option program. No SARs were outstanding at December 31, 2001. Expenses (income) relating to stock appreciation rights were $0, $760 and ($3,159) in 2001, 2000 and 1999, respectively. The outstanding book value awards entitle the holders to cash payments based upon the extent to which, if at all, the per share book value exceeds certain thresholds set at the time the award was granted.

During 2001, 2000 and 1999, the Company granted stock options ("options") totaling 1,184,343, 644,520 and 700,179, respectively, including the issuance of options previously terminated. The outstanding options entitle the recipient to purchase the Company's common stock based upon the extent to which, if at all, the per share market value of the common stock exceeds certain thresholds set at the time the option was granted. Unexercised options terminate not later than eight years after the date of grant.

(Thousands of Dollars Except for Per Share Data)

NOTE L - Stockholder's Equity (continued)

Aggregate liabilities for the combined programs were $2,614 and $2,972 at December 31, 2001 and 2000, respectively.

The following is a summary of the changes in options outstanding under the Plan:

	Shares	Weighted Average Exercise Price
Options outstanding at January 1, 1999....	-	$ -
Granted January 29, 1999..............	50,000	36.32
Granted April 30, 1999................	650,179	32.81
Options outstanding at December 31, 1999..	700,179	33.06
Granted April 5, 2000.................	644,520	31.59
Terminated...........................	(5,888)	32.81
Options outstanding at December 31, 2000..	1,338,811	32.35
Granted April 6, 2001.................	1,184,343	30.80
Terminated...........................	(80,818)	34.74
Options outstanding at December 31, 2001..	2,442,336	$ 31.52

No options were exercisable at December 31, 2001, 2000 and 1999.

The estimated weighted average fair value per share of the options was $5.26 in 2001, $4.16 in 2000 and $3.78 in 1999. Under the provisions of APB Opinion 25, no expense was recognized for these options in 2001, 2000 or 1999. No options were granted prior to 1999. Had the Company recognized such expense, the Company's net earnings and earnings per share would have approximated the pro forma amounts indicated below:

	2001	2000	1999
Net earnings:			
As reported	$ 93,094	$132,080	$ 88,676
Pro forma	$ 88,363	$130,180	$ 86,956
Basic earnings per share:			
As reported	$ 2.77	$ 3.87	$ 2.54
Pro forma	$ 2.63	$ 3.81	$ 2.49
Diluted earnings per share:			
As reported	$ 2.75	$ 3.87	$ 2.54

Pro forma	$ 2.61	$ 3.81	$ 2.49

Additionally, the Company granted 250,000 and 1,872,380 options to certain agents of American Commerce (the "American Commerce Agents' Plan") in 2001 and 1999, respectively. The right of the recipient to exercise these options is contingent upon the average volume of other-than-Massachusetts private passenger automobile and homeowners direct written premiums placed and maintained with American Commerce for a five year period specified in the option agreement. If qualified, the recipient may purchase the Company's common stock at the exercise price for a period of five years beginning five years after the date of the grant ("the confirmation date"). Unexercised options terminate not later than ten years after the date of the grant ("the expiration date"). In conjunction with meeting specified premium growth levels over the term of the options, the Company provided "put rights" to the holders of the options granted in 1999. These put rights permit the option holders to require the Company to purchase the options at the difference between $40.00 less the exercise price, at any time from and after the confirmation date through and including the expiration date. Expenses related to these options, determined in accordance with the fair value accounting provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", amounted to $2,862 in 2001, $1,307 in 2000 and $1,909 in 1999.

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(Thousands of Dollars Except for Per Share Data)

NOTE L - Stockholder's Equity (continued)

The following is a summary of the changes in options outstanding under the American Commerce Agents' Plan:

	Shares	Weighted Average Exercise Price
Options outstanding at January 1, 1999....	-	$ -
Granted..............................	1,872,380	36.32
Options outstanding at December 31, 1999..	1,872,380	36.32
Granted..............................	-	-
Options outstanding at December 31, 2000..	1,872,380	36.32
Granted..............................	250,000	41.97
Options outstanding at December 31, 2001..	2,122,380	$ 36.99

No options were exercisable at December 31, 2001, 2000, and 1999.

The fair value of each option granted under the American Commerce Agents' Plan was estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions:

	December 31, 2001	December 31, 2000
Dividend yield.................................	3.16%	4.47%
Volatility.....................................	28.30%	27.10%
Risk-free interest rate........................	4.04%	5.10%

(Thousands of Dollars Except for Per Share Data)

Expected option life in years....................	7	7

The estimated weighted average fair value per share of the options under the American Commerce Agents' Plan was $5.63, $4.48 and $5.28 at December 31, 2001, 2000 and 1999, respectively.

NOTE M - Net Capital Requirements

The insurance companies included in the consolidated financial statements are subject to the financial capacity guidelines established by their respective state Divisions of Insurance. Every Massachusetts insurance company seeking to make any dividend or other distributions to its stockholders may, within certain limitations, pay such dividends and then file a report with the Commissioner. Dividends in excess of these limitations are called extraordinary dividends. An extraordinary dividend is any dividend or other property, whose fair value together with other dividends or distributions made within the preceding twelve months exceeds the greater of ten percent of the insurer's surplus as regards policyholders as of the end of the preceding year, or the net income of a non-life insurance company for the preceding year. No pro-rata distribution of any class of the insurer's own securities is to be included. No Massachusetts insurance company shall pay an extraordinary dividend or other extraordinary distribution until thirty days after the Commissioner has received notice of the intended distribution and has not objected. No extraordinary dividends were paid in 2001, 2000 and 1999. California and Ohio have similar regulations. No extraordinary dividend was paid by American Commerce in 2001, 2000 and 1999 and no dividends were paid by Commerce West since its acquisition.

To the extent Commerce and Citation are restricted from paying dividends to CHI, CHI will be limited in its ability to pay dividends to the Company. On this basis, the Company's ability to pay dividends to its stockholders is limited. During 2001, Commerce and Citation paid $55,200 and $10,868 in dividends, respectively to CHI; CHI then paid $65,835 to the Company in March 2001. During 2000, Commerce and Citation paid $41,000 and $10,780 in dividends, respectively, to CHI; CHI then paid $51,660 to the Company in March 2000. Commerce West did not pay dividends on their common stock in 2001 and 2000. American Commerce paid ACIC Holding Co., Inc. a dividend of $9,281 in 2001, no dividend was paid in 2000. ACIC Holding Co., Inc. paid Commerce dividends of $9,582 and $9,178 in 2001 and 2000, respectively, on its outstanding preferred stock.

NOTE M - Net Capital Requirements (continued)

The Board of Directors of the Company voted to declare four quarterly dividends to stockholders of record totaling $1.19 per share and $1.15 per share in 2001 and 2000, respectively. On May 19, 2001, the Board voted to increase the quarterly stockholder dividend from $0.29 to $0.30 per share to stockholders of record as of June 4, 2001. Prior to that declaration, the Company paid quarterly dividends of $0.29 per share dating back to May 21, 2000 when the Board voted to increase the dividend from $0.28 to $0.29 per share.

(Thousands of Dollars)

NOTE N - Statutory Balances

Following is a GAAP to Statutory reconciliation for both earnings and policyholders surplus for the combined operations of Commerce, Citation, Commerce West and American Commerce:

	2001		2000		1999	
	Earnings	Equity	Earnings	Equity	Earnings	Equity
GAAP............................	$ 95,758	$787,172	$136,425	$756,922	$ 85,242	$635,787
Deferred income taxes (benefits).	(5,540)	34,518	6,077	(9,227)	(944)	(40,634)
Deferred acquisition costs.......	(5,252)	(116,557)	(12,805)	(111,305)	(3,373)	(98,499)
Bonds-book versus market.........	-	(11,578)	-	(5,726)	-	11,400
Preferred stock-market versus book...........................	-	467	-	1,506	-	(528)
Deferred income..................	(692)	6,802	231	7,493	518	7,380
Deferred service fee income (expense).....................	1,067	2,765	412	1,698	(804)	2,611
Deferred reinsurance commissions.....................	1,560	14,834	1,896	13,276	(201)	10,054
Statutory reserve over statement reserves........................	-	(115)	-	(1,042)	-	(3,053)
Goodwill in subsidiary...........	(290)	1,065	(290)	1,355	(291)	1,645
Pension and post-retirement benefit.........................	55	1,929	(2,072)	1,875	-	3,408
Yield to worst amortization......	(201)	(3,803)	-	-	-	-
Non-admitted assets..............	-	(8,682)	-	(4,308)	-	-
Adjustment for non-insurance company subsidiary..............	6,014	6,840	6,021	8,324	8,651	11,727
Equity in earnings (losses) of preferred stock mutual funds reflected in GAAP earnings......	(4,583)	-	(26,575)	-	-	-
Equity in earnings (losses) of venture capital funds reflected in GAAP earnings................	9,548	-	-	-	-	-
Equity in earnings (losses) of Liquidation Special Trust reflected in GAAP earnings......	(2,561)	-	-	-	-	-
GAAP restatement of preferred stock mutual funds..............	-	-	-	-	13,913	(21,371)
Other............................	135	275	(578)	121	329	(953)
Total adjustments...........	(740)	(71,240)	(27,683)	(95,960)	17,798	(116,813)
Statutory........................	$ 95,018	$715,932	$108,742	$660,962	$103,040	$518,974

NOTE O - Segment Information (continued)

The Company has four reportable segments: (1) property and casualty insurance - Massachusetts; (2) property and casualty insurance - other than Massachusetts; (3) real estate and commercial lending; and, (4) corporate and other. The Company's property and casualty insurance operations are written through Commerce, Citation, Commerce West, and American Commerce and are marketed to affinity groups, individuals, families and businesses through the Company's relationships with professional independent insurance agencies. The Company's real estate and commercial lending operations are a result of insurance companies having the authority to invest in mortgages. The Company's wholly-owned subsidiary, Bay Finance Company, Inc., originates and services residential and commercial mortgages in Massachusetts and Connecticut. The corporate and other segment represents the remainder of the Company's activities, including those of the parent company.

The Company evaluates performance and allocates resources based primarily on the property and casualty insurance segments, which represents 99.2% of the Company's total revenue for the past three years. The accounting policies of the reportable segments are the same as those described in Note A - Summary of Significant Accounting Policies.

Selected information by industry segment for 2001, 2000 and 1999 is summarized as follows:

	Revenue	Earnings (Losses) Before Income Taxes	Identifiable Assets
2001			
Property and casualty insurance			
Massachusetts	$1,011,318	$120,855	$1,848,333
Other than Massachusetts	135,483	(6,730)	245,397
Real estate and commercial lending	3,640	3,640	40,466
Corporate and other	3,397	(2,340)	5,886
Consolidated	$1,153,838	$115,425	$2,140,082
2000			
Property and casualty insurance			
Massachusetts	$ 969,624	$164,237	$1,780,724
Other than Massachusetts	121,028	7,115	236,240
Real estate and commercial lending	5,407	5,407	52,327
Corporate and other	3,421	(6,693)	6,323
Consolidated	$1,099,480	$170,066	$2,075,614
1999			
Property and casualty insurance			
Massachusetts	$ 844,052	$ 97,304	$1,562,975
Other than Massachusetts	110,179	3,998	224,017
Real estate and commercial lending	5,429	5,429	78,755
Corporate and other	3,374	(2,447)	12,272
Consolidated	$ 963,034	$104,284	$1,878,019

NOTE P - Supplement to Consolidated Statements of Cash Flows

During the years ended December 31, 2001 and 2000, the Company did not acquire any property through foreclosure of mortgages.

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NOTE Q - Insolvency Fund Assessments

As provided in the statutes, insurance companies which write business in Massachusetts are assessed for losses attributable to the insolvency of other insurance companies by the Massachusetts Insurers Insolvency Fund ("M.I.I.F."). From M.I.I.F.'s inception, on August 2, 1972 through December 31, 2001, the M.I.I.F. has approved assessments totaling $188,071, of which the Company's share was approximately $15,686. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. By statute, no insurer may be assessed in any year an amount greater than two percent of that insurer's direct written premiums for the calendar year preceding the assessment. Although the timing and amounts of any such assessments are not known, based on existing knowledge, management is of the opinion that such assessments will not have a material effect on the consolidated financial position of the Company. According to statute, the assessed insurance companies have the right to recoup amounts paid to the M.I.I.F., over a reasonable length of time, through premium rates approved by the Commissioner. M.I.I.F. assessed the Company $3,111 during 2001 and $5,306 for the year ended December 31, 2000 after having no activity for the year ended December 31, 1999. The assessment for 2001 was the result of two insolvencies, The Trust Insurance Company and Reliance Insurance Company, which accounted for assessment amounts of $1,244 and $1,867, respectively. The assessment for 2000 was primarily the result of two insolvencies, The Trust Insurance Company and New England Fidelity Insurance Company, which accounted for assessment amounts of $4,939 and $1,205, respectively, offset by refunds for prior year assessments on numerous insurers' insolvencies.

NOTE R - Commitments

In 2000, Commerce entered into a Limited Partnership Agreement with Conning Partners VI, L.P., a Delaware Limited Partnership. This partnership agreement required a commitment by the Company to invest up to $50,000 into the partnership. To date the Company has invested $15,091 into the partnership leaving a balance for funds still committed but not paid into the partnership of $34,909. The partnership was formed to operate as an investment fund principally for the purpose of making investments primarily in equity, equity-related and other securities issued in expansion financing, start-ups, buy-outs and recapitalization transactions relating to companies in the areas of insurance, financial services, e-commerce, healthcare, and related businesses, including, without limitation, service and technology enterprises supporting such businesses, in order to realize long-term capital returns, all as determined and managed by the General Partner for the benefit of the Partners.

Also in 2000, Commerce entered into a Limited Partnership Agreement with Distribution Partners Investment Capital, L.P. a Delaware Limited Partnership. This partnership agreement required a commitment by the Company to invest up to $3,500 into the partnership. To date the Company has invested $2,258 into the partnership leaving a balance of $1,242 for funds still committed. The partnership was formed to operate as an investment fund principally for the purpose of making investments primarily in equity and equity-related securities of companies operating in the area of insurance distribution and distribution related activities, all as determined and managed by the General Partner for the benefit of the Partners.

NOTE S - Legal Proceedings

As is common with property and casualty insurance companies, the Company is a defendant in various legal actions arising from the normal course of its business, including claims based on Chapter 176D and Chapter 93A. These proceedings are considered to be ordinary to operations or without foundation in fact. Management is of the opinion that these actions will not have a material adverse effect on the consolidated financial position of the Company. In addition to the normal course of business legal actions noted above, the Company is named as defendant in a purported class action lawsuit alleging damages as a result of the alleged diminution of value to vehicles that are involved in accidents. The "diminution of value" theory asserts that the market value of any vehicle involved in an accident inevitably and irreparably declines as a result of such accident, even if all physical damage appears to be repaired completely. This case, entitled "Elena Given, individually and as a representative of all persons similarly situated v. The Commerce Insurance Company", filed in 2001, in the Bristol Superior Court in Massachusetts. The plaintiff has not sought certification of class

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THE COMMERCE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001, 2000 and 1999
(Thousands of Dollars Except for Per Share Data)

NOTE S - Legal Proceedings (continued)

action status. The Company is vigorously contesting this suit, but is currently unable to estimate the potential exposure. The Company and its outside legal counsel are of the opinion that the Company will prevail in this case. Another Superior Court judge in Massachusetts ruled, in a similar case brought by the same plaintiff counsel against another insurer, that claims for diminution of value are not covered by the Massachusetts automobile insurance policy. Other insurance companies face similar suits in cases outside of Massachusetts.

NOTE T - Quarterly Results of Operations (Unaudited)

An unaudited summary of the Company's 2001 and 2000 quarterly performance is as follows:

2001	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenues................................	$273,428	$289,316	$294,642	$296,452

Net earnings	14,622	28,200	22,139	28,133
Comprehensive income	9,019	39,508	19,823	25,305
Operating earnings (1)	20,480	26,580	23,420	28,400
Net earnings per common share				
Basic	0.43	0.84	0.66	0.85
Diluted	0.43	0.83	0.65	0.84
Operating earnings per share (1)				
Basic	0.60	0.79	0.70	0.85
Diluted	0.60	0.78	0.69	0.85
Cash dividends paid per share	0.29	0.30	0.30	0.30

2000	First Quarter(2)	Second Quarter(2)	Third Quarter(2)	Fourth Quarter(2)
Total revenues	$261,898	$251,274	$295,780	$290,528
Net earnings	25,964	14,646	35,974	55,496
Comprehensive income	29,681	19,028	44,921	74,940
Operating earnings (1)	20,554	20,415	17,469	51,193
Net earnings per common share				
Basic	0.76	0.43	1.05	1.63
Diluted	0.76	0.43	1.05	1.63
Operating earnings per share (1)				
Basic	0.60	0.60	0.51	1.50
Diluted	0.60	0.60	0.51	1.50
Cash dividends paid per share	0.28	0.29	0.29	0.29

(1) The above figures are presented to provide information to the reader due to the amount of, and fluctuations in, net realized gains and losses. The amounts noted, which exclude the after-tax impact of net realized investment gains (losses), are important measures of corporate performance. Operating earnings per share, basic and diluted, are calculated identically to net earnings per common, basic and diluted, (see NOTE A15), with the exception that the number divided by the weighted shares would be operating earnings.

(2) During 2001 certain amounts were restated due to the change in accounting for closed-end preferred stock mutual funds to the equity method.

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SELECTED CONSOLIDATED FINANCIAL DATA

The data below should be read in conjunction with the consolidated financial statements, related footnotes, and other financial information included herein. The financial statements for the five years ended December 31, 2001 have been audited by Ernst & Young LLP. All dollar amounts set forth in the following tables are in thousands, except per share data:

	Years ended December 31,				
	2001	2000	1999	1998	1997
Statement of Earnings Data:					
Net premiums written	$1,078,967	$1,008,911	$ 911,993	$ 745,048	$ 741,501

(Increase) decrease in unearned premiums...........	(35,315)	(54,428)	(40,163)	572	(11,004)
Earned premiums..............	1,043,652	954,483	871,830	745,620	730,497
Net investment income.........	99,611	96,830	89,789	86,501	80,971
Premium finance and service fees.........................	17,819	15,227	14,774	13,440	7,074
Amortization of excess of book value of subsidiary interest over cost..........	3,389	3,390	3,019	-	-
Net realized investment gains (losses).....................	(10,633)	29,550	(16,378)	7,150	29,963
Total revenues...........	1,153,838	1,099,480	963,034	852,711	848,505
Losses and loss adjustment expenses.....................	777,543	686,157	625,090	531,429	526,127
Policy acquisition costs......	260,870	243,257	233,660	196,434	187,491
Total expenses...........	1,038,413	929,414	858,750	727,863	713,618
Earnings before income taxes and minority interest........	115,425	170,066	104,284	124,848	134,887
Income taxes..................	23,194	38,306	16,667	26,583	33,483
Net earnings before minority interest.....................	92,231	131,760	87,617	98,265	101,404
Minority interest in net loss of subsidiary..............	863	320	1,059	-	-
Net earnings............	$ 93,094	$ 132,080	$ 88,676	$ 98,265	$ 101,404
Comprehensive income.....	$ 93,655	$ 168,570	$ 40,730	$ 96,594	$ 103,460
Earnings Per Share Data:					
Basic....................	$ 2.77	$ 3.87	$ 2.54	$ 2.73	$ 2.81
Diluted..................	$ 2.75	$ 3.87	$ 2.54	$ 2.73	$ 2.81
Cash dividends paid per share...................	$ 1.19	$ 1.15	$ 1.11	$ 1.07	$ 1.03
Weighted average number of shares outstanding:					
Basic........................	33,608,804	34,121,047	34,940,074	36,042,652	36,044,679
Diluted......................	33,794,938	34,121,047	34,940,074	36,042,652	36,044,679

			December 31,		
	2001	2000	1999	1998	1997
Balance Sheet Data:					
Total investments............	$1,498,201	$1,472,562	$1,295,995	$1,262,500	$1,246,504
Premiums receivable...........	246,221	230,580	195,160	162,878	169,469
Total assets..................	2,140,082	2,075,614	1,878,019	1,747,583	1,739,562
Unpaid losses and loss adjustment expenses..........	681,624	674,140	659,841	583,996	630,473
Unearned premiums.............	563,456	519,885	457,095	391,424	379,599
Stockholders' equity..........	812,274	781,881	668,005	710,852	652,824
Stockholders' equity per share	24.52	23.16	19.44	19.72	18.11

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MANAGEMENT'S DISCUSSION OF THE SUPPLEMENTAL INFORMATION

ON INSURANCE OPERATIONS
(Thousands of Dollars)

The following tables depict the progress of the insurance operations of the Company over the past fifteen years. For these years of operation, net premiums written amounted to $8,358,235. During this period, the aggregate statutory financial ratios were 68.6% for losses and loss expenses and 26.1% for underwriting expenses resulting in an aggregate combined ratio of 94.7%. Total net investment income amounted to $876,134 or 10.5% of net premiums written. Net realized gains were $93,201. Stockholders' equity was $31,461 at the beginning of 1987 and $787,172, at the end of 2001, resulting in an average annual increase in excess of 23.9%, excluding dividends. This figure including dividends paid would have been 26.1%. The progress of the insurance operations during the most recent five year period, compared to the two previous five year periods, can best be illustrated by the following comparison:

	5-Year Period		
	1997-01	1992-96	1987-91
Direct premiums written..........................	$4,737,712	$3,110,296	$1,710,049
Net premiums written............................	4,486,420	2,976,451	895,364
Net investment income...........................	465,687	303,657	106,790
Net realized gains..............................	28,969	50,290	13,942
Stockholders' equity at end of period...........	787,172	550,087	177,225
Statutory Financial Ratios (Unaudited)			
Losses and loss expenses to premiums earned....	70.2%	66.5%	66.8%
Underwriting expenses to net premiums written..	25.2	27.4	26.6
Combined ratio............................	95.4%	93.9%	93.4%
Increase in Stockholders' Equity................	43.1%	210.4%	463.3%

The insurance operations of the Company include the operating results of Commerce and Citation, along with Commerce's subsidiary companies, Commerce West and American Commerce. Citation commenced business in 1981 as a wholly-owned subsidiary of Commerce. On December 31, 1989, the ownership of Citation was transferred to The Commerce Group, Inc. In September 1993, ownership of both Commerce and Citation was transferred from The Commerce Group, Inc. to CHI, a subsidiary of The Commerce Group, Inc. Results of Commerce West are included since its acquisition by Commerce on August 31, 1995. Results of American Commerce are included since its acquisition by Commerce on January 29, 1999. The combined balance sheets of these insurance subsidiaries appear on pages 71 and 72. The combined statements of earnings of insurance operations appear on pages 73 and 74. During 2001 certain amounts for years 1996 through 2000 were restated due to the change in accounting for closed-end preferred stock mutual funds to the equity method, reflected as realized gains or losses.

MANAGEMENT'S DISCUSSION OF THE SUPPLEMENTAL INFORMATION
ON INSURANCE OPERATIONS (continued)

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
COMBINED BALANCE SHEETS OF INSURANCE SUBSIDIARIES
December 31,
(Thousands of Dollars)

	2001	2000	1999	1998	1997
ASSETS					
Cash and short-term investments.....	$ 148,418	$ 70,392	$ 22,410	$ 75,655	$ 238,685
Bonds, at market (at amortized cost prior to 1993)....................	626,482	669,935	647,338	619,267	590,597
Preferred stocks, at market (at amortized cost prior to 1993)......	248,101	200,083	211,049	197,425	148,499
Common stocks, at market...........	107,458	115,827	77,348	111,482	58,652
Preferred stock mutual funds........	309,282	337,733	251,135	177,079	123,246
Mortgage loans on real estate.......	26,237	35,340	42,479	46,573	57,425
Other investments..................	18,743	26,802	14,139	7,825	3,783
Premium balances receivable.........	246,095	230,450	195,047	162,704	169,311
Investment income receivable........	15,460	18,118	14,531	13,544	12,103
Residual market receivable..........	125,832	127,241	141,660	140,220	161,799
Reinsurance receivable.............	70,450	61,554	48,365	36,687	18,170
Deferred acquisition costs..........	116,557	111,305	98,500	88,759	85,264
Current income taxes...............	-	-	-	2,773	-
Deferred income taxes..............	15,797	10,901	37,612	-	-
Non-compete agreement..............	2,479	2,829	3,179	-	-
Real estate, furniture and equipment	38,764	33,498	27,321	27,885	29,060
Total assets...............	$2,116,155	$2,052,008	$1,832,113	$1,707,878	$1,696,594
LIABILITIES					
Unpaid losses and loss expenses.....	$ 675,978	$ 669,837	$ 659,319	$ 579,174	$ 618,094
Unearned premiums..................	563,456	519,885	457,095	391,424	379,599
Excess of book value of subsidiary interest over cost................	5,719	8,431	10,758	-	-
Notes payable......................	-	-	-	-	-
Deferred income....................	7,015	7,703	7,464	6,948	7,271
Accounts payable, accrued and other liabilities.......................	72,998	72,333	48,505	70,558	60,332
Current income taxes...............	3,817	15,829	11,821	-	9,635
Deferred income taxes..............	-	-	-	4,955	9,218
Total liabilities..........	1,328,983	1,294,018	1,194,962	1,053,059	1,084,149
Minority interest..................	-	1,068	1,364	-	-
STOCKHOLDERS' EQUITY					
Capital stock......................	3,600	3,600	3,600	3,620	3,600
Paid-in capital....................	45,050	45,050	45,050	45,050	45,050
Retained earnings					
Balance, January 1...............	708,272	587,137	606,149	563,795	501,437

Net earnings.....................	95,758	136,425	85,242	95,661	106,718
Other comprehensive income (loss).	560	36,490	(47,948)	(1,669)	2,055
Dividends paid...................	(66,068)	(51,780)	(56,306)	(51,638)	(46,415)
Balance, December 31...............	738,522	708,272	587,137	606,149	563,795
Total stockholders' equity..	787,172	756,922	635,787	654,819	612,445
Total liabilities and stockholders' equity......	$2,116,155	$2,052,008	$1,832,113	$1,707,878	$1,696,594

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MANAGEMENT'S DISCUSSION OF THE SUPPLEMENTAL INFORMATION
ON INSURANCE OPERATIONS (continued)

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
COMBINED BALANCE SHEETS OF INSURANCE SUBSIDIARIES
December 31,
(Thousands of Dollars)

1996	1995	1994	1993	1992	1991	1990	1989	1988	198
				ASSETS					
$ 140,102	$ 52,308	$ 4,560	$ 12,615	$ 25,809	$ 11,190	$ 38,654	$ 84,308	$ 60,885	$ 21,0
716,702	815,277	745,010	649,491	505,565	329,935	242,735	153,621	133,867	116,2
147,680	111,220	85,574	80,059	2,261	869	1,010	1,324	1,606	2,2
63,156	40,359	9,656	47,462	43,545	30,055	4,869	2,900	1,921	1,4
22,727	-	-	-	-	-	-	-	-	-
45,398	31,404	35,715	42,042	60,697	66,122	56,124	52,244	42,882	15,9
127	-	-	-	67,876	55,510	57,733	56,713	33,727	19,3
157,673	126,090	101,529	94,333	-	-	-	-	-	-
12,655	14,440	13,285	10,205	9,710	6,063	4,235	3,093	2,889	2,3
182,213	187,124	198,818	203,312	253,426	254,196	266,440	246,951	184,177	123,7
19,659	21,897	16,892	12,868	365	-	-	-	-	-
82,968	67,160	59,066	53,647	55,442	33,981	27,273	22,702	15,699	10,8
-	-	-	-	-	-	-	341	266	-
-	2,100	38,180	-	-	883	1,666	-	-	-
-	-	-	-	-	-	-	-	-	-
26,011	24,642	25,246	22,371	23,183	24,163	25,046	23,118	9,684	8,3
$1,617,071	$1,494,021	$1,333,531	$1,228,405	$1,047,879	$812,967	$725,785	$647,315	$487,603	$321,6
				LIABILITIES					
$ 644,854	$ 605,791	$ 576,373	$ 550,797	$ 474,800	$416,551	$379,752	$323,020	$256,628	$160,5
367,991	330,454	314,719	283,526	264,567	192,785	175,334	174,345	118,079	84,8
-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	1,662	1,837	2,013	2,2
7,974	8,954	10,451	7,351	8,384	12,918	20,264	23,689	23,307	11,0
41,368	34,351	43,433	16,564	20,863	7,677	21,065	27,513	19,350	14,5
2,726	1,596	10,254	4,867	9,249	5,811	3,542	-	-	4

2,071	-	-	13,669	4,400	-	-	1,623	1,021	1,8
1,066,984	981,146	955,230	876,774	782,263	635,742	601,619	552,027	420,398	275,5
-	-	-	-	-	-	-	-	-	-
				STOCKHOLDERS' EQUITY					
3,600	3,450	3,450	3,450	3,450	3,450	3,450	3,450	2,350	2,3
45,050	23,700	23,700	8,700	8,700	8,700	8,700	8,700	6,500	6,5
485,725	351,151	339,481	253,466	165,075	112,016	83,138	62,877	37,231	22,6
74,543	110,450	113,892	79,837	91,980	55,214	32,414	21,966	21,837	15,6
6,399	58,919	(77,622)	21,928	9,811	2,545	(86)	645	321	(
(65,230)	(34,795)	(24,600)	(15,750)	(13,400)	(4,700)	(3,450)	(2,350)	(1,034)	(9
501,437	485,725	351,151	339,481	253,466	165,075	112,016	83,138	58,355	37,2
550,087	512,875	378,301	351,631	265,616	177,225	124,166	95,288	67,205	46,0
$1,617,071	$1,494,021	$1,333,531	$1,228,405	$1,047,879	$812,967	$725,785	$647,315	$487,603	$321,6

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MANAGEMENT'S DISCUSSION OF THE SUPPLEMENTAL INFORMATION
ON INSURANCE OPERATIONS (continued)

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF EARNINGS OF INSURANCE OPERATIONS
Years Ended December 31,
(Thousands of Dollars)

	2001	2000	1999	1998	1997
Underwriting					
Direct premiums written..................	$1,152,407	$1,071,649	$948,149	$796,858	$768,649
Net premiums written.....................	$1,078,967	$1,008,911	$911,993	$745,048	$741,501
Increase (decrease) in unearned premiums................................	35,315	54,428	40,163	(572)	11,004
Earned premiums......................	1,043,652	954,483	871,830	745,620	730,497
Expenses					
Losses and loss expenses.................	776,709	682,805	628,087	533,523	521,775
Underwriting expenses....................	263,766	251,697	238,458	200,525	185,146
(Increase) decrease in deferred acquisition costs.......................	(5,252)	(12,805)	(3,374)	(3,495)	(2,296)
Total expenses.......................	1,035,223	921,697	863,171	730,553	704,625
Underwriting income (loss).................	8,429	32,786	8,659	15,067	25,872
Net investment income......................	100,384	96,739	90,028	89,356	89,180
Premium finance fees.......................	17,814	15,221	14,768	13,426	7,056
Amortization of excess of book value of subsidiary interest over cost...........	3,389	3,390	3,019	-	-
Net realized investment gains (losses)......	(10,738)	29,380	(16,325)	4,334	22,318
Earnings before Federal income taxes, withdrawing companies' settlements and minority interest.................	119,278	177,516	100,149	122,183	144,426
Other income					

Withdrawing companies' settlements........	-	-	-	-	-
Earnings before Federal income taxes and minority interest.....................	119,278	177,516	100,149	122,183	144,426
Federal income taxes.......................	24,383	41,411	15,966	26,522	37,708
Earnings before cumulative effect of change in accounting principle and minority interest.........................	94,895	136,105	84,183	95,661	106,718
Cumulative effect on prior years (to December 31, 1986) of changing to different method of accounting for income taxes..............................	-	-	-	-	-
Minority interest in net loss of subsidiary.	863	320	1,059	-	-
NET EARNINGS.........................$	95,758	$ 136,425	$ 85,242	$ 95,661	$106,718
Statutory Financial Ratios (Unaudited)					
Losses and loss expenses to premiums earned.........................	74.7%	71.7%	72.0%	71.6%	71.4%
Underwriting expenses to net premiums written........................	24.4	25.1	26.5	26.5	25.1
Combined ratio.......................	99.1%	96.8%	98.5%	98.1%	96.5%
Underwriting profit (loss)...........	0.9%	3.2%	1.5%	1.9%	3.5%

MANAGEMENT'S DISCUSSION OF THE SUPPLEMENTAL INFORMATION
ON INSURANCE OPERATIONS (continued)

THE COMMERCE GROUP, INC. AND SUBSIDIARIES
COMBINED STATEMENTS OF EARNINGS OF INSURANCE OPERATIONS
Years Ended December 31,
(Thousands of Dollars)

1996	1995	1994	1993	1992	1991	1990	1989	1988	198
$731,823	$626,666	$ 625,023	$601,289	$525,495	$429,780	$401,077	$366,492	$304,469	$206,
$711,570	$603,421	$ 589,197	$563,416	$508,847	$310,999	$219,936	$140,313	$124,923	$ 99,
42,854	10,831	17,144	14,856	98,353	30,193	34,692	12,655	9,678	13,
668,716	592,590	572,053	548,560	410,494	280,806	185,244	127,658	115,245	85,
474,173	367,258	369,764	373,243	271,848	173,901	125,219	88,564	80,203	65,
194,873	171,892	162,446	147,290	138,669	85,655	55,551	44,181	33,115	25,
(15,809)	(5,723)	(5,420)	1,796	(21,462)	(6,708)	(4,571)	(7,003)	(4,801)	(3,
653,237	533,427	526,790	522,329	389,055	252,848	176,199	125,742	108,517	87,
15,479	59,163	45,263	26,231	21,439	27,958	9,045	1,916	6,728	(1,
76,978	71,007	63,119	52,868	39,685	32,661	25,978	21,256	15,999	10,

9,666	19,246	18,315	16,486	13,734	11,165	10,074	8,095	4,592	3,
-	-	-	-	-	-	-	-	-	-
(7,863)	720	32,025	13,040	12,368	7,529	74	618	2,298	3,
94,260	150,136	158,722	108,625	87,226	79,313	45,171	31,885	29,617	15,
-	-	-	-	43,168	-	-	-	-	-
94,260	150,136	158,722	108,625	130,394	79,313	45,171	31,885	29,617	15,
19,717	39,686	44,830	28,788	38,414	24,099	12,757	9,919	7,780	2,
74,543	110,450	113,892	79,837	91,980	55,214	32,414	21,966	21,837	12,
-	-	-	-	-	-	-	-	-	2,
-	-	-	-	-	-	-	-	-	-
$ 74,543	$110,450	$ 113,892	$ 79,837	$ 91,980	$ 55,214	$ 32,414	$ 21,966	$ 21,837	$ 15,
70.9%	62.0%	64.6%	68.0%	66.2%	61.9%	65.7%	68.0%	69.5%	7
27.1	29.0	27.1	25.7	28.1	30.0	26.7	26.3	22.0	2
98.0%	91.0%	91.7%	93.7%	94.3%	91.9%	92.4%	94.3%	91.5%	10
2.0%	9.0%	8.3%	6.3%	5.7%	8.1%	7.6%	5.7%	8.5%	(

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ORGANIZATIONAL CHART

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                                 --------------------------
                                 |The Commerce Group, Inc.|
                                 |A Massachusetts Corp.   |
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                                              |
                                              |
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                  |                               |                                   |
                  |                               |                                   |
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|Bay Finance Company, Inc.|     |Commerce Holdings, Inc. |     |Clark-Prout Insurance Agency|
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|A Massachusetts Corp.    |     |A Massachusetts Corp.   |     |A Massachusetts Corp.       |
|A wholly-owned subsidiary|     |A wholly-owned insurance|     |A wholly-owned subsidiary   |
---------------------------     |holding company         |     ------------------------------
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                   |                                                 |
                   |                                                 |
    --------------------------------                ----------------------------
    |The Commerce Insurance Company|                |Citation Insurance Company|
    |A Massachusetts Corp.         |                |A Massachusetts Corp.     |
    |A wholly-owned subsidiary     |                |A wholly-owned subsidiary |
    --------------------------------                ----------------------------
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            |                                        |
  --------------------------       ---------------------------------
  |ACIC Holding, Inc.      |       |Commerce West Insurance Company|
  |A Rhode Island Corp.    |       |A California Corp.             |
  |An 80% owned holding co.|       |A wholly-owned subsidiary      |
  --------------------------       ---------------------------------
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     |American Commerce Insurance Company|
     |An Ohio Corp.                      |
     |A wholly-owned subsidiary          |
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THE COMMERCE GROUP, INC.

DIRECTORS

Herman F. Becker......................... President and owner, Sterling Realty and Huguenot Development Corporation

Joseph A. Borski, Jr..................... Self-employed Certified Public Accountant

Eric G. Butler........................... Retired Vice President and General Claims Manager of Commerce and Citation

Henry J. Camosse......................... Retired President, Henry Camosse & Sons Co., Inc., a building and masonry supplies company

Gerald Fels.............................. Executive Vice President and Chief Financial Officer of the Company; President and Chief Operating Officer of Commerce and Citation

David R. Grenon.......................... Retired CEO, President and Chairman Emeritus of The Protector Group Insurance Agency, Inc.; President E-C Realty Corporation

Robert W. Harris......................... Retired Treasurer, H.C. Bartlett Insurance Agency,

	Inc.
Robert S. Howland........................	Retired Clerk, H.C. Bartlett Insurance Agency, Inc.
John J. Kunkel...........................	President and Treasurer, Kunkel Buick and GMC Truck; Treasurer, Kunkel Bus Company
Raymond J. Lauring.......................	Retired President, Lauring Construction Company
Normand R. Marois........................	Retired Chairman of the Board, Marois Bros., Inc., a contracting firm
Suryakant M. Patel.......................	Retired physician who specialized in internal medicine
Arthur J. Remillard, Jr..................	President, Chief Executive Officer and Chairman of the Board of the Company
Arthur J. Remillard, III.................	Senior Vice President and Assistant Clerk of the Company; Senior Vice President of Commerce and Citation in charge of Policyholder Benefits
Regan P. Remillard.......................	Senior Vice President of the Company; President and Secretary of Commerce West Insurance Company; President of ACIC Holding Co., Inc.; President, Vice Chairman of the Board and Chief Executive Officer of American Commerce Insurance Company
Gurbachan Singh..........................	Retired physician who specialized in general surgery
John W. Spillane.........................	Clerk of the Company and practicing attorney

DIRECTORS OF
COMMERCE HOLDINGS, INC.
The Commerce Insurance Company
Commerce West Insurance Company
Citation Insurance Company

Arthur J. Remillard, Jr...........	President and Chairman of the Board of Commerce Holdings, Inc.; Chief Executive Officer and Chairman of the Board of The Commerce Insurance Company, Inc.; Chairman of the Board Commerce West Insurance Company
Gerald Fels.......................	President, Chief Operating Officer and Chief Financial Officer of The Commerce Insurance Company and Citation Insurance Company; Treasurer, Commerce Holdings, Inc.; Investment Officer of Commerce West

	Insurance Company
Arthur J. Remillard, III (1)......	Senior Vice President and Clerk
Regan P. Remillard................	Senior Vice President; President and Secretary of Commerce West Insurance Company
James A. Ermilio (1)..............	Senior Vice President and General Counsel
David R. Grenon (1)...............	Retired CEO, President and Chairman Emeritus of The Protector Group Insurance Agency, Inc.; President E-C Realty Corporation
John M. Nelson (1)................	Chairman of Commonwealth National Bank
Suryakant M. Patel (1)............	Retired physician who specialized in internal medicine
William G. Pike (1)...............	Executive Vice President and Chief Financial Officer of Granite State Bankshares, Inc.
H. Thomas Rowles (1)..............	Chairman of the Board of ACIC Holding Co., Inc.; Chairman of the Board of American Commerce Insurance Company; Director of AAA Southern New England
Mark A. Shaw (1)..................	Treasurer of ACIC Holding Co., Inc.; President, Chief Executive Officer and Director of AAA Southern New England

(1) Commerce Holdings, Inc., The Commerce Insurance Company and Citation Insurance Company only.

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DIRECTORS OF
ACIC Holding Co., Inc.(1)
American Commerce Insurance Company

H. Thomas Rowles..................	Chairman of the Board of ACIC Holding Co., Inc.; Chairman of the Board of American Commerce Insurance Company; Director of AAA Southern New England
Regan P. Remillard................	President of ACIC Holding Co., Inc.; President, Vice Chairman of the Board and Chief Executive Officer of American Commerce Insurance Company; Senior Vice President of The Commerce Group, Inc.; President and Secretary of Commerce West Insurance Company
Mark A. Shaw......................	Treasurer of ACIC Holding Co., Inc.; President,

	Chief Executive Officer and Director of AAA Southern New England
Gerald Fels.......................	Executive Vice President and Chief Financial Officer of The Commerce Group, Inc.
Patrick W. Doherty (2)...........	President and Chief Executive Officer of AAA Oklahoma
Terry R. Farias (2)...............	President and Chief Executive Officer of AAA Hoosier Motor Club
Richard S. Hamilton (2)..........	President of AAA West Pennsylvania/West Virginia/South Central Ohio
Charles B. Liekweg (2)...........	President and Chief Executive Officer of AAA Washington
D. James McDowell (2)............	President and Chief Executive Officer of AAA Arizona
Peter C. Ohlheiser (2)...........	President of Ohio Motorists Association
Otto T. Wright (2)................	President and Chief Executive Officer of East Tennessee Automobile Club, Inc.

(1) Incorporated in November, 1998. 80% owned by The Commerce Insurance Company and 20% owned by AAA Southern New England.
(2) American Commerce Insurance Company only, which was acquired in January 1999.

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DIRECTORS OF
BAY FINANCE COMPANY, INC.

Arthur J. Remillard, Jr.............	President and Chairman of the Board
Gerald Fels.........................	Executive Vice President and Chief Financial Officer
John W. Spillane....................	Clerk and Practicing Attorney

Arthur J. Remillard, III.............	Senior Vice President and Assistant Clerk
Regan P. Remillard...................	Senior Vice President

DIRECTORS OF
CLARK-PROUT INSURANCE AGENCY, INC.

Arthur J. Remillard, Jr..............	President and Chairman of the Board
Gerald Fels..........................	Executive Vice President and Chief Financial Officer
John W. Spillane.....................	Clerk and Practicing Attorney
Arthur J. Remillard, III.............	Senior Vice President and Assistant Clerk
Elizabeth M. Edwards.................	Vice President

THE COMMERCE GROUP, INC.
- Commerce Holdings, Inc.
  - The Commerce Insurance Company
    - Commerce West Insurance Company
    - ACIC Holding Co., Inc. (1)
      - American Commerce Insurance Company (2)
  - Citation Insurance Company
- Bay Finance Company, Inc.
- Clark-Prout Insurance Agency, Inc.

OFFICERS OF THE COMMERCE GROUP, INC.

President, Chief Executive Officer and Chairman of the Board.....	Arthur J. Remillard, Jr.
Executive Vice President and Chief Financial Officer............	Gerald Fels
Senior Vice President and Assistant Clerk.......................	Arthur J. Remillard, III
Senior Vice President...	Regan P. Remillard
Senior Vice President and General Counsel.......................	James A. Ermilio
Vice President..	Joseph J. Staffieri
Clerk...	John W. Spillane
Treasurer and Chief Accounting Officer..........................	Randall V. Becker
Vice President and Corporate Compliance Officer.................	Robert E. McKenna
Assistant Vice President and Assistant General Counsel..........	Thomas D. Jungeberg
Assistant Treasurer...	Thomas A. Gaylord

Officers of Massachusetts Subsidiaries (3)

Chief Executive Officer and Chairman of the Board...............		Arthur J. Remillard, Jr.
President, Chief Operating Officer and Chief Financial Officer...		Gerald Fels
Senior Vice President and Secretary.............................		Arthur J. Remillard, III
Senior Vice President and General Counsel.......................		James A. Ermilio
Senior Vice Presidents..		David H. Cochrane
		Peter J. Dignan
		Regan P. Remillard
		Joyce B. Virostek
Vice Presidents...		Elizabeth M. Edwards
		Karen A. Lussier
		Robert E. McKenna
		Michael J. Richards
		Angelos Spetseris
		Joseph J. Staffieri
		Henry R. Whittier, Jr.
Assistant Vice President and Assistant General Counsel..........		Thomas D. Jungeberg
Assistant Vice Presidents.....................	David P. Antocci	James E. Gow
	Robert M. Blackmer	Susan A. Horan
	Stephen R. Clark	John V. Kelly
	Raymond J. DeSantis	Donald G. MacLean
	Warren S. Ehrlich	Patrick J. McDonald
	Richard W. Goodus	Robert L. Mooney
		Emile E. Riendeau
Treasurer and Chief Accounting Officer..........................		Randall V. Becker
Assistant Treasurer...		Thomas A. Gaylord

(1) Incorporated in November, 1998, the common stock of which is 80% owned by The Commerce Insurance Company and 20% owned by AAA Southern New England.
(2) Acquired by ACIC Holding Co., Inc. in January, 1999.
(3) Massachusetts subsidiaries include Commerce Holdings, Inc., The Commerce Insurance Company, Citation Insurance Company, Bay Finance Company, Inc. and Clark-Prout Insurance Agency. Officers often hold positions with several operating subsidiaries. The titles listed represent their primary office as of March 1, 2002.

Officers of ACIC Holding Co., Inc.

Chairman of the Board..	H. Thomas Rowles
President..	Regan P. Remillard
Treasurer..	Mark A. Shaw
Secretary..	James A. Ermilio

Officers of American Commerce Insurance Company

Chairman of the Board..	H. Thomas Rowles
President, Vice Chairman of the Board and Chief Executive Officer....	Regan P. Remillard
Senior Vice President and Chief Financial Officer....................	Michael V. Vrban
General Counsel and Secretary..	James A. Ermilio
Treasurer..	Richard B. O'Hara
Vice President...	Gregory S. Clark
Vice President...	Joseph B. Phillips, Jr.
Assistant Vice President...	William J. Hafer
Assistant Vice President...	Jeffrey B. Alexander
Assistant General Counsel and Assistant Secretary....................	Thomas D. Jungeberg

Officers of Commerce West Insurance Company

Chairman of the Board..	Arthur J. Remillard, Jr.
President and Secretary..	Regan P. Remillard
Treasurer and Chief Financial Officer	Michael V. Vrban
Chief Accounting Officer...	Albert E. Peters
Investment Officer...	Gerald Fels
Vice Presidents..	Michael J. Berryessa
	Albert R. Harris

Stockholder Information

Annual Meeting

The Annual meeting of stockholders will be held at 9:00 a.m. on Friday, May 17, 2002 at the Company's Underwriting Building, 11 Gore Road (Route 16), Webster, MA.

Form 10-K

Stockholders interested in the detailed information contained in the Company's annual report on Form 10-K, as filed with the Securities and Exchange Commission, may obtain a copy without charge, by writing to the Assistant to the President at 211 Main Street, Webster, MA 01570.

Transfer Agent

The Commerce Group, Inc.
c/o Equiserve Trust Company, N.A.
P.O. Box 43010
Providence, RI 02940-3010
(781) 575-3100 or (800) 733-5001
http://www.equiserve.com

Executive Offices

211 Main Street
Webster, MA 01570
(508) 943-9000

Company Websites

The Commerce Insurance Company	http://www.commerceinsurance.com
American Commerce Insurance Company	http://www.acilink.com
Bay Finance Company, Inc.	http://www.bayfinance.com

Trading of Common Stock

The Company's Common Stock trades on the NYSE under the symbol "CGI".

Independent Auditors

Ernst & Young LLP
200 Clarendon Street
Boston, MA 02116
(617) 266-2000
http://www.ey.com