LIBERTY MUTUAL GROUP

Combined Financial Statements

December 31, 1999 and 1998

ERNST & YOUNG

■ Ernst & Young LLP
200 Clarendon Street
Boston
Massachusetts 02116-5072

■ Phone: (617) 266-2000
Fax: (617) 266-5843
www.ey.com

Report of Independent Auditors

The Board of Directors
Liberty Mutual Insurance Company
Liberty Mutual Fire Insurance Company
Emp1oyers Insurance of Wausau A Mutual Company

We have audited the accompanying combined balance sheets of Liberty Mutual Group as of December 31, 1999 and 1998, and the related combined statements of income, policyholders' surplus, and cash flows for the years then ended. These financial statements are the responsibility of the Group'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 combined financial position of Liberty Mutual Group at December 31, 1999 and 1998, and the combined results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

September 14, 2000

Boston, MA

Ernst & Young LLP

Liberty Mutual Group
Combined Balance Sheets
(dollars in millions)

	December 31, 1999	1998
Assets		
Investments:		
Fixed maturities	$32,799	$34,075
Equity securities	2,921	3,045
Other invested assets	2,765	2,070
Short-term investments	319	530
	38,804	39,720
Cash and cash equivalents	2,417	1,683
Premium and other receivables, net	3,170	2,839
Recoverables from reinsurers, net	6,437	6,121
Reinsurance deposit receivable	167	460
Accrued investment income	515	500
Deferred income taxes	702	312
Deferred policy acquisition costs	1,366	816
Deferred distribution costs	154	130
Intangible assets	903	588
Other assets	1,975	1,778
Separate account assets	5,641	3,680
Total assets	$62,251	$58,627
Liabilities, Minority Interest and Policyholders' Surplus		
Liabilities:		
Unpaid losses and loss adjustment expenses	$24,737	$24,082
Reserve for unearned premiums	3,475	2,896
Future policy benefits	14,455	14,425
Funds held by companies under reinsurance treaties	127	88
Current income taxes payable	209	125
Debt outstanding	1,961	1,882
Guaranty fund reserve	282	270
Dividends to policyholders	213	215
Other liabilities	3,515	2,634
Separate account liabilities	5,578	3,638
Total liabilities	54,552	50,255

Liberty Mutual Group
Combined Balance Sheets
(dollars in millions)

	December 31, 1999	1998
Minority interest	360	416
Policyholders' Surplus:		
Unassigned Surplus	6,620	6,181
Accumulated other comprehensive income	719	1,775
Total policyholders' surplus	7,339	7,956
Total liabilities, minority interest and policyholders' surplus	$62,251	$58,627

See accompanying notes to the combined financial statements

Liberty Mutual Group
Combined Statements of Income
(dollars in millions)

	Year ended December 31, 1999	1998
Revenue:		
Net premiums earned	$9,483	$7,509
Net investment income	2,627	2,312
Fee income	713	621
Net realized investment gains	406	193
Other revenue	133	211
Total revenue	13,362	10,846
Losses, benefits and Expenses:		
Losses and loss adjustment expenses	8,069	6,375
Policyholder benefits	375	241
Interest credited to policyholders	577	604
General and administrative expenses	1,996	1,648
Policy acquisition costs	1,380	1,073
Dividends to policyholders	130	41
Interest expense	155	118
Total losses, benefits and expenses	12,682	10,100
Income before income taxes and minority interest	680	746
Federal and foreign income taxes:		
Current	82	86
Deferred	130	144
Total federal and foreign income taxes	212	230
Income before minority interest	468	516
Minority interest	(29)	(34)
Net income	$ 439	$ 482

See accompanying notes to the combined financial statements

Liberty Mutual Group
Combined Statements of Policyholders' Surplus
(dollars in millions)

	Unassigned Surplus	Accumulated Other Comprehensive Income	Total Policyholders' Surplus
Balance, January 1, 1998	$5,699	$1,438	$7,137
Comprehensive income:			
Net income	482		482
Other comprehensive income (loss), net of taxes:			
Unrealized gains on securities:			
Unrealized gains arising during period, net of taxes		478	478
Less: reclassification adjustment for gains included in net income, net of taxes		(125)	(125)
Foreign currency translation adjustments		(16)	(16)
Other comprehensive income, net of taxes			337
Total comprehensive income			819
Balance, December 31, 1998	6,181	1,775	7,956
Comprehensive income			
Net income	439		439
Other comprehensive income (loss), net of taxes:			
Unrealized losses on securities:			
Unrealized losses arising during period, net of taxes		(723)	(723)
Less: reclassification adjustment for gains included in net income, net of taxes		(264)	(264)
Foreign currency translation adjustments		(69)	(69)
Other comprehensive loss, net of taxes			(1,056)
Total comprehensive loss			(617)
Balance, December 31, 1999	$6,620	$ 719	$7,339

See accompanying notes to the combined financial statements

Liberty Mutual Group
Combined Statements of Cash Flows
(dollars in millions)

	Year Ended December 31, 1999	Year Ended December 31, 1998
Cash flows from operating activities:		
Net income	$ 439	$ 482
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	157	174
Net realized investments gains	(406)	(193)
Realized foreign exchange (gains) losses	(10)	8
Interest credited to policyholders	577	604
Net amortization on investments	52	44
Limited partnership investment income	(99)	(11)
Changes in operating assets and liabilities, net of acquisition of businesses:		
Accrued investment income	3	(32)
Premium and other receivables	(4)	(237)
Reinsurance recoverables from reinsurers	(36)	32
Deferred policy acquisition costs and distribution costs	(16)	(33)
Unpaid losses and loss adjustment expenses	(523)	(737)
Taxes payable, net of deferred	204	75
Future Policy benefits	(150)	(160)
Reserve for unearned premiums	41	(30)
Net change in other assets and liabilities	849	608
Total adjustments	639	112
Net cash provided by operating activities	1,078	594
Cash flows from investing activities		
Purchase of available for sale bonds and equity securities	(11,138)	(12,664)
Sales and maturities of available for sale bonds and equity securities	12,397	13,253
Property, plant and equipment purchased, net	(53)	(119)
Acquisition of businesses, net of cash received	(1,228)	(943)
Other investing activities	211	37
Net cash provided by (used in) investing activities	189	(436)

Cash flows from financing activities:

Liberty Mutual Group
Combined Statements of Cash Flows
(dollars in millions)

	Year Ended December 31, 1999	1998
Net activity in policy holder accounts	(1,055)	(359)
Proceeds from debt outstanding	113	447
Repayments of debt outstanding	(70)	(153)
Net security lending activity	505	(468)
Other financing activity	(26)	25
Net cash used in financing activities	(533)	(508)
Net increase (decrease) in cash and cash equivalents	734	(350)
Cash and cash equivalents, beginning of year	1,683	2,033
Cash and cash equivalents, end of years	$2,417	$1,683
Supplemental disclosure of cash flow information		
Income taxes (recovered) paid	$ (11)	$ 114

See accompanying notes to the combined financial statements.

LIBERTY MUTUAL GROUP

Notes to Combined Financial Statements

December 31, 1999 and 1998

(dollars in millions)

(1) Summary of Significant Accounting Policies

Principles of Combination

The accompanying combined financial statements of Liberty Mutual Group ("LMG" or "Companies") include the accounts of the Liberty Mutual Insurance Company ("Liberty Mutual"), Liberty Mutual Fire Insurance Company ("Liberty Fire"), Employers insurance of Wausau a Mutual Company ("EIOW"), Montgomery Mutual Insurance Company ("Montgomery") and Merchant's and Business Men's Mutual Insurance Company ("M&B") and subsidiaries. All material intercompany accounts and transactions have been eliminated.

Basis of Presentation

The accompanying combined financial statements have been prepared on the basis of accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Property and Casualty Insurance Operations

The property and casualty insurance companies within LMG write substantially all lines of property and casualty insurance. One or more of these companies is licensed to write substantially all of these lines in all states of the United States and in 13 foreign countries. Domestic property and casualty insurance operations comprise 75% and 74% of the Companies' revenue for the years ended December 31, 1999 and 1998, respectively. Premiums are earned primarily on a pro rata basis over the term of the related coverage. The reserve for unearned premiums represents the portion of premiums written relating to the unexpired terms of coverage.

Deferred policy acquisition costs are the costs of acquiring new business which vary with, and are primarily related to, the production of new business, principally commissions, premium taxes and certain other underwriting expenses. Deferred policy acquisition costs are amortized over the terms of the insurance policies. The Companies consider anticipated investment income in determining if a premium deficiency exists with respect to short-duration contracts. The Companies reduce deferred policy acquisition costs to the extent a premium deficiency is present.

The Companies provide reserves for unpaid insurance losses and loss adjustment expenses covering events that occurred in 1999 and prior years. These reserves reflect estimates of the total cost of claims reported but not yet paid and the cost of claims not yet reported, as well as the estimated expenses necessary to settle the claims. Reserve estimates arc based on past loss experience modified for current claim trends, as well as prevailing social, economic and legal conditions. Final claim payments, however, may ultimately differ from the established reserves, since these payments may not occur for several years. Reserve estimates are continually reviewed and updated, and any resulting adjustments are reflected in current operating results.

The Companies do not discount reserves other than tabular discounting on the long-term indemnity portion of workers compensation claims and the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states. Reserves are reduced for estimated amounts of salvage and subrogation and deductibles recoverable from policyholders.

Life Insurance Operations

The life insurance subsidiaries within LMG offer a wide range of traditional insurance and financial and investment products. Life insurance operations comprise 11% and 14% of the Companies' revenues for the years ended December 31, 1999 and 1998, respectively. Premiums on traditional life insurance policies are recognized as revenues when due. Benefits and expenses are associated with premiums so as to result in the recognition of profits over the life of the policies. This association is accomplished by providing liabilities for future policy benefits and the deferral and subsequent amortization of acquisition costs. Revenues for universal life policies represent investment income from the related invested assets and amounts assessed against policyholders. Included in such assessments are mortality charges, surrender charges paid and administrative fees. Policy account balances consist of consideration received plus credited interest, less accumulated policyholder charges, assessments and withdrawals. Credited interest rates ranged from 5.25% to 6.3% in 1999 and 1998.

The Companies write certain annuity and structured settlement contracts without mortality risk which are accounted for as investment contracts. Revenues from investment contracts consist of investment income from related invested assets, with profits recognized to the extent investment income exceeds the amount credited to the contract. Policy account balances consist of consideration received plus credited interest less policyholder withdrawals. Credited interest rates for annuity contracts were between 5.0% and 6.55% in 1999 and 5.0% and 5.85% in 1998.

Liabilities for future policy benefits for traditional life policies have been computed using the net level premium method based on estimated future investment yield, mortality and withdrawal experience. Interest rate assumptions were between 4.5% and 10.25% for all years of issue. Mortality assumptions have been calculated principally on an experience multiple applied to commonly accepted mortality tables depending on year of issue. Withdrawal assumptions generally are based on the Companies' experience.

The liability for future policy benefits with respect to structured settlement contracts with life contingencies and single premium group annuities (group pension) is determined based on interest crediting rates between 6.1% and 11.4%, and the mortality assumptions are based on the 1971 GAM and IAM tables, reflective of the Companies' experience.

Deferred policy acquisition costs are the costs of acquiring new business which vary with, and are primarily related to, the production of new business. Such costs include commissions, costs of policy underwriting and variable agency expenses. Deferred policy acquisition costs related to traditional and group life insurance and certain long-duration group accident and health insurance, to the extent recoverable from future policy revenues, are amortized over the premium-paying period of the related policies using assumptions consistent with those used in computing policy benefit reserves. Costs relating to group life and disability insurance policies are amortized straight-line over a five year period. For universal life insurance, annuity and investment products, to the extent recoverable from future group profits, deferred policy acquisition costs are amortized generally in proportion to the present value of expected gross profits from surrender charges and investment, mortality and expense margins. Deferred policy acquisition costs are adjusted for amounts relating to unrealized gains and losses on fixed maturity and equity securities the Companies have designated as available for sale. This adjustment, net of tax, is included with the net unrealized gains or losses that are reflected in accumulated other comprehensive income. Deferred policy acquisition costs were increased by $244 at December 31, 1999 and decreased by $68 at December 31, 1998, relating to this adjustment.

Participating life insurance policies issued by the life insurance subsidiaries of the Group approximate 26% and 28% of ordinary life insurance in force at December 31, 1999 and 1998, respectively, and 10% and 13% of ordinary insurance premium revenue in 1999 and 1998, respectively. The major portion of earnings from participating policies insures to the benefit of the participating policyholders and is not available to stockholders. Undistributed earnings of the participating block of business is included in other liabilities in the accompanying combined balance sheets.

Accident and health business policy and contract claims principally include claims in course of settlement and claims incurred but not reported, which are determined based on a formula derived as a result of the Companies' past experience. Claims liabilities may be more or less than the amounts paid when the claims are ultimately settled. Such differences are considered changes in estimates and are recorded in the combined statement of income in the year the claims are settled.

Financial Services Operations

The Companies' financial services subsidiaries are asset accumulation and management companies providing investment management products and retirement-oriented insurance products through multiple distribution channels. Financial service operations comprise three percent of the Companies' revenue for years ended December 31, 1999 and 1998.

Fees from asset management and investment advisory services and from transfer agent, bookkeeping, l2b-l distribution and service fees are recognized as revenues when services are provided.

Sales commissions and other direct costs related to the sale of LMG-sponsored intermediary-distributed mutual funds which charge l2b-l distribution fees and contingent deferred sales commissions are recorded as deferred distribution costs. Amortization is provided on a straight-line basis over periods of up to six years to match the estimated period in which associated fees will be earned. Contingent deferred sales charges (back-end loads) received are applied to deferred distribution costs to the extent of the estimated unamortized portion of such costs, with the remainder
recognized as additional distribution fee income.

Investments

Investments in debt and equity securities classified as available for sale are carried at current market values, and unrealized gains and losses (net of adjustments to deferred policy acquisition costs, value of insurance in force, and income taxes) are reported as a separate component of policyholders' surplus. The cost basis of securities is adjusted, by charges to income, for declines in value that are considered to be other than temporary. Realized gains and losses on sales of investments are recognized in net income using either the specific identification method or first-in first-out basis, net of adjustment for amortization of deferred policy acquisition costs.

For mortgage-backed fixed maturity securities, the Companies recognize income using a constant effective yield based on anticipated prepayments over the economic life of the security. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments and any resulting adjustment is included in investment income.

Policy loans are carried at the unpaid principal balances plus accrued interest.

Amounts classified as cash and cash equivalents include cash on hand, money market instruments and other debt issues with maturities of three months or less when purchased.

Short-term investments, consisting primarily of money market instruments and other debt issues purchased with an original maturity of over 90 days to one year, are considered available for sale and carried at fair value which approximated amortized cost.

Other invested assets, principally investments in limited partnerships, are accounted for using the equity method.

Derivatives

The Companies use interest rate swap and cap agreements to manage interest rate risk and call options and futures on the Standard & Poor's 500 Composite Stock Price index (“S&P 500 index") are used to hedge its obligations to provide annuity returns based upon this index. In addition, the Companies use equity swaps and written call options to serve as a hedge against potential losses on its equity holdings during a market decline.

The interest rate swap agreements ("swap agreements”) and interest rate cap agreements (“cap agreements”) match assets more closely to liabilities. Swap agreements are agreements to exchange with a counterparty interest rate payments of differing character (e.g., fixed-rate payments exchanged for variable-rate payments) based on an underlying principal balance (notional principal) to hedge against interest rate changes. The Companies currently utilize swap agreements to reduce asset duration and to better match interest rates earned on longer-term fixed rate assets with interest rates credited to policyholders. The Companies also utilize total return swap agreements to hedge its obligation related to certain separate account liabilities. A total return swap agreement is an agreement to exchange payments based upon an underlying notional balance and changes in variable rate and total return indices.

Cap agreements are agreements with a counter party which require the payment of a premium for the right to receive payments for the difference between the cap interest rate and a market interest rate on specified future dates based on an underlying principal balance (notional principal) to hedge against rising interest rates.

Hedge accounting is applied after the Companies determine that the items to be hedged expose it to interest rate or price risk, designate the instruments as hedges and assess whether the instruments reduce the indicated risks through the measurement of changes in the value of the instruments and the items being hedged at both inception and throughout the hedged period. From time to time, interest rate swap agreements, cap agreements, call options and futures are terminated. If the terminated position was accounted for as a hedge, realized gains and losses are deferred and amortized over the remaining lives of the hedged assets or liabilities. Conversely, if the terminated position was not accounted for as a hedge, or the assets and liabilities that were hedged no longer exist, the position is "marked to market" and realized gains and losses are immediately recognized in income.

The net differential to be paid or received on interest rate swap agreements is recognized as a component of net investment income. The net differential to be paid or received on total return swaps is recognized as a component of separate account fees. Premiums paid for interest rate cap agreements are deferred and amortized to net investment income on a straight-line basis over the terms of the agreements. The unamortized premium is included in other invested assets. Amounts earned on interest rate cap agreements are recorded as an adjustment to net investment income. Interest rate swap agreements and cap agreements hedging investments designated as available for sale are adjusted to fair value with the resulting unrealized gains and losses included in policyholders' surplus. Total return swap agreements hedging certain separate account liabilities are adjusted to fair value with the resulting unrealized gains and losses included in policyholders' surplus.

Premiums paid on call options are amortized to net investment income over the terms of the contracts. The call options are included in other invested assets and are carried at amortized cost plus intrinsic value, if any, of the call options as of the valuation date. Changes in intrinsic value of the call options are recorded as an adjustment to interest credited to policyholders. Futures are carried at fair value and require daily cash settlement. Changes in the fair value of futures that qualify as hedges are deferred and recognized as an adjustment to the hedged asset or liability. Call options and futures that do not qualify as hedges are carried at fair value; changes in value are immediately recognized in income.

The Companies are party to derivative contracts in the form of equity swap contracts. The purpose of the equity swap contracts is to exchange rates of return of is specified set of common -stocks-for rates of return consistent with the broad equity markets as represented by the S&P 500 Index. The Companies agree with counter parties to exchange, at specified intervals, the net performance differential of the S&P 500 index and notional portfolio of common stocks. A single net payment is made by one counter party at each due date. The Companies are exposed to potential credit loss with respect to only the net differential payments in the event of nonperformance by the counter parties. The fair value of the equity swaps is recorded as the net differential to be settled quarterly. Changes in fair value are immediately recognized in income.

In 1998, the Companies were party to derivative contracts in the form of written covered call options. The purpose of written covered call options is to enhance the rate of return on the Companies' holdings of equities in the S&P 500 Index and to serve as a hedge against potential losses on these holdings during a market decline. Cash generated from call premium proceeds and capital gains on the options will partially offset losses incurred on the underlying equity holdings. The premium proceeds, net of any losses on the options, will increase returns on the underlying stocks. Credit risk is negligible and there is a potential risk of loss on the option program should the market rise substantially during the options' term. Covered call options are carried at fair value; changes in value are immediately recognized in income.

Securities Lending
Securities lending activities consist of lending certain U.S. government and corporate bonds to approved counter parties. All lending transactions are collateralized by securities and cash with a total market value equal to or in excess of 102% of the market value of the loaned securities. Short-term investments and cash collateral received are recorded as assets, with a corresponding liability recorded for the return obligation.

Reinsurance
All assets and liabilities related to reinsurance ceded contracts are reported on a gross basis in the combined balance sheets. The combined statements of income reflect premiums, benefits and settlement expenses net of reinsurance ceded.

Reinsurance premiums, commissions, expense reimbursements, benefits and reserves related to reinsured business are accounted for on bases consistent with those used in accounting for original policies issued and the terms of the reinsurance contracts.

Intangible Assets
Intangible assets consist of goodwill and certain unidentifiable intangible assets arising from business combinations accounted for as a purchase. Amortization is provided on a straight-line basis over estimated lives of the acquired intangibles which range from 5 to 30 years. The Companies evaluate the carrying value of goodwill and other intangible assets when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Any impairments would be recognized when the expected future cash flows derived from such goodwill and other intangibles assets are less than their carrying value.

Separate Account Assets and Liability
The assets and liabilities resulting from variable annuities, variable life policies and certain separate institutional accounts are segregated in separate accounts. Separate account assets consist principally of investments in mutual funds and fixed maturities and are carried at fair value. Investment income and changes in mutual fund asset values are allocated to the policyholders, and therefore, do not affect the operating results of the Companies. The Companies earn separate account fees for providing administrative services and bearing the mortality risk related to these contracts. The difference between investment income and interest earned on the institutional accounts is reported

as separate account fee income. The assets of each account are legally segregated and are not subject to claims which arise out of any other business of the Companies.

Future Policy Benefits

Future policy benefits consist of deposits received plus interest credited, less accumulated policyholder charges, assessments, and withdraws related to deferred annuities and singled premium whole life policies. Policy benefits that are charged to expense include benefit claims incurred in the period in excess of related policy account balances.

Translation of Foreign Currencies

Financial statement accounts expressed in foreign currencies are translated into U.S. dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, *Foreign Currency Translation*. Under SFAS 52, functional currency assets and liabilities are translated into U.S. dollars generally using current rates of exchange and the related translation adjustments are recorded as a separate component of comprehensive income, net of any related taxes. Functional currencies are generally the currencies of the local operating environment. Income statement items are translated using average rates while balance sheet items are translated using the spot rate as of the balance sheet date. Exchange gains and losses resulting from foreign currency transactions are recorded in income currently.

Income Taxes

Federal income taxes have been provided using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced by a valuation allowance if, based on available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Accounting Standards

In 1999, the Companies adopted Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.* SOP 98-1 provides guidance for determining whether computer software is for internal use and when costs incurred for internal use software are to be capitalized. The adoption of SOP 98-1 did not have a material impact on the Companies' combined financial statements.

(dollars in millions)

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement standardizes the accounting for derivative instruments and the derivative portion of certain other contracts that have similar characteristics by requiring that an entity recognize those instruments on the balance sheet at fair value. This statement also requires a new method of accounting for hedging transactions, prescribes the type of items and transactions that may be hedged, and specifies detailed criteria to be met to quality for hedge accounting. In June 1999, the FASB issued SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No.* 133, SFAS 137 defers the effective date of SFAS No. 133 until fiscal years beginning after June 15, 2000. Upon adoption, the Companies will be required to record a cumulative effect adjustment to reflect this accounting change. At this time, LMG has not completed its analysis and evaluation of the requirements and impact of this statement on the Companies' combined financial statements.

In October, 1998, AcSEC issued SOP 98-7, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk.* This statement identifies several methods of deposit accounting and provides guidance on the application of each method. This statement classifies insurance and reinsurance contracts for which the deposit method is appropriate as contracts that (1) transfer only significant timing risk, (2) transfer only significant underwriting risk, (3) transfer neither significant timing nor underwriting risk, and (4) have an indeterminate risk. This statement is effective for the year commencing January 1, 2000. Restatement of previously issued financial statements is not permitted. SOP 98-7 is not expected to have a material impact on the Companies' financial statements.

Comprehensive Income

Comprehensive income (loss) consists of net income, foreign currency translation adjustments and unrealized gains and losses on certain investments in debt and equity securities. The components of accumulated other comprehensive income, net of related tax and including other comprehensive income from discontinued operations, are as follows:

	1999	1998
Unrealized gains on securities	$800	$1,787
Foreign currency translation adjustments	(81)	(12)
Accumulated other comprehensive income	$719	$1,775

(2) Foreign Operations

Certain subsidiaries operate solely outside of the United States. Their assets and liabilities are located principally in the countries where the insurance risks are written. In addition, certain domestic companies have branch operations in foreign countries. Certain countries have restrictions on the conversion of funds which generally cause a delay in the outward remittance of such funds. Approximately five percent of the combined assets at December 31, 1999 and 1998, and eleven and nine percent of revenues for the years ended December 31, 1999 and 1998, respectively, were located in or derived from foreign countries.

(3) Acquisitions

Effective May 11, 1999, Liberty Mutual acquired the U.S. property and casualty operations of Guardian Royal Exchange (renamed Liberty Insurance Holdings, Inc.), including its wholly owned insurance subsidiaries and affiliates. The purchase method was used and the consideration was $1,465. The transaction resulted in the goodwill of $255 which is being amortized over 20 years.

Effective December 31, 1998, Liberty Mutual affiliated with EIOW and purchased Wausau Service Corporation and its subsidiaries, Wausau Business Insurance Company, Wausau Underwriters Insurance Company and Wausau General Insurance Company (collectively the "Wausau Companies"). The affiliation with EIOW and purchase of its subsidiaries has been accounted for under the purchase method of accounting, although the equity interest of EIOW remains with its policyholders. The consideration paid was $550 and the transaction resulted in negative goodwill of $83 which is being amortized over 5 years.

Effective August 31, 1998, Liberty Financial Companies, Inc. ("LFC"), an indirectly owned subsidiary of Liberty Mutual, acquired certain assets and assumed certain liabilities of Progress Investment Management Company, a registered investment adviser to institutional accounts with approximately $2,100 in assets under management as of that date. Effective September 30, 1998, LFC acquired certain assets and assumed certain liabilities of the Crabbe Huson Group, Inc., a registered investment adviser with approximately $3,300 in assets under management as of that date. The combined purchase price for these transactions totaled $104 and consisted of $95 in cash and $9 in LFC's common stock. In addition, LFC has agreed to pay additional cash and common stock over four years, contingent upon the attainment of certain earnings objectives. In 1999, LFC paid $4 of such contingent payments. An additional $68 may be paid as contingent payments if earnings objectives are attained. These transactions were accounted for as purchases and resulted in goodwill and other intangible assets of approximately $106.

(dollars in millions)

Effective September 29, 1998, Liberty Mutual acquired Summit Holding Southeast, Inc. including its wholly owned subsidiaries. The purchase method was used and the consideration was $220. The transaction resulted in goodwill of $162 which is being amortized over 20 years.

(4) Investments

(a) Fixed Maturities

The gross unrealized gains and losses and fair values of fixed maturities at December 31, 1999 and 1998 are as follows:

December 31, 1999	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Treasury securities	$ 2,613	$ 59	$ (47)	$ 2,625
Mortgage and asset-backed securities of government and corporate agencies	12,321	90	(403)	12,008
State and municipal	2,938	68	(29)	2,977
Corporate and other	15,618	201	(630)	15,189
Total fixed maturities	$33,490	$ 418	$(1,109)	$32,799

December 31, 1998	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Treasury securities	$ 3,143	$ 217	$ (3)	$ 3,357
Mortgage and asset-backed securities of government and corporate agencies	11,616	303	(60)	11,859
State and municipal	4,338	289	(1)	4,626
Corporate and other	13,772	675	(214)	14,233
Total fixed maturities	$32,869	$1,484	$(278)	$34,075

(dollars in millions)

During the years ended December 31, 1999 and 1998, proceeds from sales of fixed maturities available for sale were $9,704 and $9,224, respectively. The gross realized gains and (losses) on such sales totaled $178 and $(174) in 1999 and $149 and $(99) in 1998, respectively.

At December 31, 1999 and 1998, fixed maturities carried at $4,675 and $3,850, respectively, were on deposit with regulatory authorities as required by law.

The amortized cost and fair value of fixed maturities at December 31, 1999 by contractual maturity, are set forth as follows. Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due to Mature:		
One year or less	$ 694	$ 694
Over one year through five years	6,367	6,312
Over five years through ten years	8,398	8,209
Over ten years	5,710	5,576
Mortgage and asset-backed securities	12,321	12,008
	$33,490	$32,799

(dollars in millions)

(b) Derivatives

Outstanding derivatives are as follows:

			Assets (Liabilities)			
	Notional Amounts		**1999**		**1998**	
December 31	**1999**	**1998**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Interest Rate swap agreements	$2,917	$2,369	$41	$41	$ (71)	$(71)
Total return swap agreements	500	-	38	36	-	-
Interest rate cap agreements	50	250	-	-	-	-
Equity swaps	373	338	31	31	5	5
Written covered call options	-	774			(34)	(34)
S&P 500 Index call options	-	-	701	803	536	607
S&P 500 Index futures	-	-	-	-	(1)	(1)

The interest rate and total return swap agreements expire in 2000 through 2029. The interest rate cap agreement expires in 2000. The S&P 500 Index call options and futures maturities range from 2000 to 2006.

At December 31, 1999 and 1998, the Companies had approximately $129 and $156, respectively of unamortized premium in call option contracts.

Fair values for swap and cap agreements are based on current settlement values. The current settlement values are based on quoted market prices and brokerage quotes, which utilize pricing models or formulas using current assumptions. Fair values for call options are based upon quoted market prices.

There are risks associated with some of the techniques the Companies use to match its assets and liabilities. The primary risk associated with swap, cap and call option agreements is the risk associated with counter party nonperformance. The Companies believe that the counter parties to its swap, cap and call option agreements are financially responsible and that the counterparty risk associated with these transactions is minimal. Futures trade on organized exchanges and, therefore, have minimal credit risk.

(dollars in millions)

(5) Losses and Loss Adjustment Expenses Unpaid

The Companies establish loss and loss adjustment expense reserves, which are estimates of future payments of reported and unreported claims for losses and the related future expenses. The process of establishing loss reserves is subject to uncertainties that are normal, recurring and inherent in the property and casualty insurance business. The process requires reliance upon estimates based on available data that reflects past experience, current trends and other information, and the exercise of informed judgment.

As information develops that varies from past experience, provides additional data or, in some cases, augments data that previously was not considered sufficient for use in determining reserves, changes in the Companies estimate of ultimate liabilities may be required. The effects of these changes are reflected in current operating results.

Activity in the insurance loss and loss adjustment expense reserves of the Companies is summarized as follows:

	1999	1998
Balance as of January 1	$24,082	$19,058
Less: unpaid reinsurance recoverables	5,694	3,362
Net balance as of January 1	18,388	15,696
Balance attributable to acquisitions and affiliations	1,114	3,001
Incurred attributable to:		
Current year	8,058	6,237
Prior years	11	138
Total incurred	8,069	6,375

(dollars in millions)

	1999	1998
Paid attributable to:		
Current year	3,198	2,920
Prior years	5,645	3,746
Total paid	8,843	6,666
Net adjustment due to foreign exchange	(22)	(18)
Add: unpaid reinsurance recoverables	6,031	5,694
Balance as of December 31	$24,737	$24,082

The Companies do not discount unpaid insurance losses and loss adjustment expenses other than tabular discounting on the long-term indemnity portion of workers compensation claims and the Companies accident and health claims as permitted by insurance regulations in certain states.

The tabular discounting on these workers compensation claims is based upon Unit Statistical Plan tables as approved by the respective states and generally approximates 3.5%. Unpaid losses at December 31, 1999 and 1998 include liabilities of $2,684 and $2,374 at discounted values of $1,608 and $1,481, respectively.

The tabular discounting on Companies accident and health claims is based on the 1987 Commissioners Companies Disability Table (CGDT) at annual discount rates varying from 5.00% (5.25% in 1998) to 5.75%. Unpaid losses at December 31, 1999 and 1998 include liabilities of $433 and $333 carried at discounted values of $334 and $254, respectively.

For certain commercial lines of insurance, the Companies offer experience-rated insurance contracts whereby the ultimate premium is dependent upon the level of ultimate losses incurred. At December 31, 1999 and 1998, the Companies held $4,276 and $3,888, respectively, of loss and loss adjustment expense reserves related to experience-rated contracts.

The Companies have exposure to asbestos and environmental claims. The Companies' exposure arises from the sale of general liability insurance. The Companies try to estimate the full impact of the asbestos and environmental exposures by establishing case basis reserves on all known losses and computing incurred but not reported losses based on previous experience and known changes in the legal and regulatory environment.

(dollars in millions)

The process for establishing reserves for asbestos and environmental claims is subject to significant uncertainties. Among the complications are lack of historical data, long reporting delays, uncertainty as to the number and identity of insureds with potential exposure and unresolved legal issues regarding policy coverage. The legal issues concerning the interpretation of various insurance policy provisions and whether asbestos and environmental losses are or were ever intended to be covered are complex. Courts have reached different and sometimes inconsistent conclusions as to when the loss occurred and what policies provide coverage, whether there is an insured obligation to defend, how policy limits are determined, how policy exclusions are applied and interpreted, and whether clean-up costs are covered as insured property damage.

Reserve changes on individual asbestos and environmental matters reflect consideration of any newly acquired relevant information that may have an impact on reserve development. Given the complexities and significant uncertainties associated with estimating asbestos and environmental exposures, no assurances can be made as to the future potential impact of such claims upon the Companies. As additional information develops which would dictate a reserve change, the Companies estimates of losses and loss adjustment expenses associated with asbestos and environmental claims are adjusted accordingly.

(6) Reinsurance

In the ordinary course of business, the Companies assume and cede reinsurance with other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Companies are also members of various involuntary pools and associations and serve as servicing carriers for residual market organizations.

A summary of reinsurance financial data reflected within the combined statements of income is presented below:

	1999		**1998**	
	Written	**Earned**	**Written**	**Earned**
Direct	$11,192	$10,567	$8,451	$8,097
Assumed	469	456	522	581
Ceded	1,599	1,540	1,166	1,169
Net premiums	$10,062	$9,483	$7,807	$7,509

The Companies remain contingently liable in the event reinsurers are unable to meet the obligations for paid and unpaid loss recoverables and unearned premiums ceded under reinsurance agreements.

(dollars in millions)

The Companies do not have any material balances accrued for contingent commissions, sliding scale or other profit sharing commissions related to reinsurance contracts.

The Companies entered into commutation agreements in 1999 with several unaffiliated reinsurers. Loss and loss adjustment expense reserves and cash of $293 were returned resulting in no impact on net income.

The Companies have reinsurance recoverables from Nationwide Indemnity Company in the amount of $1,147 as of December 31, 1999. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company.

(7) Debt Outstanding

Debt outstanding at December 31, 1999 and 1998 includes the following:

	1999	1998
8.2% surplus notes due May 2007	$250	$250
6.75% notes due 2008	300	300
8.50% surplus notes, due May 2025	150	150
7.87% surplus notes, due October 2026	250	250
7.63% debentures due 2028	150	150
7.70% surplus notes, due october 2097	500	500
Medium term notes	163	180
Commercial paper	106	51
Revolving credit facilities	105	62
	1,974	1,893
Unamortized discount	(13)	(11)
Total outstanding debt	$1,961	$1,882

Payments for interest on or principal of the surplus notes are expressly subordinate to all policyholder claims and other obligations of Liberty Mutual. Accordingly, interest and principal payments are contingent upon prior approval of the Commissioner of Insurance of the Commonwealth of Massachusetts.

The Group's medium term notes may not be redeemed prior to maturity. As of December 31, 1999, $163 of medium-term notes were outstanding with maturity dates ranging from 2000 to 2013 at interest rates ranging from 6.35% to 8.10% after consideration of two put options. Interest expense on these notes was $13 and $16 for 1999 and 1998, respectively.

(dollars in millions)

At December 31, 1999, the principal maturity schedule of medium term notes is as follows:

Current Maturities	$ 12
2001	-
2002	12
2003	43
2004	-
Thereafter	96
	$ 163

The Companies issue commercial paper to meet short term operating needs and provide bridge financing. Commercial paper issued and outstanding at December 31, 1999 and 1998 was $106 and $51, respectively. Interest rates ranged from 4.71% to 6.4% in 1999 and 4.80% to 6.35% in 1998. Interest expense on the commercial paper was $6 and $3 for 1999 and 1998, respectively.

LFC has a $150 revolving credit facility (the “Facility”) which is utilized to finance sales commissions paid in connection with the distribution of mutual funds shares sold with 12b-1 distribution fees and contingent deferred sales charges. The Facility was established in April 1999 and replaced a $60 revolving credit facility which was used for the same purpose. This five year Facility is secured by such 12b-1 distribution fees and contingent deferred sales charges. Interest accrues on the outstanding borrowings under the Facility at a rate determined by sales of highly rated commercial paper backed in part by the security interest in such fees and charges. At December 31, 1999, the interest paid on borrowings under the Facility was at the rate of 6.13% per annum.

Total interest paid by the Companies, for the years ended December 31, 1999 and 1998, was $151 and $117, respectively.

(8) Federal and Foreign Income Taxes

Liberty Mutual, LFC, Liberty Fire, EIOW, Montgomery and M&B each file separate federal income tax returns. The Companies file consolidated federal income tax returns with their respective eligible subsidiary companies. Pursuant to intercompany federal income tax allocation agreements between the companies and their respective subsidiaries, net operating losses and tax credits generated by subsidiaries and used to reduce the consolidated tax liability are reimbursed only as utilized by the subsidiaries on a separate-return basis. Intercompany tax balances are settled quarterly. Provision is made, where applicable, for taxes on foreign branch operations.

LIBERTY MUTUAL GROUP

Notes to Combined Financial Statements

(dollars in millions)

The components for the provision for federal and foreign income taxes are:

Year ended December 31,	**1999**	**1998**
Current expense:		
United States Federal	$ 58	$ 53
Foreign	24	33
Total current taxes	82	86
Deferred expense (benefit):		
United States Federal	141	137
Foreign	(11)	7
Total deferred taxes	130	144
Total federal and foreign income tax expense	$212	$230

(dollars in millions)

The effective income tax rate on pre-tax income varies from the prevailing corporate federal income tax rate and is summarized as follows:

Year ended December 31,	**1999**	**Percent of pre-tax income**	**1998**	**Percent of pre-tax income**
Expected federal income tax expense	$238	35%	$261	35%
Tax effect of:				
Nontaxable investment income	(74)	(11%)	(81)	(11%)
Change in valuation allowance	6	1%	(8)	(1%)
Other	42	6%	58	8%
Actual federal and foreign income tax expense	$212	31%	$230	31%

Deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws. The significant components of the net deferred tax asset as of December 31, 1999 and 1998 are summarized as follows:

	1999	**1998**
Deferred tax assets:		
Unpaid losses	$1,090	$1,119
Unearned premium reserves	196	157
Net operating losses	190	236
Employee benefits	148	126
Other	300	460
Less: valuation allowance	(160)	(44)
Total deferred tax assets	1,764	2,054

(dollars in millions)

	1999	1998
Deferred tax liabilities:		
Deferred acquisition costs	406	220
Investments	502	1,148
Other	154	374
Total deferred tax liabilities	1,062	1,742
Net deferred tax assets	$ 702	$ 312

In the opinion of management it is more likely than not that a portion of the deferred tax asset will not be realized. Accordingly, a valuation allowance has been established. As of December 31, 1999, the Companies had Federal and foreign net operating loss carryforwards related to certain of the tax filing groups of $687 expiring in 2000 through 2019. Use of some of these loss carryforwards is or may become limited under current tax law.

Taxes are not provided on unremitted earnings of subsidiaries outside the United States where such earnings are permanently reinvested. At December 31, 1999, unremitted earnings of foreign subsidiaries were $68. If these earnings were distributed in the form of dividends or otherwise, the Companies would be subject the U.S. income taxes less an adjustment for applicable foreign tax credits.

(9) Benefit Plans

Employees of the Companies are covered under various noncontributory pension plans (the "Plans"). Eligibility requirements for participation in the Plans is based on either completion of a specified, period of service, age or a combination of both. Benefits under the Plans are computed based upon a formula, as more fully described in the Plan documents, which considers years of service, compensation levels for specified years and an offset for social security benefits.

Assets of the Plans consist primarily of investments in life insurance company separate accounts and a collective investment trust fund, which invests primarily in fixed income securities and the S&P 500 Index. At December 31, 1999 and 1998, assets of the Plans totaling $2,091 and $1,548, respectively, were held in separate accounts managed by LMG.

The Companies have also adopted supplemental retirement programs for certain executives to provide pension benefits above the levels provided by the pension plans without regard to the statutory earnings limitations of qualified defined benefit pension plans. Currently the supplemental plans are unfunded.

(dollars in millions)

The Companies also provide certain health care and life insurance benefits ("postretirement") for retired employees of certain subsidiaries. A significant portion of domestic employees may become eligible for these benefits. Alternatively, retirees may elect certain prepaid health care benefit plans. Life insurance benefits are based upon a participant's final compensation subject to the plan maximum.

The following table sets forth the assets, obligations and assumptions associated with the various pension plan and post-retirement benefits. The amounts are recognized in the accompanying combined balance sheets as of December 31, 1999 and 1998 or combined statements of income for the years then ended:

	Pension Benefits		**Postretirement Benefits**	
	1999	**1998**	**1999**	**1998**
Benefit obligation	$1,585	$1,598	$ 355	$ 345
Fair value of plan assets	2,560	2,135	25	27
Funded status	$ 975	$ 537	$(330)	$(318)
Prepaid (accrued) benefit cost recognized	$35	$46	$(286)	$(249)
Weighted average assumptions:				
Discount rate	7.75%	6.75%	7.75%	6.75%
Expected return on plan assets	9.00%	9.00%	7.00%	7.00%
Rate of compensation increase	5.70%	5.60%	-	-
Benefit cost	$17	$ 7	$38	$26
Employer contribution	2	2	24	13
Benefits paid	83	53	24	13

The health care cost trend rates were 10% (graded to 6% in 2013) in 1999 and 10.25% (graded to 4.5% in 2003) in 1998. Health care cost trend rate assumptions have a material impact on postretirement benefit obligation. An assumed change in health care cost trend rates by one percentage point increase or decrease in each year would impact the postretirement benefit obligation as of December 31, 1999 by an increase or a decrease of $18 and the estimated eligibility cost and interest cost components of the net periodic postretirement benefit cost for 1999 by an increase or decrease of $3.

The Companies sponsor defined contribution savings plans for substantially all domestic employees who meet certain eligibility requirements (a 401K plan). During 1999 and 1998, employees were permitted to contribute a percentage of their annual compensation on a combined before-tax and after-tax basis, subject to certain limitations imposed by the Tax Reform Act of 1986. In 1999 and 1998, the Companies made matching contributions of $59 and $40, respectively.

(10) Fair Value of Financial Instruments

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* requires disclosure of fair value information about financial instruments, as defined therein, for which it is practicable to estimate such fair value. All financial instruments may not be recognized in the combined balance sheets. In the measurement of the fair value of certain of the financial instruments, quoted market prices were not available and other valuation techniques were utilized. These derived fair value estimates are significantly affected by the assumptions used. SFAS 107 excludes certain financial instruments, including those related to insurance contracts.

The following methods and assumptions were used in estimating the fair value of the financial instruments presented:

Cash and short term investments: The carrying amounts reported in the consolidated balance sheet for these instruments approximate fair values.

Fixed maturities: Fair values for fixed maturities were generally based upon quoted market prices. For certain fixed maturities securities for which quoted market prices were not available, fair values were estimated using values obtained from independent pricing services, or, in the case of private placements, were determined by discounting expected future cash flows using a current market rate applicable to the yield, credit quality, and maturity of the securities.

Equity securities: Fair values for equity securities were based upon quoted market prices.

Future policy benefits: Fair values for deferred annuity contracts are equal to current net surrender value. Fair values of liabilities under investment-type insurance contracts, including individual and group annuities, are estimated using discounted cash flow calculations at current pricing rates.

(dollars in millions)

Debt Outstanding: Fair values of commercial paper, short term borrowings approximate carrying value. Fair values of notes payable were either estimated based upon quoted market prices or using discounted cash flow analyses based on the Companies incremental borrowing rate.

The fair values and carrying values of the Companies financial instruments at December 31, 1999 and 1998 are as follows:

	1999		1998	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturity securities	$32,799	$32,799	$34,075	$34,075
Equity securities	2,921	2,921	3,045	3,045
Short-term investments	319	319	530	530
Cash and cash equivalents	2,417	2,417	1,683	1,683
Future policy benefits	14,455	13,747	14,425	13,650
Debt outstanding	1,961	2,062	1,882	2,006

(11) Commitments and Contingent Liabilities

Various lawsuits against the Companies have arisen in the normal course of business. Contingent liabilities arising from litigation, income taxes and other matters are not considered material in relation to the financial position of the Companies.

The Companies lease certain office facilities and equipment from others under operating leases expiring in various years through 2009. Rental expense amounted to $174 and $112 for the years ended December 31, 1999 and 1998, respectively. Future minimum rental payments under non-cancelable leases with terms in excess of one year are estimated to be $157 for 2000, $130 for 2001, $101 for 2002, $80 for 2003 and $229 for 2004 and thereafter. It is expected that as leases expire they will be replaced by new leases.

(12) Restructuring Charge

During 1999, the Companies announced a restructuring of certain commercial operations in order to streamline operations and reduce distribution channel conflicts resulting from affiliation with EIOW. Implementation began in the third quarter of 1999 and is expected to be completed in 2001. The Companies recorded a restructuring liability of $77 of which $55 was included as a purchase price adjustment. The restructuring liability primarily represents the severance costs associated with the elimination of jobs, the present value of future lease payments for discontinued leases and certain integration costs associated with the restructuring plan.

(13) Subsequent Events (Unaudited)

On September 13, 2000, the Boards of Directors of Liberty Mutual Insurance Company ("LMIC") and Liberty Mutual Fire Insurance Company ("LMFIC") each unanimously approved and adopted Plans of Reorganization. On September 14, 2000, the Board of Directors of Employers Insurance of Wausau A Mutual Company ("EIOW") unanimously approved and adopted a Mutual Holding Company Plan. Each of the Plans are contemplated as first steps in a series of transactions resulting in the Global Transaction.

Under the Global Transaction, it is contemplated that (i) LMIC will form Liberty Mutual Holding Company ("LMHC"), a Massachusetts mutual holding company and reorganize into a Massachusetts stock insurance company and subsidiary of LMHC (ii) Employers Insurance of Wausau A Mutual Company ("EIOW"), a Wisconsin mutual property and casualty insurance company, will reorganize into a Wisconsin stock property and casualty insurance company and form Employers Insurance of Wausau Mutual Holding Company ("EIOW MHC"), a Wisconsin mutual holding company; (iii) assuming the reorganizations of LMIC and EIOW are consummated, EIOW MHC and LMHC will merge, with LMHC as the surviving corporation, pursuant to the terms of a merger agreement between the parties ("MHC Merger Agreement"); and (iv) simultaneously with the effectuation of the MHC Merger Agreement, LMFIC will reorganize into a Massachusetts stock holding company and then merge with and into Liberty Acquisition Corporation ("Liberty Acquisition Corp."), a Massachusetts stock company and a direct, wholly-owned subsidiary of LMHC, with LMHC as the surviving corporation. Assuming consummation of these above-mentioned steps, LMHC will contribute the shares of Reorganized EIOW and Reorganized LMFIC to LMGI. As a result, Reorganized EIOW and Reorganized LMFIC and Reorganized LMIC will become indirect, wholly-owned subsidiaries of LMHC.

On June 12, 2000, LFC announced its intended acquisition of Wanger Asset Management. The initial consideration will be $280 million and is subject to an additional $170 million over a 5 year period contingent upon Wanger Asset Management achieving established earnings targets. It is anticipated that the deal will close on or about September 30, 2000.

ERNST & YOUNG

■ Ernst & Young LLP
200 Clarendon Street
Boston
Massachusetts 02116-5072

Phone: (617) 266-2000
Fax: (617) 266-5843
www.ey.com

Report of Independent Auditors on Other Financial Information

The Board of Directors
Liberty Mutual Insurance Company
Liberty Mutual Fire Insurance Company
Employers Insurance of Wausau A Mutual Company

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The accompanying combining balance sheet and combining statement of income and changes in policyholders' surplus are presented for purposes of additional analysis and are not a required part of the combined financial statements. Such information has been subjected to the auditing procedures applied in our audit of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

September 14, 2000

Ernst & Young LLP

Liberty Mutual Group
Combining Balance Sheet
December 31, 1999
(dollars in millions)

	Statutory LMIC	Statutory Fire	Statutory EIOW	GAAP and Consolidating Entries	GAAP Combined
Assets					
Investments:					
Fixed maturities	$ 9,258	$ 1,727	$ 2,372	$ 19,442	$ 32,799
Equity securities	2,181	372	2	366	2,921
Investment in affiliates	4,506	49	-	(4,555)	-
Other invested assets	560	60	1	2,144	2,765
Short-term investments	-	-	-	319	319
Cash and short-term investments	509	133	18	(660)	-
	17,014	2,341	2,393	17,056	38,804
Cash and cash equivalents	-	-	-	2,417	2,417
Premium and other receivables, net	1,420	218	320	1,212	3,170
Recoverables from reinsurers, net	-	-	40	6,397	6,437
Reinsurance deposit receivable	372	-	182	(387)	167
Accrued investment income	153	28	30	304	515
Recoverable income taxes	-	-	4	(4)	-
Deferred income taxes	-	-	-	702	702
Deferred policy acquisition costs	-	-	-	1,366	1,366
Deferred distribution costs	-	-	-	154	154
Intangible assets	-	-	-	903	903
Other assets	920	222	238	595	1,975
Separate account assets	-	-	-	5,641	5,641
Total assets	$ 19,879	$ 2,809	$ 3,207	$ 36,356	$ 62,251
Liabilities, Minority Interests and Policyholders' Surplus					
Liabilities:					
Unpaid losses and loss adjustment expenses	$ 10,154	$ 1,540	$ 2,001	$ 11,042	$ 24,737
Reserve for unearned premiums	1,497	227	295	1,456	3,475
Future policy benefits	-	-	-	14,455	14,455
Funds held by companies under reinsurance treaties	-	-	28	99	127
Current income taxes payable	202	10	-	(3)	209
Debt outstanding	-	-	-	1,961	1,961
Deposits and other liabilities	2,236	123	209	(2,568)	-
Collateral held for securities loaned	216	48	-	(264)	-
Guaranty fund reserve	-	-	-	282	282
Dividends to policyholders	25	4	5	179	213
Other liabilities	-	-	-	3,515	3,515
Separate account liabilities	-	-	-	5,578	5,578
Total liabilities	14,330	1,952	2,538	35,732	54,552
Minority interest	-	-	-	360	360
Policyholders' Surplus					
Surplus notes	1,141	-	220	(1,361)	-
Guaranty funds	1	1	-	(2)	-
Accumulated translation adjustment	8	-	-	(8)	-
Unassigned surplus	4,399	856	449	916	6,620
Accumulated other comprehensive income	-	-	-	719	719
Total surplus	5,549	857	669	264	7,339
Total liabilities, minority interest and surplus	$ 19,879	$ 2,809	$ 3,207	$ 36,356	$ 62,251

Liberty Mutual Group
Combining Statement of Income
Year ended December 31, 1999
(dollars in millions)

	Statutory LMIC	Statutory Fire	Statutory EIOW	GAAP and Consolidating Entries	GAAP Combined
Revenues:					
Net premiums earned	$ 4,553	$ 690	$ 898	$ 3,342	$ 9,483
Net investment income	598	136	235	1,658	2,627
Fee income	-	-	-	713	713
Net realized investment gains	354	44	-	8	406
Other revenues	(55)	(7)	(9)	204	133
Total revenues	5,450	863	1,124	5,925	13,362
Losses, Benefits and Expenses:					
Losses and loss adjustment expenses	4,188	635	824	2,422	8,069
Policyholder benefits	-	-	-	375	375
Interest credited to policyholders	-	-	-	577	577
General and administrative expenses	932	141	216	707	1,996
Policy acquisition costs	-	-	-	1,380	1,380
Premium and other taxes	164	25	-	(189)	-
Dividends to policyholders	77	12	15	26	130
Interest expense	-	-	-	155	155
Total losses, benefits and expenses	5,361	813	1,055	5,453	12,682
Income before income taxes and minority interest	89	50	69	472	680
Federal and foreign income taxes:					
Current	(84)	11	-	155	82
Deferred	-	-	-	130	130
Total federal and foreign income taxes	(84)	11	-	285	212
Income before minority interest	173	39	69	187	468
Minority interest	-	-	-	(29)	(29)
Net income	$ 173	$ 39	$ 69	$ 158	$ 439

Liberty Mutual Group
Combining Balance Sheet
December 31, 1998
(dollars in millions)

	Statutory LMIC	Statutory Fire	Statutory EIOW	GAAP and Consolidating Entries	GAAP Combined
Assets					
Investments:					
Fixed maturities	$ 10,682	$ 1,693	$ 1,796	$ 19,904	$ 34,075
Equity securities	2,195	343	-	507	3,045
Investment in affiliates	3,363	41	-	(3,404)	-
Other invested assets	279	34	-	1,757	2,070
Short-term investments	-	-	-	530	530
Cash and short-term investments	202	63	333	(598)	-
	16,721	2,174	2,129	18,696	39,720
Cash and cash equivalents	-	-	-	1,683	1,683
Premium and other receivables, net	1,504	189	272	874	2,839
Recoverables from reinsurers, net	-	-	41	6,080	6,121
Reinsurance deposit receivable	260	-	122	78	460
Accrued investment income	166	25	26	283	500
Intercompany receivable	-	-	75	(75)	-
Recoverable income taxes	-	-	30	(30)	-
Deferred income taxes	-	-	-	312	312
Deferred policy acquisition costs	-	-	-	816	816
Deferred distribution costs	-	-	-	130	130
Intangible assets	-	-	-	588	588
Other assets	794	86	142	756	1,778
Separate account assets	-	-	-	3,680	3,680
Total assets	$ 19,445	$ 2,474	$ 2,837	$ 33,871	$ 58,627
Liabilities, Minority Interests and Policyholders' Surplus					
Liabilities:					
Unpaid losses and loss adjustment expenses	$ 10,484	$ 1,321	$ 1,484	$ 10,793	$ 24,082
Reserve for unearned premiums	1,674	211	76	935	2,896
Future policy benefits	-	-	-	14,425	14,425
Funds held by companies under reinsurance treaties	-	-	6	82	88
Intercompany payable	-	-	457	(457)	-
Current income taxes payable	149	7	-	(31)	125
Debt outstanding	-	-	-	1,882	1,882
Deposits and other liabilities	954	130	234	(1,318)	-
Collateral held for securities loaned	89	35	-	(124)	-
Guaranty fund reserve	-	-	-	270	270
Dividends to policyholders	27	4	5	179	215
Other liabilities	-	-	-	2,634	2,634
Separate account liabilities	-	-	-	3,638	3,638
Total liabilities	13,377	1,708	2,262	32,908	50,255
Minority interest	-	-	-	416	416
Policyholders' Surplus					
Surplus notes	1,141	-	220	(1,361)	-
Guaranty funds	1	1	-	(2)	-
Accumulated translation adjustment	(16)	-	-	16	-
Unassigned surplus	4,942	765	355	119	6,181
Accumulated other comprehensive income	-	-	-	1,775	1,775
Total surplus	6,068	766	575	547	7,956
Total liabilities, minority interest and surplus	$ 19,445	$ 2,474	$ 2,837	$ 33,871	$ 58,627

Liberty Mutual Group
Combining Statement of Income
Year ended December 31, 1998
(dollars in millions)

	Statutory LMIC	Statutory Fire	Statutory EIOW	GAAP and Consolidating Entries	GAAP Combined
Revenues:					
Net premiums earned	$ 4,842	$ 610	$ 1,095	$ 962	$ 7,509
Net investment income	717	117	502	976	2,312
Fee income	-	-	-	621	621
Net realized investment gains	153	15	-	25	193
Other revenues	5	1	-	205	211
Total revenues	5,717	743	1,597	2,789	10,846
Losses, Benefits and Expenses:					
Losses and loss adjustment expenses	4,426	558	1,123	268	6,375
Policyholder benefits	-	-	-	241	241
Interest credited to policyholders	-	-	-	604	604
General and administrative expenses	903	114	242	389	1,648
Policy acquisition costs	-	-	-	1,073	1,073
Premium and other taxes	167	21	-	(188)	-
Dividends to policyholders	25	3	13	-	41
Interest expense	-	-	-	118	118
Total losses, benefits and expenses	5,521	696	1,378	2,505	10,100
Income before income taxes and minority interest	196	47	219	284	746
Federal and foreign income taxes:					
Current	32	10	(24)	68	86
Deferred	-	-	-	144	144
Total federal and foreign income taxes	32	10	(24)	212	230
Income before minority interest	164	37	243	72	516
Minority interest	-	-	-	(34)	(34)
Net income	$ 164	$ 37	$ 243	$ 38	$ 482