ASSURANCE AND ADVISORY
BUSINESS SERVICES

AUDITED STATUTORY - BASIS FINANCIAL STATEMENTS

Employers Insurance of Wausau A Mutual Company
Years ended December 31, 1999 and 1998

ERNST & YOUNG

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Report of Independent Auditors

The Board of Directors
Employers Insurance of Wausau A Mutual Company:

We have audited the accompanying statutory balance sheet of Employers Insurance of Wausau A Mutual Company as of December 31, 1999, and the related statutory statements of income, changes in statutory surplus, and cash flow for the year then ended. 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 audit. The financial statements of the Company, for the year ended December 31, 1998, before the reclassifications described in Note 1(m), were audited by other auditors whose report dated March 12, 1999, except as to Note 11, which is as of April 28, 1999, expressed an adverse opinion with respect to accounting practices generally accepted in the United States and an unqualified opinion with respect to statutory accounting practices.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin, which practices differ from accounting principles generally accepted in the United States. The variances between such practices and accounting principles generally accepted in the United States are also described in Note 1. The effects on the financial statements of these variances are not reasonably determinable but are presumed to be material.

In our opinion, because of the effects of the matter described in the preceding paragraph, the 1999 financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States, the financial position of Employers Insurance of Wausau A Mutual Company at December 31, 1999, or the results of its operations or its cash flows for the year then ended.

However, in our opinion, the 1999 financial statements referred to above present fairly, in all material respects, the financial position of Employers Insurance of Wausau A Mutual Company at December 31, 1999, and the results of its operations and its cash flows for the year then ended in conformity with accounting practices prescribed or permitted by the Office of the Commissioner of Insurance of the State of Wisconsin.

February 3, 2000 ERNST & YOUNG LLP

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Balance Sheets

December 31, 1999 and 1998

(dollars in thousands)

Admitted Assets	1999	1998
Investments:		
Bonds	$2,372,173	$1,796,029
Common and preferred stock	1,754	-
Real estate, at cost less accumulated depreciation:		
1999, $27,042; 1998, $27,078	46,301	46,331
Cash and short-term investments	18,370	333,196
Other invested assets	776	212
Cash and invested assets	2,439,374	2,175,768
Agents' balances and uncollected premiums	278,958	205,265
Reinsurance recoverable on loss payments	40,046	40,537
Federal income taxes recoverable	3,959	30,345
Accrued investment income	29,968	26,045
Receivable from affiliates	-	75,017
Receivable from nonaffiliates	41,458	66,410
Funds deposited with reinsurers	181,540	121,713
Other assets	192,069	95,675
Total admitted assets	$3,207,372	$2,836,775

Liabilities and Surplus	1999	1998
Liabilities:		
Losses unpaid	$1,661,807	$1,199,266
Loss adjustment expenses unpaid	339,739	285,246
Unearned premiums	295,136	76,052
Dividends declared and payable	4,910	4,674
Funds held under reinsurance treaties	27,595	6,146
Payable to affiliates	-	456,500
Other liabilities	209,381	233,891
Total liabilities	2,538,568	2,261,775
Surplus:		
Contribution notes	220,000	220,000
Unassigned surplus	448,804	355,000
Total surplus	668,804	575,000
Total liabilities and surplus	$3,207,372	$2,836,775

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Income

Years ended December 31, 1999 and 1998

(dollars in thousands)

	1999	1998
Underwriting:		
Net premiums written	$ 1,110,081	$ 680,324
(Increase) decrease in unearned premiums	(212,509)	414,131
Premiums earned	897,572	1,094,455
Deductions:		
Losses	671,420	905,770
Loss adjustment expenses	152,649	217,407
Other underwriting expenses	216,077	237,945
Net losses and expenses	1,040,146	1,361,122
Net underwriting loss	(142,574)	(266,667)
Net investment income	234,745	501,778
Other expenses, net	(8,975)	(3,703)
Income before dividends to policyholders and federal and other income tax benefit	83,196	231,408
Dividends to policyholders	15,072	12,621
Income before federal and other income tax benefit	68,124	218,787
Federal and other income tax benefit	-	24,332
Net income	$ 68,124	$ 243,119

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statements of Changes in Statutory Surplus

December 31, 1999 and 1998

(dollars in thousands)

	1999	1998
Statutory surplus, beginning of year	$575,000	$525,221
Add (deduct):		
Net income	68,124	243,119
Unrealized capital loss	(2,469)	(17,826)
(Increase) decrease in non-admitted assets	(17,191)	31,949
Change in contribution notes	-	(180,000)
Interest paid on contribution notes	-	(27,083)
Other surplus changes, net	45,340	(380)
Statutory surplus, end of year	$668,804	$575,000

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Cash Flow

December 31, 1999 and 1998

(dollars in thousands)

	1999	1998
Cash from operations:		
From underwriting:		
Premiums collected, net of reinsurance	$ 1,019,417	$ 772,376
Losses and loss adjustments expenses paid (net of salvage and subrogation)	(247,086)	(1,409,200)
Underwriting expenses paid, net	(234,371)	(251,860)
Cash provided by (used in) underwriting	537,960	(888,684)
Investment income, net of expenses	163,913	167,417
Other expenses, net	(251,413)	19,493
Dividends paid to policyholders	(14,836)	(9,021)
Federal income taxes recovered	25,277	2,596
Net cash provided by (used in) operations	460,901	(708,199)
Cash from investments:		
Proceeds from investments sold, matured, or repaid:		
Bonds	592,445	550,407
Common and preferred stocks	-	567,224
Other	-	11,632
Total investment proceeds	592,445	1,129,263
Cost of investments acquired:		
Bonds	1,171,927	239,451
Common and preferred stocks	236	19,411
Real estate	-	2,200
Other	5,273	160
Total investments acquired	1,177,436	261,222
Net cash (used in) provided by investments	(584,991)	868,041

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Cash Flow Continued

December 31, 1999 and 1998

(dollars in thousands)

	1999	1998
Cash from other financing and miscellaneous sources:		
Other cash provided:		
Surplus notes	-	$(180,000)
Net transfer from affiliates	-	324,740
Other	$176,326	78,485
Total other cash provided	176,326	223,225
Other cash applied:		
Interest on contribution notes	-	27,083
Net transfers to affiliates	367,062	22,378
Total other cash applied	367,062	49,461
Net cash (used in) provided by other financing and miscellaneous sources	(190,736)	173,764
Net (decrease) increase in cash and short-term investments	(314,826)	333,606
Cash and short-term investments at beginning of year	333,196	(410)
Cash and short-term investments at end of year	$18,370	$333,196

See accompanying notes to statutory financial statements.

(1) Description of Business and Summary of Significant Accounting Policies

EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (the "Company") is a mutual company operating principally within the property and liability insurance industry. On November 23, 1985, the Company entered into a plan of affiliation with Nationwide Mutual Insurance Company (Nationwide). The Company writes, or assumes through a pooling agreement (note 6), a full complement of commercial and personal property and casualty insurance exposures including workers' compensation, general liability, automobile, and special multi-peril to policyholders located throughout the United States and Canada. The Company is subject to regulation by the Insurance Departments of states in which it is licensed, and undergoes periodic examinations by those departments.

On December 31, 1998, the Company deaffiliated with Nationwide. In accordance with the De-Affiliation Master Agreement between Nationwide and the Company, the Company repaid in full the $400,000 principal plus accrued interest on the contribution notes issued by the Company to Nationwide. In addition, the Company terminated its participation in the Nationwide Pool on December 31, 1998 (note 6). Pursuant to an Affiliation and Contribution Note Purchase Agreement dated October 5, 1998, Liberty Mutual Insurance Company (Liberty) purchased a Contribution Note in the amount of $220,000 from the Company (note 8). Pursuant to that Agreement, certain officers of Liberty became members of the Board of Directors of the Company. On December 31, 1998, Wausau Service Corporation (WSC), a wholly-owned subsidiary of the Company, including its three property and casualty insurance companies [Wausau Underwriters Insurance Company ("WUIC"), Wausau General Insurance Company ("WGIC") and Wausau Business Insurance Company ("WBIC")] was purchased by Liberty from the Company for $518,017, which resulted in a capital gain of $341,254. In addition, during 1998, the Company sold Wausau (UK) to Liberty for $8,000, realizing a loss of $10,683. The receivable from nonaffiliates primarily represents the estimated final settlement due from Nationwide resulting from the sale of WSC and the deaffiliation.

In 1999, the Company sold its National Markets Customer List to Liberty for $83,000. The Company has a promissory note due from Liberty for $83,000. The note matures on December 17, 2004 and interest is payable at 6.95%.

Following is a description of the most significant risks facing property/casualty insurers and how the Company mitigates those risks:

<u>Legal/Regulatory Risk</u> is the risk that changes in the legal or regulatory environment in which an insurer operates will change and create additional loss costs or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those currently recorded in the financial statements. The Company mitigates this risk by operating throughout the United States, thus reducing its exposure to any single jurisdiction, and also by underwriting and loss adjusting practices which identify and minimize the adverse impact of this risk.

<u>Credit Risk</u> is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers which owe the Company money, will not pay. Also, the Company writes a significant amount of business under which policyholders reimburse the Company for large policy deductibles or pay additional premiums in the future based on claim activity. The Company minimizes this risk by adhering to a conservative investment strategy, by maintaining reinsurance and by credit and collection policies.

<u>Interest Rate Risk</u> is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Company mitigates this risk by attempting to match the maturity schedule of its assets with the expected payout of its liabilities. To the extent that liabilities come due more quickly than assets mature, an insurer may have to sell assets prior to maturity and recognize a gain or loss.

(dollars in thousands)

In preparing the statutory financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and revenues and expenses for the period. Actual results could differ from those estimates.

The estimates most susceptible to change are those used in determining the reserves for losses and loss adjustment expenses and retrospective premium adjustments to unearned premium reserve. Although considerable variability is inherent in these estimates, management believes that these reserves are adequate. The estimates are continually reviewed and adjusted as necessary. Such adjustments are generally reflected in current operations.

(a) Basis of Presentation

The accompanying statutory financial statements have been prepared in conformity with accounting practices prescribed or permitted by the State of Wisconsin Office of the Commissioner of Insurance., which vary in some respects from generally accepted accounting principles ("GAAP"). Principal variations include the following:

- Acquisition costs, such as commissions, premium taxes, and other items, are charged to current operations as incurred, whereas related premium income is taken into earnings on a prorata basis over the periods covered by the policies;
- On certain lines of insurance, liabilities in excess of the amounts considered adequate by the Company may be provided through a charge to unassigned surplus;
- Reserves are provided through a charge to unassigned surplus for the excess of unearned premiums and losses recoverable over related collateral held on business reinsured with companies not authorized to do business in Wisconsin and for a portion of past-due recoverables from authorized reinsurers;
- The statutory financial statements reflect certain assets and liabilities net of ceded reinsurance;
- Certain assets designated as "non-admitted assets" (principally direct premiums "overdue" and office furniture and equipment) are charged to unassigned surplus;
- Federal income taxes are provided based upon taxes currently payable or recoverable without regard to temporary differences between the financial statements and tax return bases of assets and liabilities;
- In 1998, the costs and related liabilities of providing postretirement benefits were calculated without regard to active non-vested participants; in 1999, pension expense and postretirement benefits and related disclosures are calculated and reported on a modified GAAP basis;
- In 1998, changes in the estimate of unpaid losses and loss adjustment expenses on certain discontinued lines of business were reflected as direct adjustments to unassigned surplus, as these changes in estimates were unrelated to current underwriting activities;
- Bonds are generally recorded at amortized cost, and are not classified as either held-to-maturity securities, trading securities, or available-for-sale securities;
- Policyholder dividends are provided upon declaration by the Board of Directors, rather than as incurred;

(dollars in thousands)

- Contribution notes and interest thereon (in 1998) are accounted for as a component of statutory surplus; and

- Guaranty funds are accrued when the Company receives notice that an assessment is payable.

The aggregate effect of the foregoing differences has not been determined.

(b) Investment Securities

Investment securities are carried according to valuations promulgated by the National Association of Insurance Commissioners ("NAIC"). Fixed maturity securities are generally carried at cost and adjusted where appropriate for amortization of premium or discount, including anticipated prepayments; common and preferred stocks and other investments are carried at market value; short-term investments are carried at cost; and company-occupied properties are carried at depreciated cost. Realized gains and losses on sales of investments are recognized in net income using the specific identification method. Changes in unrealized appreciation or depreciation on stocks and certain fixed maturities are recorded in surplus. Prepayment assumptions for single class mortgage-backed/asset-backed securities and multi-class securities are obtained from internal estimates. These assumptions are consistent with the current interest rate and economic environment. The retrospective adjustment method is used to value all single class mortgage-backed/asset-backed securities and multi-class securities.

(c) Losses and Loss Adjustment Expenses Unpaid

The liability for losses is provided based upon formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based upon past experience, estimates based on information received relating to assumed reinsurance, and deduction of amounts for reinsurance placed with other insurers. Certain workers' compensation liabilities are discounted based on National Council Unit Statistical Plan Tables at an annual rate of 3.5%

The liability for loss adjustment expenses is provided by estimated future expenses to be incurred in settlement of claims provided for in the liability for losses and is stated after deduction of amounts for reinsurance placed with other insurers.

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

(d) Premiums

Premiums earned are determined on a daily pro rata basis over the contract period and are reduced for reinsurance placed with other insurers. Premium adjustments resulting from retrospective rating of experience-rated policies and unbilled audit premiums are estimated and accrued, along with the related expenses associated with acquiring, billing and collecting these premiums and associated taxes. Estimates of premiums for retrospectively rated policies are included in income as a decrease in unearned premiums. Premiums receivable included accrued retrospective premiums and accrued unbilled audit premiums of $71,432 at December 31, 1999. Ten percent of the amount not offset by retrospective return premiums or collateral has been designated non-admitted and charged to surplus.

(e) Policyholder Dividends

A liability for dividends payable to policyholders is established when declared by the Board of Directors. An asset is established for dividends previously paid which the Company expects to recover from policyholders under the terms of their policies, net of a provision for uncollectible amounts.

(f) Reinsurance

The Company accounts for reinsurance contracts on a basis consistent with the underlying policies. Transactions which do not transfer risk or which transfer risk but are retroactive are included in other assets or other liabilities.

(g) Affiliate Balances

Receivables and payables from/to affiliates result primarily from affiliate reinsurance agreements described in note 6 and expense allocations described in note 7. These balances are generally settled on a monthly basis.

In 1998, the employees of WSC provided services to the Company and other affiliated companies. Accordingly, payroll and related costs and certain other expenses were allocated between the Company and the affiliated companies. These allocated expenses, which were determined using Employers' cost accounting system, were intended to approximate the actual costs of services provided.

(h) Short-Term Investments

Investments with a maturity of one year or less at the time of purchase are reported as short-term investments

(i) Fair Value of Financial Instruments

The Company has used the following methods and assumptions in estimating its fair value disclosures of financial instruments:

Investment securities: Fair values for fixed maturity securities are based on quoted market prices, when available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or values obtained from independent pricing services. The fair values for equity securities are based on quoted market prices.

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

(j) Foreign Exchange

The Company converts foreign currencies to U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52. *"Foreign Currency Translation"*, whereby items of income and expense are translated at the average exchange rate for the period while balance sheet items are translated using the spot rate, as of the balance sheet date.

(k) Contribution Notes

Contribution notes represent subordinated debt instruments classified as a component of surplus for statutory accounting purposes. Associated debt issuance costs are deferred, non-admitted, and amortized using the interest method over the period to maturity. The difference between proceeds received and the face value of the contribution notes is amortized using the interest method over the period to maturity. Interest expense on contribution notes is reported as a component of net investment income in 1999.

(l) Intercompany Pooling Agreement

Effective January 1, 1999, the Company, Liberty Mutual Insurance Company ("Liberty"), Liberty Mutual Fire Insurance Company ("Liberty Fire"), Liberty Insurance Corporation, Golden Eagle Insurance Corporation, Montgomery Mutual Insurance Company, Wausau Business Insurance Company ("WBIC"), Wausau General Insurance Company ("WGIC"), Wausau Underwriters Insurance Company ("WUIC"), Merchants and Business Men's Mutual Insurance Company, LM Insurance Corporation, Montgomery Indemnity Company, and The First Liberty Insurance Corporation (collectively referred to as the "Liberty Companies") share their underwriting operations in a pooling agreement ("the Pool"), with participation being 13%, 65.95%, 10%, 6%, 2.5%, 0.70%, 0.40%, 0.40%, 0.40%, 0.25%, 0.20%, 0.10% and 0.10%, respectively. Liberty Mutual serves as the lead company with all activity ceded to Liberty and retro ceded to pool members in their proportionate percentages.

The Company's entry into the Pool, and its assumption of underwriting balances as of January 1, 1999 was accounted for as prospective reinsurance in accordance with statutory accounting. In exchange for assuming loss and loss adjustment expense reserves upon entry into the Pool, the Company received an immediate reduction to paid losses resulting in negative paid losses. Effective January 1, 1999, WGIC, WBIC and WUIC also entered the Pool.

(m) Reclassification

Certain reclassifications to the 1998 statutory financial statements have been made to conform to the 1999 presentation

(dollars in thousands)

(2) Investments

At December 31, 1999 and 1998, bonds having an admitted value of $619, 362 and $604,520, respectively, were on deposit with regulatory authorities as required by law.

The statement value and estimated fair value of investments in bonds at December 31 are as follows:

December 31, 1999	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 281,092	$ 315	$ (8,612)	$ 272,795
Obligations of states and political subdivision	3,951	101	--	4,052
Debt securities issues by foreign governments	66,462	46	(2,809)	63,699
Corporate Securities	1,086,663	2,895	(37,517)	1,052,041
Mortgage and asset-backed securities	934,005	5,251	(26,762)	912,494
Totals	$ 2,372,173	$ 8,608	$ (75,700)	$ 2,305,081

December 31, 1998	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 546,989	$ 18,670	$ (78)	$ 565,581
Obligations of states and political subdivisions	4,652	221	–	4,873
Debt securities issued by foreign governments	50,386	2,767	–	53,153
Corporate securities	615,633	29,761	(104)	645,290
Mortgage and asset-backed securities	578,369	17,084	(247)	595,206
Totals	$ 1,796,029	$ 68,503	$ (429)	$ 1,864,103

The statement and fair values of bonds at December 31, 1999, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because some securities may be called or prepaid.

	Statement Value	Fair Value
Due to mature:		
One year or less	$ 68,423	$ 68,543
Over one year through five years	544,956	535,778
Over five years through ten years	609,096	585,227
Over ten years	215,693	203,039
Mortgage and asset-backed securities	934,005	912,494
Total fixed maturities	$ 2,372,173	$ 2,305,081

(dollars in thousands)

Proceeds from the sale of bonds were $471,480 and $355,435 in 1999 and 1998, respectively. Gross gains of $7,915 and $10,045 and gross losses of $966 and $1,000 were realized on sales in 1999 and 1998, respectively.

Investment income for the years ended December 31, 1999 and 1998 was as follows:

	1999	1998
Interest earned	$ 153,784	$ 154,277
Dividends earned	8	145
Real estate income	8,757	8,791
Realized capital gains	89,450	345,944
Other	2,170	3,540
Gross investment income	254,169	512,697
Investment expense	17,314	9,014
Depreciation on real estate	2,110	1,905
Net investment income	$ 234,745	$ 501,778

The cumulative net unrealized investment gain (loss) for nonaffiliated stocks carried at fair value was $ (4) and $ (1,523) at December 31, 1999 and 1998, respectively. The cost of nonaffiliated stocks carried at fair value was $ 1,759 and $1,523 at December 31, 1999 and 1998, respectively. The net unrealized gain (loss) at December 31, 1999 and 1998, respectively, is composed of $0 and $0 of gross unrealized gains and $4 and $1,523 of gross unrealized losses.

(3) Federal Income Taxes

In 1998, the Company filed a consolidated Federal income tax return, which included all eligible U.S. subsidiaries. In this regard, the includable subsidiaries paid to the Company the amount which should have been payable on a separate return basis. The Company paid taxes due on a consolidated basis. As a result of the sale of its' subsidiaries to Liberty, the Company's federal income tax return for 1999 is not consolidated with any other entities. There were no federal income taxes incurred and available for recoupment in the event of future net losses for the current year of for the first preceding year.

Federal income taxes incurred for financial statement purposes are provided based upon the manner in which income and deductions are reported for tax purposes. Effective tax rates differ from the current statutory rate of 35%, principally due to the effects of tax-exempt interest, dividends-received deductions, discounting of reserves for unpaid losses and loss adjustment expenses, an unearned premium adjustment, alternative minimum taxes, revisions to prior years' estimates and use of net operating losses.

(dollars in thousands)

The amount of consolidated net operating loss carryforwards by expiration year available to offset future income subject to Federal income tax is as follows:

2000	$166,148
2001	24,691
2003	53,788
2004	28,194
2005	51,960
2007	51,471
2008	18,072
2010	34,438
2011	41,723
2018	62,515

(4) Losses and Loss Adjustment Expenses Unpaid

Activity in the liabilities for losses and loss adjustment expenses is summarized as follows:

	1999	1998
Balance as of January 1	$ 1,484,512	$ 1,781,065
Incurred attributable to:		
Current year	835,935	1,127,974
Prior years	(11,866)	(4,797)
Total incurred	824,069	1,123,177
Paid attributable to:		
Current year	351,731	836,963
Prior years	(44,392)	584,627
Total paid:	307,339	1,421,590
Reserve adjustments to surplus, net	304	1,860
Balance as December 31	$ 2,001,546	$ 1,484,512

Incurred attributable to prior years in 1999 was favorably impacted by a reinsurance transaction between Liberty Mutual and a wholly owned subsidiary as more fully disclosed in Note 6.

The liabilities are intended to cover ultimate losses incurred except for certain workers' compensation claims subject to scheduled, periodic payments which are discounted at approximately 3.5% over the estimated future payment periods. The impact of this discounting was to reduce the liabilities for losses and loss adjustment expenses by approximately $137,675 and $121,600 at December 31, 1999 and 1998, respectively.

Anticipated future salvage and subrogation recoveries reduced the liabilities for losses and loss adjustment expenses by approximately $41,784 and $29,729 at December 31, 1999 and 1998, respectively.

(dollars in thousands)

The tabular discounting on group accident and health claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 5.00% to 5.75%. Unpaid losses at December 31, 1999 include liabilities of $56,306 carried at discounted values of $43,368.

For certain commercial lines of insurance, the Company offers experience-rated Insurance Contracts whereby the ultimate premium is dependent upon the level of ultimate losses incurred. At December 31, 1999, the Company held $523,159 of loss and loss adjustment expense reserves related to experience-rated contracts.

(5) Asbestos and Environmental Reserves

Included in the reserve amounts shown above are the net loss and loss adjustment expense reserves for asbestos and environmental exposures totaling $7,200 at December 31, 1998. The reduction in the reserves is due to the reinsurance contract with Nationwide Indemnity Company discussed in note 6.

Establishing reserves for asbestos and environmental claims is subject to uncertainties that are greater than those presented by other types of claims. Among the complications are lack of sufficient historical data, long reporting delays, uncertainty as to the number and identity of insureds with potential exposure, and unresolved legal issues regarding policy coverage and the extent and timing of any such contractual liability. The legal issues concerning the interpretation of various insurance policy provisions and whether environmental losses are or were ever intended to be covered are complex. Courts have reached different and often inconsistent conclusions concerning when the loss occurred and which, if any, policies provide coverage; whether there is a defense obligation; how policy limits are determined; and how policy exclusions are applied and interpreted. Based on the foregoing, reserves for asbestos and environmental claims cannot be estimated with traditional loss reserving techniques. Case reserves have been established when sufficient information has been developed to indicate the involvement of a specific insurance policy. In addition, incurred but not reported reserves have been established to cover additional exposures on both known and unasserted claims. These reserves will continue to be reviewed and updated by the Company, as appropriate.

(dollars in thousands)

The following table summarizes reserve activity for the Company's asbestos and environmental losses and loss adjustment expense reserves, a component of the Company's total reserves summarized in above, for the year ended December 31, 1999 (Beginning net asbestos and environmental restated to reflect entry into Intercompany Pool):

	1999
Gross Asbestos:	
January 1 reserves	$ 457,204
Incurred activity	249,932
Paid activity	71,785
Ending reserves	$ 635,351
Net Asbestos:	
January 1 reserves	$ 90,568
Incurred activity	7,810
Paid activity	10,739
Ending reserves	$ 87,639

	1999
Gross Environmental:	
January 1 reserves	$ 448,447
Incurred activity	50,092
Paid activity	48,445
Ending reserves	$ 450,084
Net Environmental:	
January 1 reserves	$ 94,910
Incurred activity	(1,118)
Paid activity	9,870
Ending reserves	$ 83,922

(6) Reinsurance

In the ordinary course of business, the Liberty Companies assume reinsurance and also cede reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Liberty Companies are also members of various involuntary pools and associations and serve as servicing carriers for residual market organizations. Pursuant to the intercompany pooling agreement, the Company cedes 100% of its insurance risks to Liberty and assumes 13% of the Liberty Companies' net underwriting results in return.

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

(dollars in thousands)

In 1998, the Company was a party to a pooling arrangement with affiliated property and casualty companies under an agreement which terminated December 31, 1998. All underwriting results of the affiliates were pooled with the exception of a small segment of servicing carrier business of one of the affiliates.

Nationwide was the lead company in the pool. As of January 1, 1998, the pool members and their respective participation percentages in the pooling agreement were as follows:

Nationwide Mutual Insurance Company	62.0%
Nationwide Mutual Fire Insurance Company	11.3
Nationwide General Insurance Company	0.3
Nationwide Property and Casualty Insurance Company	0.3
Colonial Insurance Company	0.4
Scottsdale Insurance Company	4.0
EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	16.4
Wausau Underwriters Insurance Company	2.1
Wausau General Insurance Company	0.8
Wausau Business Insurance Company	0.7
Farmland Mutual Insurance Company	1.0
Nationwide Agribusiness Insurance Company	0.5
Scottsdale Indemnity Company	0.2
	100.0%

In conjunction with the deaffiliation with Nationwide, the pooling participation for the Company, Wausau Underwriters Insurance Company, Wausau General insurance Company and Wausau Business Insurance Company, collectively "the Wausau Companies," was terminated on December 31, 1998. As a result of the termination of the Wausau Companies participation in the Nationwide Pool, the admitted assets and liabilities covered under the reinsurance pooling agreement were depooled on December 31, 1998 (the 1998 income statement activity remained pooled at the rates in effect as of January 1, 1998). Effective January 1, 1999, the Wausau Companies entered the Liberty Mutual Group intercompany reinsurance pool as more fully disclosed in Note 1.

On December 31, 1998, the Wausau Companies ceded to the Nationwide Indemnity Company their liabilities for 100% of all losses and loss adjustment expenses related to Discontinued Operations, as defined in the reinsurance agreements. The ceded premium and the loss and loss adjustment expense reserves transferred under the agreements, which were primarily reserves for asbestos and environmental claims, totaled $1,353,718. In consideration for ceding those liabilities, the Wausau Companies transferred cash and securities estimated to be equal to the ceded premium plus 100% of the loss and loss adjustment expense reserves reinsured under this agreement.

The reinsurance agreement covering Discontinued Operations, as previously defined, with Nationwide Indemnity Company is guaranteed by Nationwide. Pursuant to a permitted practice by the State of Wisconsin Office of the Commissioner of Insurance, this agreement has been accepted as security for the reinsurance recoverables relating to such Discontinued Operations. Recoverables guaranteed at December 31, 1999 and 1998 were $29,633 and $31,267 respectively.

Effective July 1, 1996, the Company and its property and casualty insurance subsidiaries purchased from its affiliate, Nationwide Indemnity Company, $150,000 of excess of loss property catastrophe reinsurance covering losses incurred in excess of $50,000 after the Company's participation in the pooling agreement. Premiums ceded under this agreement were $13,500 annually. This contract was terminated December 31, 1998.

The Company entered into a reinsurance agreement with ELICW, which provides for ELICW to assume 100% of the Company's net group accident and health business. Net written premiums on this business were approximately $105,528 for the year ended December 31, 1998. This agreement was terminated December 31, 1998 and ELICW ceded to the Company their liabilities for 100% of all losses totaling $36,363.

The Company was a party to aggregate excess of loss agreements covering accident years 1985 and 1988 through 1991. Under the terms of these agreements, the Company recovered $44,160 of ceded paid losses and loss adjustment expense in 1998. Based on current estimates of the value of the contracts' experience accounts, the Company had accrued on present value basis $135,319 of adjustable commissions at December 31, 1998, which were estimated to be recoverable in the future and were not subject to the aforementioned pooling agreement. The net results under these contracts increased statutory income $14,571 in 1998.

The Company, WBIC, WGIC, and WUIC entered into commutation agreements relating to above excess of loss agreements in 1999. Loss and loss expense reserves of $248,114 were returned along with cash of $191,586. The transaction resulted in a net statutory loss of $4,778 after intercompany pooling.

Liberty entered into an intercompany reinsurance agreement with a wholly owned unconsolidated subsidiary in 1999 whereby Liberty ceded $188,063 of loss and loss adjustment expense reserves in exchange for premium of $137,920. The transaction resulted in net statutory income of $4,550 after intercompany pooling, with no impact upon statutory surplus.

(dollars in thousands)

The following is a summary of the Company's reinsurance program.

		Ceded 1999	Ceded 1998	Assumed 1999	Assumed 1998
Nonaffiliates:					
	Premiums Written	$209,980	$192,759	$25,390	$16,028
	Unpaid Losses and expenses	2,237,536	1,280,178	436,671	509,418
	Unearned Premiums	35,105	37,744	5,382	8,122
Affiliates:					
	Premiums Written	595,124	803,135	1,113,111	956,099
	Unpaid losses and expenses	1,479,582	1,042,375	1,204,195	109,999
	Unearned Premiums	110,334	1,680	295,248	21

In connection with the intercompany pooling agreement, the Company has a funds held asset, included in other admitted assets, of $181,527 as of December 31, 1999 due from Liberty. Interest is accrued on the unpaid balance at a rate 6.50%.

At December 31, 1999, the balances in unsecured aggregate amounts of unearned premium and losses paid and unpaid, including incurred but not reported losses, recoverable from individual unaffiliated reinsurers (excluding syndicates, pools, and associations)which exceed 3% of surplus were as follows:

National Indemnity Company	$132,716
Underwriters at Lloyds	36,308
Farmland Mutual insurance Company	22,376

Liberty entered into a reinsurance agreement effective January 1, 1998 with Liberty Life Assurance Company of Boston ("Liberty Life"), an indirect, unconsolidated subsidiary of the Liberty Companies, whereby Liberty Life ceded 100% of long and short-term disability business on a funds withheld basis. Liberty assumed premiums earned of $176,000 in 1999; and loss and loss adjustment expense reserves of $440,504 as of December 31, 1999. The transaction resulted in a net statutory loss to the Company of $3,234 in 1999, after intercompany pooling.

(dollars in thousands)

(7) Employee Benefit Plans

(a) Pension Plans and Postretirement Benefits

In 1998, the employees of WSC provided services to the Company and other affiliated companies. Alternatively, other affiliated companies provided services to the Company. Accordingly, payroll and related costs and certain other expenses were allocated between the Company and the affiliated companies. These allocated expenses, which were determined using the Company's cost accounting system, were intended to approximate the actual costs of services provided.

In addition, in 1998, the Company was a participant, together with other affiliated companies, in the Nationwide Insurance Enterprise Retirement Plan (Enterprise Plan) which covered all employees who had completed at least one year of service. Benefits are based upon the highest average annual salary of a specified number of consecutive years over the last ten years of service. The Company funded pension costs accrued for an allocated share of direct employees plus an allocation of pension costs accrued for employees of affiliates whose work efforts benefitted the Company.

Effective December 31, 1998, WSC ended its affiliation with the Nationwide Insurance Enterprise and employees of WSC ended participation in the plan. As of January 1, 1999, the employees of WSC became participants of the Liberty Mutual Insurance Company retirement plan.

The Company had no accrued pension obligations at December 31, 1998. Pension costs charged to operations under the Retirement Plan during the year ended December 31, 1998 were $11,106.

In addition to the defined benefit pension plan, the Company had a stand-alone post-retirement benefit plan that provided certain health care and life insurance benefits for qualified retired employees who have attained age 55 and accumulated 5 years of service with the Company. The Company elected to amortize its transition obligation for retirees and fully vested current employees over 20 years. Costs of these plans were shared with affiliates and pooling participants similar to the Company's pension plan.

The components of net periodic postretirement benefit cost for the other postretirement benefit plans of the Company for 1998 follow:

	1998
Service cost	254
Interest cost on ABO	4,718
Return on plan assets	(2,646)
Amortization and deferrals	3,312
Net postretirement benefit cost	$5,638
Basis of measurement, net periodic cost:	
Discount rate	6.70%
Health care cost trend rate	15% grading to 8% over 15 years
Expected long-term rate of return on plan assets	7.15%

(dollars in thousands)

Net postretirement benefit cost allocated to the Company and charged to operations under these plans during the year ended December 31, 1998 was approximately $3,710.

Information regarding the funded status of the other postretirement benefit plans at December 31, 1998 follows:.

	1998
Accumulated postretirement benefit obligation (APBO)	$82,241
Plan assets at fair value	27,363
APBO in excess of plan assets	54,878
Unrecognized net losses from performance different than assumptions	(12,290)
Unrecognized transition obligation	(33,107)
Remaining prior service cost	(369)
Accrued postretirement benefit liability	$9,112

Basis for measurements, funded status of plan:	
Discount rate	6.70%
Health care cost trend rate	15.00% grading to 8.00% over 15 years

Due to the provisions of the Company's health care and life insurance benefit plans, a 1% increase in the medical inflation rate would not have had a material effect on the net postretirement benefit cost or the accumulated postretirement benefit obligation.

Effective January 1, 1999, the Wausau Group pension plan was merged into the Liberty Retirement Benefit Plan. Assets of approximately $369,000 and vested projected benefit obligation of approximately $315,000 were added to the Liberty plan. Liberty sponsors noncontributory defined benefit pension plans ("the Plans") covering substantially all U.S. employees who have attained age 21 and have completed one year of service and Canadian employees who have completed one year of service. The benefits are based on years of service and the employee's compensation, as more fully defined in the Plans.

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 and Standard & Poor's Index of 500 equity securities. At December 31, 1999 and 1998, assets of the Plans totaling $2,090,854 and $1,548,141, respectively, were held in separate accounts managed by Liberty Life.

Liberty also provides certain health care and life insurance benefits ("postretirement") for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age and have ten years of service working for the Companies. 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.

Under the intercompany pooling agreement, $1,456 of the pension expense and $4,675 of postretirement expense were charged to the Company in 1999.

(dollars in thousands)

(b) Thrift-Incentive Plan

In 1998, the Company and WSC participated in the savings plan which was available to substantially all employees on a voluntary basis. Effective July 1, 1996, Wausau Insurance Companies Employees' Savings Plan was merged with Nationwide Insurance Companies and Affiliates Employee Incentive Savings Plan to form the Nationwide Insurance Enterprise Savings Plan. The Company made a matching contribution to the plan which amounted to $5,679 for the year ended December 31, 1998.

Effective January 1, 1999, the employees of WSC became participants of the Liberty Mutual Employees' Thrift-Incentive Plan. Liberty sponsors defined contribution savings plans for employees who meet certain eligibility requirements. During 1999, employees of the Liberty companies 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, the Liberty Companies made matching contributions of $56,068. Under the intercompany pooling agreement, $7,289 of expense was charged to operations in 1999.

(8) Contribution Notes

At December 31, 1999, Liberty holds contribution notes issued by the Company as follows:

Amount	Interest Rate	Maturity Date
$220,000	4.52%	December 31, 2005

In accordance with the De-Affiliation Master Agreement between Nationwide and the Company, the Company repaid in full the $400,000 principal plus accrued interest on the contribution notes issued by the Company to Nationwide. Pursuant to an Affiliation and Contribution Note Purchase Agreement dated October 5, 1998, Liberty Mutual Insurance Company purchased a Contribution Note in the amount of $220,000 from the Company.

Interest on the notes is charged directly to unassigned surplus when it is paid. Interest of $9,143 and $0 was paid on the notes in 1999 and 1998, respectively. Unpaid interest at December 31, 1999 and 1998 amounted to $856 and $28, respectively.

(9) Contingencies

The Company is a defendant in lawsuits arising in the ordinary course of business from claims under insurance policies and from other matters. Accruals for these lawsuits have been provided to the extent that losses are deemed probable. Such accruals do not materially affect the statutory financial statements. Certain of the lawsuits seek extraordinary damages. Management believes these claims to be without merit and, to date, has been successful in settling similar cases for insignificant amounts, having the extraordinary damage aspects dismissed, or defending to verdict without the imposition of such extraordinary damages.

The Company is subject to assessments from insurance guaranty funds in states it writes business. These assessments relate to losses resulting from the insolvency of insurers in those states. The Company accrues the estimated amount of assessments for known insolvencies.

The Liberty Companies periodically purchase annuity contracts from various life insurance companies to settle claims. When the contract is purchased, the corresponding loss reserve is eliminated. The primary liability for future claim payments resides with the life insurance company, but in certain instances, the Liberty Companies remain contingently liable in the event the life insurer is unable to meet its obligation. These annuities were primarily purchased from Liberty Life. At December 31, 1999, the contingent liabilities amounted to $572,683, and represent the statutory reserves of the annuities as reported by the issuing companies. Under the intercompany pooling agreement, the Company's share at December 31, 1999 was $74,449. In addition, at December 31, 1998, the amount of structured claim settlements for which the Company was contingently liable was $182,505, which included settlements from ELICW, of $182,458.

The Company, WGIC, WBIC and WUIC lease certain office facilities and equipment from others under operating leases expiring in various years through 2009. Rental expense amounted to $22,994 for the year ended December 31, 1999. Future minimum rental payments under non-cancellable leases with terms in excess of one year are estimated to be $17,225 for 2000, $15,478 for 2001, $14,192 for 2002, $11,670 for 2003 and $29,628 for 2004 thereafter. It is expected that as leases expire they will be replaced by new leases.

(10) Risk Based Capital

Each insurance company's state of domicile imposes minimum risk-based capital requirements that were developed by the NAIC. The formulas for determining the amount of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Regulatory compliance is determined by a ratio of the enterprise's regulatory total adjusted capital to its authorized control level risk-based capital, as defined by the NAIC. Companies below specific trigger points or ratios are classified within certain levels, each of which requires specified corrective action. At December 31, 1999 and 1998, the Company exceeds the minimum risk-based capital requirement.

(dollars in thousands)

(11) Reconciliation to Annual Statement

	1998			
	Admitted Assets	Liabilities	Capital and Surplus	Net Income
Annual Statement, as filed	$ 2,825,909	$ 2,825,909	$ 575,000	$ 250,387
Accrued retrospective premium	2,600		2,600	2,600
Agents balances	(2,319)		(2,319)	(2,319)
Federal income tax recoverable	1,109		1,109	1,109
Provision for reinsurance		(7,519)	7,519	
Other assets	2,546		2,546	2,546
Losses unpaid		15,000	(15,000)	(15,000)
Loss adjustment expenses unpaid		1,900	(1,900)	(1,900)
Receivable from nonaffiliates	6,930		6,930	7,181
Payable to affiliates		1,485	(1,485)	(1,485)
Accompanying financial statements	$ 2,836,775	$ 2,261,775	$ 575,000	$ 243,119

The differences between the annual statement and the audited statements in 1998 were the result of information obtained subsequent to the filing of the annual statement. The procedures used to arrive at the new reserve estimates were consistent with those underlying the annual statement.

(12) Permitted Statutory Accounting Practices

The Company's statutory-basis financial statements are prepared in accordance with accounting practices prescribed or permitted by the State of Wisconsin Office of the Commissioner of Insurance. Currently, "prescribed" statutory accounting practices are interspersed throughout the state insurance law and regulations, the Accounting Practices and Procedures Manual of the NAIC and a variety of other NAIC publications.

In 1998, the NAIC adopted codified statutory accounting practices ("Codification") effective January 1, 2001. Codification will change, to some extent, prescribed statutory accounting practices and may result in changes to the accounting practices that the Company uses to prepare its statutory-basis financial statements. Management believes that the impact of codification will not materially affect reported surplus.

(13) Restructuring Charge

During 1999, the Liberty Companies announced a restructuring of certain commercial operations in order to streamline operations and eliminate distribution channel conflicts from the EIOW acquisition. Implementation began in the third quarter of 1999 and is expected to be completed by the end of 2000. Liberty recorded a restructuring liability of $130,000 of which $50,000, recorded as a direct charge to surplus, was attributed to the affiliation of EIOW and the acquisition of its insurance subsidiaries. The $80,000 charge to income was pooled under the Intercompany Pooling arrangement with $10,400 being charged to the Company. 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.