EMPLOYERS INSURANCE OF WAUSAU

A Mutual Company

Statutory Financial Statements

December 31, 1998 and 1997

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Admitted Assets, Liabilities, and Surplus, continued

December 31, 1998 and 1997
(Dollars In Thousands)

Admitted Assets	**1998**	**1997**
Bonds (note 2)	$1,796,029	$2,111,787
Stocks, other than investments in subsidiaries (note 2):		
Preferred, at fair value (cost $0 in 1998 and $127 in 1997)	-0-	34
Common, at fair value (cost $1,523 in 1998 and $8,087 in 1997)	-0-	14,095
Investments in subsidiaries (note 3)	-0-	210,817
Real estate, at cost less accumulated depreciation: 1998, $27,078; 1997, $25,173	46,331	46,036
Cash and short-term investments	333,196	(410)
Other invested assets	212	5,256
Agents' balances and uncollected premiums	205,265	240,370
Reinsurance recoverable on loss payments	40,537	52,607
Federal income taxes recoverable	30,345	8,609
Accrued investment income	26,045	29,516
Receivable from affiliates	75,017	17,707
Receivable from nonaffiliates	66,410	-0-
Funds deposited with reinsurers	121,713	149,129
Agents' security fund deposit	-0-	79,410
Other assets	95,675	74,397
Total admitted assets	$2,836,775	$3,039,360
Liabilities and Surplus		
Liabilities:		
Losses (note 5)	$1,199,266	$1,390,080
Loss adjustment expenses (note 5)	285,246	390,985
Assumed reinsurance losses payable	21,859	21,538
Unearned premiums	76,052	431,669
Accrued expenses	57,485	62,472
Dividends declared and payable	4,674	1,074
Funds held under reinsurance treaties	6,146	28,149
Amounts withheld for account of others	105,800	61,194
Statutory reinsurance liability	3,454	12,562
Excess statutory over statement reserves	251	183
Payable to affiliates	456,500	13,736
Agents' security fund reserve	-0-	79,410
Other liabilities	45,042	21,087
Total liabilities	$2,261,775	$2,514,139
Surplus:		
Contribution notes (note 8)	220,000	400,000
Unassigned surplus	355,000	125,221
Total surplus	575,000	525,221
Commitments and contingencies (notes 6 and 9)		
Total liabilities and surplus	$ 2,836,775	$ 3,039,360

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Income

Years ended December 31, 1998 and 1997
(Dollars In Thousands)

	1998	1997
Underwriting:		
Net premiums written	$680,324	$1,329,763
Decrease (increase) in unearned premiums	414,131	(20,273)
Premiums earned	1,094,455	1,309,490
Deductions:		
Losses incurred (note 5)	905,770	810,453
Loss adjustment expenses incurred (note 5)	217,407	219,697
Other underwriting expenses incurred, net	237,945	346,656
Net losses and expenses incurred	1,361,122	1,376,806
Net underwriting loss	(266,667)	(67,316)
Net investment income (note 2)	501,778	153,790
Other expenses, net	(3,703)	(6,435)
Income before dividends to policyholders and Federal and other income tax benefit	231,408	80,039
Dividends to policyholders	12,621	14,544
Income before Federal and other income tax benefit	218,787	65,495
Federal and other income tax benefit (note 4)	24,332	8,081
Net income	$ 243,119	$ 73,576

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Surplus

Years ended December 31, 1998 and 1997
(Dollars In Thousands)

	1998	**1997**
Balance at beginning of year	$ 525,221	$ 494,758
Net increases (decreases) for the year:		
Net income	243,119	73,576
Change in net unrealized capital gains	(17,826)	15,921
Change in non-admitted assets	31,949	(28,156)
Change in statutory reinsurance liability	9,108	(7,759)
Change in foreign exchange adjustment	(2,386)	5,553
Change in excess statutory reserves over statement reserves	(68)	(178)
Change in surplus notes	(180,000)	-0-
Reserve adjustment on discontinued product lines (note 5)	(1,860)	(1,765)
Interest paid on contribution notes (note 8)	(27,083)	(25,000)
Change in deferred pool service revenue	-0-	184
Other changes	(5,174)	(1,913)
Net increase	49,779	30,463
Balance at end of year	$ 575,000	$ 525,221

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Cash Flow

Years ended December 31, 1998 and 1997
(Dollars In Thousands)

	1998	**1997**
Cash from operations:		
From underwriting:		
Premiums collected, net of reinsurance	$ 772,376	$ 1,341,743
Losses and loss adjustment expenses paid (net of salvage and subrogation)	(1,409,200)	(1,076,634)
Underwriting expenses paid, net	(251,860)	(338,530)
Cash used in underwriting	(888,684)	(73,421)
Investment income, net of expenses	167,417	164,611
Other expenses	19,493	(1,883)
Dividends paid to policyholders	(9,021)	(14,550)
Federal income taxes recovered	2,596	13,294
Net cash (used in) provided by operations	(708,199)	88,051
Cash from investments:		
Proceeds from investments sold, matured, or repaid:		
Bonds	550,407	191,016
Stocks	567,224	24,579
Other	11,632	5,148
Total investment proceeds	1,129,263	220,743
Cost of investments acquired		
Bonds	239,451	203,853
Stocks	19,411	5,216
Real estate	2,200	5,403
Other	160	1,838
Total investments acquired	261,222	216,310
Net cash provided by investments	$ 868,041	$ 4,433

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Statutory Statements of Cash Flow, continued

Years ended December 31, 1998 and 1997
(Dollars In Thousands)

	1998	1997
Cash from other financing and miscellaneous sources:		
Other cash provided:		
Surplus notes	$ (180,000)	$ -0-
Net transfers from affiliates	324,740	7,735
Other	78,485	20,717
Total other cash provided	223,225	28,452
Other cash applied:		
Interest on contribution notes	27,083	25,000
Other	22,378	173,023
Total other cash applied	49,461	198,023
Net cash provided by (used in) other financing and miscellaneous sources	173,764	(169,571)
Net change in cash and short-term investments	333,606	(77,087)
Cash and short-term investments at beginning of year	(410)	76,677
Cash and short-term investments at end of year	$ 333,196	$ (410)

See accompanying notes to statutory financial statements.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements

December 31, 1998 and 1997
(Dollars In Thousands)

(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 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, Wausau General Insurance Company and Wausau Business Insurance Company), was purchased by Liberty from the Company for $518,017. The receivable from nonaffiliates primarily represents the estimated final settlement due from Nationwide resulting from the sale of WSC and the deaffiliation. The sales price and settlement of the receivable from Nationwide are expected to be finalized in second quarter of 1999.

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. At December 31, 1998, the fair value of the Company's bond portfolio was greater than the carrying value in the accompanying statutory financial statements. The duration of its assets were also less than its liabilities.

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.

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. Prescribed statutory accounting practices include those promulgated by state laws, regulations, and general administrative rules, as well as by a variety of publications of the National Association of Insurance Commissioners (NAIC). Permitted statutory accounting practices encompass all accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future. In March 1998, the NAIC adopted the Codification of Statutory Accounting Principles (the Codification). The Codification will constitute the only source of "prescribed" statutory accounting practices. Accordingly, once implemented, the definition of what comprises prescribed versus permitted statutory accounting practices may result in changes to the accounting policies that insurance enterprises use to prepare their statutory financial statements. The implementation date is ultimately dependent on an insurer's state of domicile. The Company is currently evaluating the impact of the Codification on its statutory financial statements. All material transactions recorded by the Company are in conformity with prescribed practices. Prescribed practices vary in some respects from generally accepted accounting principles and 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 pro rata 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 statement and tax return bases of assets and liabilities;

- No provision has been made for Federal income taxes on unrealized appreciation or depreciation of investments;

(Dollars In Thousands)

- The costs and related liabilities of providing postretirement benefits are calculated without regard to active nonvested participants;

- Changes in the estimate of unpaid losses and loss adjustment expenses on certain discontinued lines of business are reflected as direct adjustments to unassigned surplus, as these changes in estimates are unrelated to current underwriting activities;

- Goodwill from acquisitions of subsidiaries is amortized over no longer than l0 years, rather than amortized over the expected future economic benefit period;

- Bonds are generally recorded at amortized cost, and are not classified as either held-to-maturity securities, trading securities, or available-for-sale securities;

- Investments in subsidiaries are generally carried at their underlying statutory book value using the equity method of accounting, rather than consolidated;

- Policyholder dividends are provided upon declaration by the Board of Directors, rather than as incurred; and

- Contribution notes and interest thereon are accounted for as a component of statutory surplus.

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

Investments

Bonds and stocks are valued in accordance with the valuations prescribed by the Committee on Valuation of Securities of the NAIC. Generally, bonds and short-term investments are stated at amortized cost; common and preferred stocks values based upon market quotations; stocks of subsidiaries, if any, generally at the Company's pro rata share underlying statutory equity; and real estate at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the properties. Real estate income consists primarily of the estimated rental value of self occupancy.

Realized gains and losses are determined on a specific identification basis and reflected as a component of investment income. Unrealized gains and losses resulting from changes in the value of common and non-redeemable preferred stocks are recorded directly to unassigned surplus.

Losses

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 Company reflects its liability for losses net of estimated salvage and subrogation recoverables.

(Dollars In Thousands)

Loss Adjustment Expenses

The liability for loss adjustment expenses is provided by estimating 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.

Premiums

Premiums earned are determined on a daily pro rata basis over the contract period and are reduced for reinsurance placed with other insurers. Estimates of premiums for retrospectively rated policies are included in income as a decrease in unearned premiums. A provision, net of a statutory penalty, for additional or return premiums is made for anticipated retrospective premium adjustments.

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.

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.

Fair Value of Financial Instruments

The carrying amounts for short-term investments approximate fair value because they mature in 90 days or less and generally do not present credit concerns. The fair value of bonds, except certain state and municipal securities, are estimated based on published bid prices or bid quotations received from securities dealers. The fair values of certain state and municipal securities are not readily available through market sources other than dealer quotations; accordingly, fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued. Fair values for stocks are estimated based on quoted market prices.

Fair value of bonds is presented in note 2. Fair value of all other significant financial instruments is estimated to approximate carrying value.

Reclassification

The Wisconsin report of examination as of December 31, 1996, included a recommendation that the Company report checks outstanding net of its cash balances. This change was incorporated into the December 31, 1998 presentation.

Certain 1997 amounts have been reclassified in order to conform to their 1998 presentation.

(2) Investments

At December 31, 1998, bonds having an admitted value of $604,520 ($595,684 in 1997) were on deposit with regulatory authorities as required by law.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

The Company's investment policy for bonds is to purchase only investment grade bonds. No provision has been made for possible losses on bonds where amortized cost exceeds market value as the Company generally intends to hold the bonds to maturity or until such time as it will not realize any significant losses.

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

At December 3l, 1998:

	Statement value	Gross unrealized gains	Gross unrealized losses	Estimated 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	-0-	4,873
Debt securities issued by foreign governments	50,386	2,767	-0-	53,153
Corporate securities	615,633	29,761	104	645,290
Mortgage backed securities	578,369	17,084	247	595,206
Totals	$1,796,029	$68,503	$429	$1,864,103

At December 31, 1997:

	Statement value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 540,497	$ 7,631	$ 676	$ 547,452
Obligations of states and political subdivisions	7,427	269	9	7,687
Debt securities issued by foreign governments	59,623	2,512	-0-	62,135
Corporate securities	717,187	25,374	277	742,284
Mortgage backed securities	787,053	27,813	1,072	813,794
Totals	$2,111,787	$63,599	$2,034	$2,173,352

(Dollars In Thousands)

The statement value and estimated fair value of bonds at December 31, 1998, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the nght to call or prepay obligations with or without call or prepayment penalties.

	Statement value	Estimated fair value
Due in one year or less	$ 61,661	$ 62,125
Due after one year through five years	710,887	735,219
Due after five years through ten years	320,286	338,371
Due after ten years	124,826	133,182
Mortgage backed securities	578,369	595,206
Totals	$1,796,029	$1,864,103

Proceeds from the sale of bonds were $355,435 and $28,137 in 1998 and 1997, respectively. Gross gains of $10,045 and $2,145 and gross losses of $1,000 and $0 were realized on sales in 1998 and 1997, respectively.

Investment income for the years ended December 31, 1998 and 1997 was as follows:

	1998	1997
Interest earned	$ 154,277	$ 148,764
Dividends earned	145	991
Real estate income	8,791	8,886
Realized capital gains	345,944	4,303
Other	3,540	1,060
Gross investment income	512,697	164,004
Investment expense	9,014	8,526
Depreciation on real estate	1,905	1,688
Net investment income	$ 501,778	$ 153,790

The cumulative net unrealized investment gain (loss) for nonaffiliated stocks carried at fair value was $(1,523) and $5,915 at December 31, 1998 and 1997, respectively. The cost of nonaffiliated stocks carried at fair value was $1,523 and $8,214 at December 31, 1998 and 1997, respectively. The net unrealized gain (loss) at December 31, 1998 and

(Dollars In Thousands)

1997, respectively, is composed of $0 and $10,278 of gross unrealized gains and $1,523 and $4,363 of gross unrealized losses.

(3) Investments in Subsidiaries

The cost and carrying values of investments in subsidiaries, by classification, at December 31, 1998 and 1997 are as follows:

	1998 Cost	1998 Carrying value	1997 Cost	1997 Carrying value
Property and casualty insurance	$ 0	$ 0	$ 142,360	$ 138,877
Foreign insurance	0	0	23,683	12,932
Noninsurance	0	0	31,232	59,008
	$ 0	$ 0	$ 197,275	$ 210,817

During 1997, the Company acquired an 80% ownership in Key Health Plan, Inc. at a cost of $1,508 from Employers Life Insurance Company of Wausau (ELICW), an affiliated company. The Company made a capital contribution to Key Health Plan, Inc., of $320. During 1998, the Company sold Key Health Plan, Inc. to Health Pro Inc. for $182 realizing a loss of $l68.

During 1997, Wausau (Bermuda) Ltd. was incorporated as a stock corporation under the laws of Bermuda and will operate as a rent-a-captive reinsurer. During 1997, WSC contributed $4,880 to the capital of Wausau (Bermuda) Limited.

On December 31, 1998, Wausau Service Corporation, a wholly owned subsidiary of the Company, including its three property and casualty insurance companies (Wausau Underwriters Insurance Company, Wausau General Insurance Company, and Wausau Business Insurance Company), was purchased by Liberty from the Company for $518,017 resulting in a capital gain of $341,254.

During 1998, the Company sold Wausau (UK) to Liberty for $8,000, realizing a loss of $10,683.

(4) Federal Income Taxes

The Company files a consolidated Federal income tax return, which includes all eligible U.S. subsidiaries. In this regard the includable subsidiaries pay to the Company the amount which would have been payable on a separate return basis. The Company pays taxes due on a consolidated basis.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

The federal income tax benefit is different from the amount computed by applying the normal tax rate of 35% to income before federal income taxes as follows:

	1998	1997
Computed "normal" tax expense	$ 76,575	$ 22,923
Adjustment to annual statement	2,932	-0-
Tax-exempt interest	(176)	(265)
Dividends received deduction	(35)	(242)
NOL Carryforward	-0-	(32,211)
Agents' security compensation	(19,892)	2,793
Current year net operating loss not utilized	2,555	-0-
Accretion of discount on bonds	321	(308)
Discounting of liability for losses	(5,493)	7,339
Change in unearned premiums deductible for books, not for taxes	(24,893)	1,089
Tax on realized gains in excess of book	(50,110)	209
Nondeductible travel, etc., and expenses deducted in return, not on books	(379)	248
Interest incurred on contribution notes	(8,400)	(8,750)
Adjustment of prior years' taxes	1,464	(1,741)
State taxes	(56)	66
Other, net	1,255	769
Federal and other income tax benefit	$(24,332)	$ (8,081)

Several provisions of the Internal Revenue Code affect only property and casualty insurers. The major provisions are discounting of loss reserves, the accrual of salvage and subrogation recoverable, a reduction in the allowable change in the unearned premium reserve and a reduced exclusion for interest for certain tax-exempt bonds.

The IRS has audited tax returns through tax year 1995.

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

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

1999	$170,049
2000	172,035
2001	24,691
2003	53,788
2004	28,194
2005	51,960
2007	51,471
2008	18,072
2010	34,438
2011	41,723
2013	10,182

(5) Losses and Loss Adjustment Expenses

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

	1998	1997
Balance as of January 1, net of reinsurance recoverables of $4,145,976 and $4,794,973	$1,781,065	$1,818,672
Incurred related to:		
Current accident year	1,127,974	1,034,999
Prior accident years	(4,797)	(4,849)
Total incurred	1,123,177	1,030,150
Paid related to:		
Current accident year	836,963	538,815
Prior accident years	584,627	530,307
Total paid	1,421,590	1,069,522
Reserve adjustments to surplus, net	1,860	1,765
Balance as of December 31, net of reinsurance recoverables of $2,322,553 and $4,145,976	$1,484,512	$1,781,065

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 ($229,400 at December 31, 1997). 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.

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 1/2% over the estimated future payment periods. The impact of this discounting was to reduce the liabilities for losses and loss adjustment expenses by approximately $121,600 and $40,893 at December 31, 1998 and 1997, respectively

Anticipated future salvage and subrogation recoveries reduced the liabilities for losses and loss adjustment expenses by approximately $47,325 and $39,949 at December 31, 1998 and 1997, respectively

(6) Reinsurance

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 are pooled with the exception of a small segment of servicing carrier business of one of the affiliates.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

Nationwide was the lead company in the pool. As of January 1, 1998 and 1997, 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 remains 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.

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 are 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. Subsequent to year-end a final settlement will be made.

The reinsurance agreement covering Discontinued Operations, as previously defined, with Nationwide lndemnity 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, 1998 are $31,267.

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 are $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 and $136,532 for the years ended December 31, 1998 and 1997, respectively. 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 is 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 and $57,782 of ceded paid losses and loss adjustment expenses in 1998 and 1997, respectively. Based on current estimates of the value of the contracts' experience accounts, the Company has accrued on a present value basis $135,319 and $121,010 of adjustable commissions at December 31, 1998 and 1997, respectively, which are estimated to be recoverable in the future and are not subject to the aforementioned pooling agreement. The net results under these contracts increased statutory income $14,571 and $18,584 in 1998 and 1997, respectively.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

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

		Ceded 1998	Ceded 1997	Assumed 1998	Assumed 1997
Nonaffiliates:					
	Premiums written	$ 192,759	$ 211,415	$ 16,028	$ 54,307
	Losses paid	199,346	304,528	39,044	94,135
	Unpaid losses and expenses	1,280,178	1,364,106	509,418	500,108
	Unearned premiums	37,744	35,634	8,122	14,167
Affiliates:					
	Premiums written	803,135	605,842	956,099	1,341,223
	Losses paid	(82,955)	614,911	487,568	886,169
.	Unpaid losses and expenses	1,042,375	2,781,870	109,999	1,129,116
	Unearned premiums	1,680	10,561	21	413,835

At December 31, 1998, 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 syndicated, pools, and associations) which exceed 3% of surplus were as follows:

National Indemnity Company	$134,431
Underwriters at Lloyds	32,245
United States Fidelity & Guaranty Company	84,713

The Company has significant ceded balances with both voluntary and involuntary syndicates, pools, and associations. The amounts are not considered unsecured since the amounts are either recoverable by statute (involuntary pools) or the contract specifies joint and severable liability by all members (voluntary syndicates, pools and associations).

Management believes the possibility of such balances becoming unrecoverable is remote. Ceded amounts deducted from the liabilities for losses and loss adjustment expenses and unearned premiums would become liabilities of the Company if reinsurers were unable to meet existing obligations under reinsurance agreements.

(7) Employee Benefit Plans

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

The Company is a participant, together with other affiliated companies, in the Nationwide Insurance Enterprise Retirement Plan (Enterprise Plan) which covers all employees who have completed at least one year of service. Benefits are based upon the highest average annual salary of a specified number of consecutive years of the last ten years of service. The Company funds pension costs accrued for an allocated share of direct employees plus an allocation of pension costs accrued for employees of affiliates whose work efforts benefit 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 anticipates that the plan will settle the obligation related to WSC employees with a transfer of assets during 1999.

The Company had no accrued pension obligations at December 31, 1998 or 1997. Pension costs charged to operations under the Retirement Plan during the years ended December 31, 1998 and 1997 were $11,106 and $15,674, respectively.

In addition to the defined benefit pension plan, the Company has a stand-alone post-retirement benefit plan that provides 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.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

The components of net periodic postretirement benefit cost for the other postretirement benefit plans of the Company for 1998 and 1997 follow:

	1998	1997
Service cost	$ 254	$ 59
Interest cost on ABO	4,718	6,154
Return on plan assets	(2,646)	(1,979)
Amortization and deferrals	3,312	3,124
Net postretirement benefit cost	$ 5,638	$ 7,558
Basis of measurement, net periodic cost:		
Discount rate	6.70%	7.25%
Health care cost trend rate	15% grading to 8% over l5 years	11% grading to 6% over l2 years
Expected long-term rate of return on plan assets	7.15%	7.75%

Net postretirement benefit cost allocated to the Company and charged to operations under these plans during the year ended December 31, 1998 and 1997 was approximately $3,710 and $5,274, respectively.

EMPLOYERS INSURANCE OF WAUSAU
A Mutual Company

Notes to Statutory Financial Statements, continued

(Dollars In Thousands)

Information regarding the funded status of the other postretirement benefit plans at December 31, 1998 and 1997 follows:

	1998	1997
Accumulated postretirement benefit obligation (APBO)	$ 82,241	$ 84,699
Plan assets at fair value	27,363	27,242
APBO in excess of plan assets	54,878	57,457
Unrecognized net losses from performance different than assumptions	(12,290)	(14,033)
Unrecognized transition obligation	(33,107)	(35,472)
Remaining prior service cost	(369)	(394)
Accrued postretirement benefit liability	$ 9,112	$ 7,558
Basis for measurements, funded status of plan:		
Discount rate	6.70%	6.70%
Health care cost trend rate	15.00% grading to 8.00% over 15 years	12.13% grading to 6.12% over 12 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 a material effect on the net postretirement benefit cost or the accumulated postretirement benefit obligation.

The Company and WSC participate in the savings plan which is 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 makes a matching contribution to the plan which amounted to $5,679 and $5,778 for the years ended December 31, 1998 and 1997, respectively. Effective January 1, 1999, the employees of WSC became participants of the Liberty Mutual Employees' Thrift-Incentive Plan.

(Dollars In Thousands)

(8) Contribution Notes

At December 31, 1998, 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.

At December 31, 1997, Nationwide holds contribution notes issued by the Company as follows:

Amount	Interest Rate	Maturity Date
$ 100,000	6.7%	December 1, 2002
300,000	6.1	December 1, 2002
$ 400,000		

Interest on the notes is charged directly to unassigned surplus when it is paid. Unpaid interest at December 31, 1998 and 1997 amounted to $28 and $2,083, 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.

In the normal course of business the Company purchases annuities to fulfill its obligations on claim settlements with fixed funding requirements. To the extent that the purchase of these annuities does not include a notation from the claimant releasing the Company of its obligation, the Company remains contingently liable for the payment of claims. As of December 31, 1998, the amount of structured claim settlements for which the Company is contingently liable is $182,505, which includes settlements from ELICW, of $182,458.

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.

(Dollars In Thousands)

Beginning in 1997, the Company entered into a securities lending program administered by the Bank of New York (BONY) in which U.S. treasury notes are made available for lending. Cash collateral received on the loaned securities is invested by BONY in accordance with the Company's reinvestment guidelines. As of December 31, 1997, $3,897 U.S. treasury notes were on loan. Income earned from the lending program was immaterial to the statutory statements of income for 1997. There were no securities on loan at December 31, 1998.

(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, 1998 and 1997 the Company exceeds the minimum risk-based capital requirements.

(11) Reconciliation to Annual Statement

	1998			
	Admitted Assets	Liabilities	Capital and Surplus	Net Income
Annual Statement, as filed	$2,825,909	$2,250,909	$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
Loss Reserve		15,000	(15,000)	(15,000)
Loss Adjustment Expense Reserve		1,900	(1,900)	(1,900)
Receivable Nonaffiliates	6,930		6,930	7,181
Payable 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 are 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.