

Liberty Mutual Holding Company Inc.

First Quarter 2021

Consolidated Financial Statements

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	Three Months Ended March 31,	
	2021	2020
Revenues		
Premiums earned	\$ 10,053	\$ 9,841
Net investment income	1,290	582
Fee and other revenues	218	281
Net realized gains (losses)	254	(247)
Total revenues	11,815	10,457
Claims, Benefits and Expenses		
Benefits, claims and claim adjustment expenses	7,240	6,476
Operating costs and expenses	1,746	1,877
Amortization of deferred policy acquisition costs	1,534	1,431
Interest expense	118	107
Interest credited to policyholders	9	8
Total claims, benefits and expenses	10,647	9,899
Ironshore acquisition & integration costs	(4)	(4)
Restructuring costs	(1)	(2)
Unit linked life insurance	(56)	114
Income from continuing operations before income tax expense and non-controlling interest	1,107	666
Income tax expense	250	147
Consolidated net income	857	519
Less: Net income attributable to non-controlling interest	1	-
Net income attributable to Liberty Mutual Holding Company Inc.	\$ 856	\$ 519
Net Realized Gains (Losses)	2021	2020
Other-than-temporary impairment losses	\$ (5)	\$ (26)
Other net realized gains	125	262
Valuation changes on equity investments, derivatives, other	134	(483)
Total net realized gains (losses)	\$ 254	\$ (247)

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Comprehensive Income

(dollars in millions)

(Unaudited)

	Three Months Ended	
	March 31,	
	2021	2020
Consolidated net income	\$ 857	\$ 519
Other comprehensive (loss), net of taxes:		
Unrealized gains (losses) on securities	(1,158)	(823)
Foreign currency translation and other adjustments	(4)	(193)
Other comprehensive (loss), net of taxes	(1,162)	(1,016)
Comprehensive loss	\$ (305)	\$ (497)

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

	March 31, 2021	December 31, 2020
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of \$70,169 and \$67,614)	\$ 72,355	\$ 71,301
Equity securities, at fair value	2,694	2,572
Short-term investments	259	276
Commercial mortgage loans	1,949	2,219
Other investments	10,460	9,387
Total investments	87,717	85,755
Cash and cash equivalents	7,797	8,224
Premium and other receivables	14,807	14,367
Accounts receivable	3,509	3,458
Reinsurance recoverables	16,741	16,163
Deferred acquisition costs	3,763	3,766
Goodwill	5,710	5,733
Prepaid reinsurance premiums	2,251	1,877
Other assets	6,514	6,034
Total assets	\$ 148,809	\$ 145,377
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	\$ 68,697	\$ 67,465
Life	2,001	2,108
Other policyholder funds and benefits payable	12	15
Unearned premiums	23,850	23,281
Funds held under reinsurance treaties	326	327
Short-term debt	330	330
Long-term debt	9,210	8,497
Accrued postretirement and pension benefits	3,428	3,469
Payable for investments purchased and loaned	4,754	3,410
Deferred tax liability	24	219
Other liabilities	10,525	10,299
Total liabilities	123,157	119,420
Equity:		
Unassigned equity	26,564	25,708
Accumulated other comprehensive income (loss)	(944)	218
Total policyholders' equity	25,620	25,926
Non-controlling interest	32	31
Total equity	25,652	25,957
Total liabilities and equity	\$ 148,809	\$ 145,377

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Total Equity

(dollars in millions)

(Unaudited)

	Three Months Ended March 31,	
	2021	2020
Balance at beginning of the year	\$ 25,957	\$ 23,619
Comprehensive (loss):		
Consolidated net income	857	519
Other comprehensive (loss), net of taxes	(1,162)	(1,016)
Total comprehensive (loss)	(305)	(497)
Balance at end of the period	<u>\$ 25,652</u>	<u>\$ 23,122</u>

See accompanying notes to the unaudited consolidated financial statements

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Cash Flows

(dollars in millions)

(Unaudited)

	Three Months Ended	
	March 31,	
	2021	2020
Cash flows from operating activities:		
Consolidated net income	\$ 857	\$ 519
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	187	217
Realized (gains) losses	(254)	247
Undistributed private equity investment gains	(825)	(102)
Premium, other receivables, and reinsurance recoverables	(860)	(1,161)
Deferred acquisition costs	(20)	(58)
Liabilities for insurance reserves	2,274	577
Taxes payable, net of deferred	252	92
Other, net	(565)	88
Total adjustments	189	(100)
Net cash provided by operating activities	1,046	419
Cash flows from investing activities:		
Purchases of investments	(22,171)	(20,986)
Sales and maturities of investments	19,057	20,315
Property and equipment purchased, net	(41)	(53)
Cash provided by disposals and acquisitions	-	12
Other investing activities	147	1,062
Net cash (used in) provided by investing activities	(3,008)	350
Cash flows from financing activities:		
Net activity in policyholder accounts	(19)	(17)
Debt financing, net	799	6
Net security lending activity and other financing activities	810	497
Net cash provided by financing activities	1,590	486
Effect of exchange rate changes on cash	(55)	(65)
Net (decrease) increase in cash and cash equivalents	(427)	1,190
Cash and cash equivalents, beginning of year	8,224	4,969
Cash and cash equivalents, end of period	\$ 7,797	\$ 6,159

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc., entities over which the Company exercises control including majority and wholly owned subsidiaries, and variable interest entities (“VIE”) when the Company is deemed the primary beneficiary (collectively “LMHC” or the “Company”). The minority ownership of consolidated affiliates is represented in equity as non-controlling interest. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company’s principal estimates include (1) unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years, (2) reinsurance recoverables and associated uncollectible allowance, (3) fair value determination and other-than-temporary impairments of the investment portfolio and direct investments in natural resources, (4) valuation of goodwill and intangible assets, (5) deferred income tax valuation allowance, and (6) pension and postretirement benefit obligations. While the amounts included in the consolidated financial statements reflect management’s best estimates and assumptions, these amounts ultimately could vary.

Future Adoption of New Accounting Standards

The Company will adopt the FASB issued ASU 2016-02, Leases (“ASU 2016-02”). The amendments will require a lessee to recognize a right-of-use asset and a lease liability on the balance sheet for leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statements of income. The amendments of ASU 2016-02 are effective for nonpublic business entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. The Company is currently evaluating the impact of the adoption of ASU 2016-02. The adoption is expected to have a material impact on the Company’s balance sheet.

The Company will adopt the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 replaces the current incurred loss model with an expected credit loss model, which measures credit losses on financial instruments measured at amortized cost, and will require companies to recognize an allowance for expected credit losses. In addition, ASU 2016-13 also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. This amendment removes certain factors to consider when determining whether credit losses should be recognized and will require companies to recognize expected credit losses through an allowance. ASU 2016-13 is effective for nonpublic business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2022. The Company is currently evaluating the impact of the adoption of ASU 2016-13.

There are no other accounting standards not yet adopted by the Company that are expected to have a material impact on the consolidated financial statements.

Securities Lending

The Company participates in a securities lending program to generate additional income, whereby certain domestic fixed maturity securities and equity securities are loaned for a short period of time from the Company’s portfolio to qualifying third parties via a lending agent. Terms of the agreement are for borrowers of these securities to provide collateral of at least 102% of the market value of the loaned securities. Acceptable collateral may be in the form of cash or permitted securities as outlined in the securities lending agreement. The market value of the loaned securities is monitored and additional collateral is obtained if the market value of the collateral falls below 102% of the market value of the loaned securities. Under the terms of the securities lending program, the lending agent indemnifies the Company against borrower defaults. The loaned securities remain a recorded asset of the Company; however, the Company records a liability for the amount of cash collateral held, representing its obligation to return the collateral related to the loaned securities.

Net Investment Hedge Instruments

The Company has designated non-derivative foreign-currency denominated long-term debt and the related accrued interest as hedges of its net investment in certain foreign operations. Accordingly, the foreign currency translation of the debt instrument and accrued interest is recorded in accumulated other comprehensive loss, offsetting the foreign currency translation adjustment of the related net investment that is also recorded in accumulated other comprehensive loss. As of March 31, 2021, the Company had €1,750 million of outstanding long-term debt and approximately €36 million of accrued interest designated as non-derivative hedges of its net investment in certain foreign operations. As of March 31, 2021, the foreign currency translation of the debt instrument and accrued interest recorded in accumulated other comprehensive loss was of \$(68). (See Note 5 for further discussion.)

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive loss consists principally of unrealized gains and losses on certain investments in debt securities, foreign currency translation adjustments, and pension and postretirement liability adjustments.

The components of accumulated other comprehensive loss excluding non-controlling interest, net of related deferred acquisition costs and taxes, are as follows:

	March 31, 2021	December 31, 2020
Unrealized gains on securities	\$1,493	\$2,651
Foreign currency translation and other adjustments	(792)	(757)
Pension and post retirement liability funded status	(1,645)	(1,676)
Accumulated other comprehensive (loss) income	\$(944)	\$218

The following tables presents the changes in the components of other comprehensive income (loss) for the three months ended March 31, 2021 and 2020, respectively.

	Unrealized gains on securities	Change in pension and post retirement plans funded status	Foreign currency translation and other adjustments ⁽¹⁾	Total
Three months ended March 31, 2021				
Unrealized change arising during the period	\$(1,401)	\$-	\$(20)	\$(1,421)
Less: Reclassification adjustments included in consolidated net income	62	(39)	-	23
Total other comprehensive (loss) before income tax expense	(1,463)	39	(20)	(1,444)
Less: Income tax (benefit) expenses	(305)	8	15	(282)
Total other comprehensive (loss), net of income tax expense	\$(1,158)	\$31	\$(35)	\$(1,162)

⁽¹⁾Includes \$1 of non-controlling interest

	Unrealized gains on securities	Change in pension and post retirement plans funded status	Foreign currency translation and other adjustments ⁽¹⁾	Total
Three months ended March 31, 2020				
Unrealized change arising during the period	\$(713)	\$-	\$(238)	\$(951)
Less: Reclassification adjustments included in consolidated net income	313	(52)	-	261
Total other comprehensive (loss) before income tax expense	(1026)	52	(238)	(1,212)
Less: Income tax (benefit) expenses	(203)	11	(4)	(196)
Total other comprehensive (loss) net of income tax expense	\$(823)	\$41	\$(234)	\$(1,016)

⁽¹⁾Includes \$(2) of non-controlling interest

(2) ACQUISITIONS AND DISPOSITIONS

ACQUISITIONS

AmTrust Financial Services

On April 15, 2019, the Company entered into an agreement to acquire the global surety and credit reinsurance operations of AmTrust Financial Services, including AmTrust Surety, AmTrust Insurance Spain, Nationale Borg and Nationale Borg Reinsurance. The acquisition of the US Surety business closed on May 31, 2019.

The Company completed the acquisition of Nationale Borg, Nationale Borg Reinsurance, and AmTrust Insurance Spain on October 2, 2019. The acquisition strengthened the Company's global surety and reinsurance expertise, market leadership and geographic scope.

In total, the Company recognized \$100 of intangible assets and \$159 of goodwill related to the US & International Surety business. For the three months ended March 31, 2021, the Company recognized \$1 of amortization expense which is reflected in operating costs and expenses on the consolidated statements of income. Estimated amortization for the years ended December 31, 2021 through 2024 is \$6, \$6, \$5 and \$5 respectively.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

DISPOSITIONS

On January 19, 2018, the Company announced the sale of the Liberty Life Assurance Company of Boston (“LLAC”), which provides group disability, group life, individual life and annuity products, to Lincoln Financial Group. The transaction closed on May 1, 2018 resulting in a gain of approximately \$412. Accordingly, for the twelve months ended December 31, 2018, the results of LLAC have been classified as discontinued operations in the consolidated statements of income.

In connection with the Company’s May 2018 sale of LLAC to Lincoln Financial Group, the Company agreed, pursuant to the master transaction agreement, to indemnify Protective Life Corporation and Protective Life Insurance Company (together with certain of their respective affiliates, “Protective”), Lincoln and other parties against certain liabilities. In late 2018, Protective initiated informal discussions with the Company regarding potential indemnification claims (the “Initial Claims”) and in 2019 the Company began an investigation and evaluation of such Initial Claims. This investigation is ongoing. On April 30, 2019, Protective delivered to the Company a formal demand for indemnification related to the Initial Claims and in addition, demands for indemnification including matters unrelated to the Initial Claims. The Company is in the process of investigating these claims and whether they have any merit or significant monetary value. Based on the Company’s investigation to date of the claims generally, the Company has accrued a reserve of \$52, net of tax, year to date December 31, 2019 presented in discontinued operations in the consolidated statements of income, which is primarily related to the Initial Claims, and may be adjusted up or down as the Company’s investigation of all claims continues. The Company intends to vigorously defend all claims.

At this time, if these claims are ultimately determined to have merit and if the monetary value equal to the amount alleged to be due, the aggregate potential liability represented by the claims would not have a material adverse effect on the financial condition of the Company, although such aggregate potential liability may be material relative to the Company’s results of operations for a single reporting period, depending on the facts and circumstances at such time.

In addition, the Company is engaged in the customary process of determining post-closing adjustments to the purchase price for LLAC, however, the final outcome of that process is not expected to materially change the \$3,300 initial purchase price agreed in connection with the master transaction agreement. During 2020, the Company booked an additional \$17, net of tax, presented in discontinued operations in the Consolidated Statements of Income to reflect a final closing balance sheet settlement related to the sale of LLAC.

(3) INVESTMENTS

The amortized cost, gross unrealized gains and losses and fair values of available for sale investments as of March 31, 2021 and December 31, 2020, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2021				
U.S. government and agency securities	\$8,308	\$ 105	\$(40)	\$ 8,373
Residential MBS ⁽¹⁾	6,318	170	(12)	6,476
Commercial MBS	4,431	235	(11)	4,655
Other MBS and ABS ⁽²⁾	5,836	100	(18)	5,918
U.S. state and municipal	8,012	546	(18)	8,540
Corporate and other	32,450	1,214	(230)	33,434
Foreign government securities	4,814	196	(51)	4,959
Total securities available for sale	<u>\$70,169</u>	<u>\$2,566</u>	<u>\$(380)</u>	<u>\$72,355</u>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2020				
U.S. government and agency securities	\$7,056	\$159	\$(6)	\$7,209
Residential MBS	5,755	206	(2)	5,959
Commercial MBS	4,407	328	(8)	4,727
Other MBS and ABS	5,229	118	(35)	5,312
U.S. state and municipal	8,549	740	(2)	9,287
Corporate and other	31,876	1,957	(55)	33,778
Foreign government securities	4,742	290	(3)	5,029
Total securities available for sale	<u>\$67,614</u>	<u>\$3,798</u>	<u>\$(111)</u>	<u>\$71,301</u>

⁽¹⁾ Mortgage-backed securities (“MBS”)

⁽²⁾ Asset-backed securities (“ABS”)

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

As of March 31, 2021 and December 31, 2020, the fair value of common stock securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk were approximately \$781 and \$773, respectively.

As of March 31, 2021 and December 31, 2020, the fair values of fixed maturity securities and equity securities loaned were approximately \$2,874 and \$1,986, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately \$2,139 and \$1,507 as of March 31, 2021 and December 31, 2020, respectively. Investments other than cash and short-term investments received as collateral in connection with the loaned securities were approximately \$796 and \$521 as of March 31, 2021 and December 31, 2020, respectively.

The amortized cost and fair value of fixed maturities as of March 31, 2021, by contractual maturity are as follows:

	Amortized Cost	Fair Value
Due to mature:		
One year or less	\$3,534	\$3,570
Over one year through five years	24,289	25,085
Over five years through ten years	17,992	18,482
Over ten years	7,769	8,169
MBS and ABS of government and corporate agencies	16,585	17,049
Total fixed maturities	\$70,169	\$72,355

Actual maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Due to the potential for prepayment on MBS and ABS, they are not categorized by contractual maturity.

The following table summarizes the Company's gross realized gains and losses by asset type for the three months ended March 31, 2021 and 2020:

	Three Months Ended March 31,	
	2021	2020
<i>Components of Net Realized Gains (Losses)</i>		
Fixed maturities:		
Gross realized gains	\$192	\$412
Gross realized losses	(130)	(99)
Equities:		
Gross realized gains	148	43
Gross realized losses	(29)	(439)
Derivatives:		
Gross realized gains	105	2
Gross realized losses	(7)	(127)
Other:		
Gross realized gains	19	1
Gross realized losses	(44)	(40)
Total net realized gains (losses)	\$254	\$(247)

Included in the above are unrealized gains (losses) related to equity securities still held of \$121 and \$(420) respectively, for the three months ended March 31, 2021 and 2020.

As of March 31, 2021 and December 31, 2020, other-than-temporary impairment losses recognized through accumulated other comprehensive loss were \$(3) and \$(4), respectively.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

During the three months ended March 31, 2021 and 2020, the Company recorded \$(5) and \$(26) of impairment losses, respectively. Included in the impairment losses are impairment charges for assets measured at fair value on a non-recurring basis which are summarized in the following table for the three months ended March 31, 2021 and 2020:

	2021	2020
Natural resources	\$(3)	\$-
Real estate	-	(11)
Total	\$(3)	\$(11)

During the three months ended March 31, 2021 and 2020, proceeds from sales of fixed maturities available for sale were \$16,595 and \$17,685, respectively. The gross realized gains (losses) on sales of fixed maturities available for sale totaled \$171 and \$(121) in 2021 and \$400 and \$(74) in 2020. During the three months ended March 31, 2021 and 2020, proceeds from sales of equities at fair value were \$104 and \$628, respectively. The gross realized gains (losses) on sales of equities at fair value totaled \$3 and \$(8) in 2021 and \$31 and \$(5) in 2020.

The following tables summarize the gross unrealized losses and fair value of available for sale investments by the length of time that individual securities have been in a continuous unrealized loss position as of March 31, 2021 and December 31, 2020, and that are not deemed to be other-than-temporarily impaired:

March 31, 2021

	Less Than 12 Months		12 Months or Longer	
	Fair Value of		Fair Value of	
	Investments with		Investments with	
	Unrealized	Unrealized	Unrealized	Unrealized
	Losses	Losses	Losses	Losses
U.S. government and agency securities	\$(40)	\$4,397	\$-	\$-
Residential MBS	(12)	2,009	-	4
Commercial MBS	(5)	260	(6)	193
Other MBS and ABS	(12)	1,466	(6)	337
U.S. state and municipal	(17)	829	(1)	19
Corporate and other	(204)	7,908	(26)	407
Foreign government securities	(51)	1,435	-	-
Total Securities Available for Sale	\$(341)	\$18,304	\$(39)	\$960

December 31, 2020

	Less Than 12 Months		12 Months or Longer	
	Fair Value of		Fair Value of	
	Investments with		Investments with	
	Unrealized	Unrealized	Unrealized	Unrealized
	Losses	Losses	Losses	Losses
U.S. government and agency securities	\$(6)	\$797	\$-	\$-
Residential MBS	(2)	283	-	3
Commercial MBS	(5)	329	(3)	17
Other MBS and ABS	(26)	850	(9)	328
U.S. state and municipal	(2)	92	-	-
Corporate and other	(31)	1,278	(24)	282
Foreign government securities	(3)	300	-	4
Total Securities Available for Sale	\$(75)	\$3,929	\$(36)	\$634

As of March 31, 2021, there were 278 securities that were in an unrealized loss position for 12 months or longer. The Company monitors the difference between the amortized cost and estimated fair value of fixed maturity securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed maturity securities before they recover their fair value.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

If the Company believes a decline in the value (including foreign exchange rates) of a particular fixed maturity security is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be other-than-temporary, and the Company believes that it will not be able to collect all cash flows due on its fixed maturity securities, then the carrying value of the investment is written down to the expected cash flow amount and a realized loss is recorded as a credit impairment. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes, as the difference between expected cash flows and fair value. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of March 31, 2021 are temporary.

The Company reviews fixed maturity securities and other investments for impairment on a quarterly basis. These investments are reviewed for both quantitative and qualitative considerations including, but not limited to: (a) the extent of the decline in fair value below book value, (b) the duration of the decline, (c) significant adverse changes in the financial condition or near term prospects of the investment or issuer, (d) significant change in the business climate or credit ratings of the issuer, (e) general market conditions and volatility, (f) industry factors, (g) the past impairment of the security holding or the issuer and (h) impact of foreign exchange rates on foreign currency denominated securities. For fixed maturity securities that the Company does not intend to sell or for which it is more likely than not that the Company would not be required to sell before an anticipated recovery in value, the Company separates impairments into credit loss and non-credit loss components. The determination of the credit loss component of the impairment charge is based on the Company's best estimate of the present value of the cash flows expected to be collected from the fixed maturity security compared to its amortized cost and is reported as part of net realized gains. The non-credit component, the residual difference between the credit impairment component and the fair value, is recognized in other comprehensive income. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the fixed maturity security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration and (e) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all fixed maturity securities and certain preferred equity securities) or the Company does not have the intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in fair value.

The Company is required to review its natural resource and other equity method investments when facts and circumstances indicate that carrying values may not be recoverable. In performing a quarterly review, the fair value of the Company's investment is estimated using indicators including, but not limited to, market comparables and analyses, commodity prices, and discounted cash flows and a realized loss is recognized for the excess, if any, of the investment's carrying value over its estimated fair value.

Variable Interest Entities

The Company invests in limited partnerships and other entities subject to VIE analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of March 31, 2021 and December 31, 2020, the Company has determined that it is not the primary beneficiary of any of its VIEs except for the Company's investment in its India joint venture, which is deemed immaterial.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323, *Investments-Equity Method and Joint Ventures*. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. The net carrying value of non-consolidated VIEs in which the Company has a variable interest was \$8,608 and \$6,765 as of March 31, 2021 and December 31, 2020, respectively, and the Company's maximum exposure to loss was \$12,382 and \$10,362 as of March 31, 2021 and December 31, 2020, respectively. The assets are included in other investments on the accompanying consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. The increase in the maximum exposure to loss from December 31, 2020 to March 31, 2021 is primarily related to new commitments to VIEs related to traditional private equity.

LPs, LLCs and Other Equity Method Investments

As of March 31, 2021 and December 31, 2020, the carrying values of LP, LLC and other equity method investments were \$9,601 and \$8,664, respectively. These investments consist of traditional private equity partnerships, natural resources partnerships (primarily energy, metals and mining, and agriculture and timber), real estate partnerships, and other partnership funds and equity method investments. The Company's investments in LPs, LLCs and other equity method investments are long-term in nature. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

(4) REINSURANCE

In the ordinary course of business, the Company assumes reinsurance and also cedes reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Company is also a member of various involuntary pools and associations and serves as a servicing carrier for residual market organizations. The Company remains contingently liable in the event reinsurers are unable to meet their obligations for paid and unpaid reinsurance recoverables and unearned premiums ceded under reinsurance agreements.

The Company reported reinsurance recoverables of \$16,741 and \$16,163 as of March 31, 2021 and December 31, 2020, respectively, net of allowance for doubtful accounts of \$116 and \$113, respectively. Included in these balances are \$931 and \$1,145 of paid recoverables and \$15,926 and \$15,131 of unpaid recoverables (including retroactive reinsurance), respectively.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The Company evaluates and monitors the financial condition of its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. The Company reports its reinsurance recoverables net of an allowance for estimated uncollectible reinsurance recoverables. The allowance is based upon the Company's ongoing review of amounts outstanding, length of collection periods, changes in reinsurer credit standing and other relevant factors. Accordingly, the establishment of reinsurance recoverables and the related allowance for uncollectible reinsurance recoverables is also an inherently uncertain process involving estimates. Changes in these estimates could result in additional charges to the accompanying consolidated statements of income.

On November 5, 2019, Liberty Mutual Insurance Company ("LMIC") entered into a reinsurance transaction with National Indemnity Company ("NICO"), a subsidiary of Berkshire Hathaway Inc., on a combined aggregate excess of loss agreement for certain GRM U.S. Business Lines and GRS National Insurance workers compensation liabilities, commercial auto liability and general liability excluding umbrella and warranty ("NICO Casualty Reinsurance Transaction"). The first layer of the contract attaches at \$300 below applicable held reserves at inception of \$8,342 of combined aggregate reserves. The second layer of the contract provides adverse development coverage for \$1,000 above a retention equal to \$8,742. The contract includes a sublimit of \$100 for certain general liability liabilities. At the closing of the NICO Casualty Reinsurance Transaction, but effective as of January 1, 2019, the Company ceded \$300 of existing undiscounted liabilities, paid NICO total consideration of \$462 and recorded a pre-tax loss of \$173. This contract is accounted for on a retroactive basis.

In general terms, the covered business includes post December 31, 2018 development on: (1) certain workers compensation liabilities arising under policies on the books of the Company's GRM U.S. Business Lines and GRS National Insurance strategic business units as of December 31, 2018 as respects injuries or accidents occurring after December 31, 2013 and prior to January 1, 2019; (2) commercial auto liabilities arising under policies on the books of the Company's GRM U.S. Business Lines and GRS National Insurance strategic business units as of December 31, 2018 as respects injuries or accidents occurring prior to January 1, 2019; and (3) general liability excluding umbrella and warranty arising under policies on the books of the Company's GRM U.S. Business Lines and GRS National Insurance strategic business units as of December 31, 2018 as respects injuries or accidents occurring prior to January 1, 2019.

Since the NICO Casualty Reinsurance Transaction is accounted for as retroactive reinsurance in the Company's Consolidated Financial Statements, to the extent there is unfavorable development of losses covered by this reinsurance, an additional reinsurance benefit is recognized in the consolidated statements of income until those benefits exceed the loss on the transaction. Reinsurance benefits will be deferred and are amortized into earnings over the period when underlying claims are settled.

As the aggregate development on the contract has exceeded the original pre-tax loss of \$173, deferred gains are now being recorded. The Company reported deferred gain amortization of \$28 and \$25 at March 31, 2021 and December 31, 2020, respectively. As of March 31, 2021 and December 31, 2020, deferred gains were \$235 and \$240. Limits remaining on the contract as of March 31, 2021 were \$551.

In conjunction with the Ironshore acquisition and effective May 1, 2017, the Company entered into a reinsurance transaction with NICO on a combined aggregate excess of loss agreement providing coverage for substantially all of Ironshore's reserves related to losses occurring prior to January 1, 2017. The first layer of the contract transfers \$400 of held reserves at inception, for which the Company established reinsurance recoverables on the consolidated balance sheets. The second layer of the contract provides adverse development coverage for 95% of \$500 above a retention equal to \$3,006, minus paid losses between January 1, 2017 and May 1, 2017, which retention approximates the total held reserves on the covered business on Ironshore's opening balance sheet. The contract includes a sublimit of \$277 for certain construction liability liabilities. The Company paid NICO consideration of \$550, including interest accrued at the time of the settlement. The contract is accounted for on a prospective basis. Limits remaining on the contracts in total, and for construction liability liabilities, respectively, were \$475 and zero as of March 31, 2021.

On July 17, 2014, LMIC entered into a reinsurance transaction with NICO on a combined aggregate excess of loss agreement for substantially all of the Company's U.S. workers compensation, asbestos and environmental liabilities (the "NICO Reinsurance Transaction"), attaching at \$12,522 of combined aggregate reserves, with an aggregate limit of \$6,500 and sublimits of \$3,100 for asbestos and environmental liabilities and \$4,507 for certain workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but effective as of January 1, 2014, the Company ceded \$3,320 of existing undiscounted liabilities under this retroactive reinsurance

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

agreement. NICO will provide \$3,180 of additional aggregate adverse development reinsurance. The Company paid NICO total consideration of \$3,046. With respect to the ceded asbestos and environmental business, NICO has been given authority to handle claims, subject to the Company's oversight and control. With respect to the ceded workers compensation business, the Company will continue to handle claims. The contract is accounted for on a retroactive basis.

In general terms, the covered business includes post December 31, 2013 development on: (1) asbestos and environmental liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005; and (2) workers compensation liabilities arising out of policies on the books of the Company's former Commercial Insurance Strategic Business Unit as of December 31, 2013, as respects injuries or accidents occurring prior to January 1, 2014.

The Company reported the net position of the contract as a loss of \$8 and \$4 as of March 31, 2021 and December 31, 2020, respectively. Limits remaining on the contracts in total, and for asbestos and environmental liabilities, respectively, were \$3,173 and \$613 as of March 31, 2021.

Non Catastrophe Reinsurance

The Company purchases facultative and treaty reinsurance protection on a per risk, per policy, per loss and/or per occurrence basis. Treaty coverage is provided on a pro rata and excess of loss basis for portions of the Company's property, marine, terrorism, energy, third party motor, cyber, financial risk, surety, aviation and casualty lines portfolios.

Catastrophe Reinsurance

The Company has property catastrophe reinsurance coverage for its domestic business and certain specialty operations including: 1) hurricanes and earthquake reinsurance covering a substantial portion of \$3,300 of loss in excess of \$300 of retained loss in the United States, Canada and the Caribbean, excluding certain reinsurance exposures; 2) aggregate excess of loss programs; and 3) quota share reinsurance programs. These programs are structured to meet the Company's established tolerances under its Enterprise Risk Management Program.

The Company purchases property catastrophe reinsurance coverage for the international property books to protect against international catastrophe events.

The Company purchases workers compensation catastrophe reinsurance, including coverage for its domestic commercial operations and certain specialty operations' US exposures. This program provides significant reinsurance protection in excess of \$360 per occurrence retention, including coverage for terrorism events and/or losses for a single event at a single insured location in excess of \$75. These contracts generally exclude acts of terrorism which are "certified" by the US government where such certified terrorism events involve the intentional use of nuclear, chemical, or biological materials.

Catastrophe Bond Reinsurance

On January 1, 2021, the Company entered into a multi-year property catastrophe reinsurance agreement with Mystic Re IV Ltd. ("Mystic IV"), a Bermuda domiciled reinsurer, to provide a total of \$300 of reinsurance coverage for the Company and its affiliates for named storms covering U.S. and earthquakes covering U.S. and Canada. The reinsurance agreement is collateralized. Such collateral is provided by Mystic IV using proceeds from the issuance of certain catastrophe bonds. The reinsurance agreement provides per occurrence coverage based on weighted industry insured loss index. This loss index is weighted to align with the Company's assumed reinsurance portfolio. The Company has not recorded any recoveries under this program. Mystic IV does not have any other reinsurance in force.

Florida Hurricane Catastrophe Fund

The Company participates in the Florida Hurricane Catastrophe Fund ("FHCF"), a state-mandated catastrophe fund that provides reimbursement to insurers for a portion of their Florida hurricane losses. FHCF resources may be insufficient to meet the obligations of FHCF. Limits, premium and reimbursements from FHCF apply on a per company basis. If losses fall disproportionately on one insurance entity within the Company, recovery from FHCF could be less than anticipated. On June 1, 2020, the Company renewed coverage for 90% of approximately \$56 excess of \$22. Recoveries from FHCF inure to the sole benefit of the Company. If the Company fails to recover as anticipated from FHCF there could be an adverse effect on the Company's business, financial condition or results of operations.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

(5) DEBT OUTSTANDING

Debt outstanding as of March 31, 2021 and December 31, 2020 includes the following:

Short-term debt:

	2021	2020
Short-term debt ⁽¹⁾	\$330	\$330

Long-term debt:

	2021	2020
4.95% Notes, due 2022	473	473
4.25% Notes, due 2023	547	547
1.75% €500 million Notes, due 2024	588	612
8.50% Surplus Notes, due 2025	140	140
2.75% €750 million Notes, due 2026	880	917
7.875% Surplus Notes, due 2026	227	227
7.625% Notes, due 2028	3	3
4.569% Notes, due 2029	1,000	1,000
3.91% - 4.25% Federal Home Loan Bank Borrowings due 2032	300	300
7.00% Notes, due 2034	124	124
6.50% Notes, due 2035	271	271
7.50% Notes, due 2036	19	19
6.50% Notes, due 2042	250	250
4.85% Notes, due 2044	564	564
4.50% Notes, due 2049	232	232
3.951% Notes, due 2050	1,248	1,248
3.625% €500 million Junior Subordinated Notes, due 2059 ⁽²⁾	588	612
3.95% Notes, due 2060	746	746
4.30% Junior Subordinated notes, due 2061 ⁽³⁾	800	-
7.80% Junior Subordinated Notes, due 2087 ⁽⁴⁾	437	437
10.75% Junior Subordinated Notes, due 2088 ⁽⁵⁾	35	35
7.697% Surplus Notes, due 2097	260	260
Unamortized discount	(467)	(472)
Total long-term debt excluding unamortized debt issuance costs	9,265	8,545
Unamortized debt issuance costs	(55)	(48)
Total long-term debt	\$9,210	\$8,497

⁽¹⁾ Short-term debt is the current maturity of the 5.00% Notes, due June 1, 2021

⁽²⁾ The par value call date and final fixed rate interest payment date is May 23, 2024, subject to certain requirements

⁽³⁾ The par value call date is February 1, 2026 after which the notes are callable at par on each subsequent interest payment date.

⁽⁴⁾ The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements

⁽⁵⁾ The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements

Debt Transactions and In-Force Credit Facilities

On February 1, 2021, Liberty Mutual Group, Inc. (“LMGI”) issued \$800 of Series E Junior Subordinated Notes, due 2061 (the “Series E Notes”). Interest is payable semi-annually at a fixed rate of 4.30%. The Notes may be redeemed in whole or in part on February 1, 2026, after which the notes may be redeemed on any interest payment date thereafter until February 1, 2061.

On December 1, 2020, LMIC terminated its \$250 repurchase agreement.

On November 24, 2020, LMIC terminated its \$250 repurchase agreement.

On May 7, 2020, Liberty Mutual Group, Inc. (“LMGI”) issued \$500 of Senior Notes due 2060 (the “2060 Notes”) and LMGI exchanged \$246 par value of Senior Notes due 2060 for \$29 of its 7.00% Senior Notes due 2034, \$29 of its 6.50% Senior Notes due 2035, \$20 of its 6.50% Senior Notes due 2042, \$50 of its 4.85% Senior Notes due 2044 and \$118 of its 4.50% Senior Notes due 2049. Interest is payable semi-annually at a fixed rate of 3.95%. The exchanged notes are fully fungible with the 2060 Notes. The 2060 Notes mature on May 15, 2060.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

Concurrently with the 2060 Notes exchange offer, LMGI completed a tender offer for the Target Notes with investors not eligible to participate in the 2020 Exchange Offer for an aggregate cash consideration of \$2, including accrued and unpaid interest, for the tender of \$1 of its 6.50% Senior Notes due 2035 and a nominal amount of its 6.50% Senior Notes due 2042.

On June 25, 2019, LMGI amended and restated its five-year unsecured revolving credit facility of \$1,000 with an expiration date of June 25, 2024. To date, no funds have been borrowed under the facility.

LMIC, Peerless Insurance Company (“PIC”), Liberty Mutual Fire Insurance Company (“LMFIC”) and Employers Insurance Company of Wausau (“EICOW”) are members of the Federal Home Loan Bank. On March 21, 2012, LMFIC borrowed \$150 at a rate of 3.91% with a maturity date of March 22, 2032. On March 23, 2012 and April 2, 2012, LMIC borrowed \$127 at a rate of 4.24% with a maturity date of March 23, 2032 and \$23 at a rate of 4.25% with a maturity date of April 2, 2032, respectively. As of March 31, 2021, all outstanding Federal Home Loan Bank borrowings are fully collateralized. Ironshore Indemnity Inc. (“IIP”) and Ironshore Specialty Insurance Company (“ISIC”) memberships were cancelled on February 24th and 25th, 2020, respectively, however there is a five-year waiting period requirement, so the effective date of these membership cancellations will be February 2025.

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

(6) UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

The Company establishes reserves for payment of claims and claim adjustment expenses that arise from the policies issued. As required by applicable accounting rules, no reserves are established until a loss, including a loss from a catastrophe, occurs. The Company’s reserves are segmented into three major categories: reserves for reported claims (estimates made by claims adjusters); incurred but not reported claims reserves (“IBNR”) representing reserves for unreported claims and supplemental reserves for reported claims; and reserves for the costs to settle claims. The Company establishes its reserves net of salvage and subrogation by line of business or coverage and year in which losses occur.

Establishing loss reserves, including loss reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigation, medical costs, the costs of repair materials, and labor rates can all affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement can be. Accordingly, “short-tail” claims, such as property damage claims, tend to be easier to estimate than “long-tail” claims, such as workers compensation or general liability claims.

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

In order to establish a reserve for IBNR claims, the actuarial teams within each of the strategic business units use their experience and knowledge of the lines of business to estimate the potential future development of the incurred claims. The Company uses a number of actuarial methods and assumptions to develop an estimate of ultimate claim liabilities. Generally, these are a combination of exposure and experience based actuarial methods and review of other pertinent and available information from claims, underwriting, product and finance. Exposure based actuarial methods consider historical loss ratios and adjust for rate changes, premium and loss trends, industry trends and other information. These methods are typically used when developing an actuarial central estimate for more recent policy periods when claims data is insufficient to produce a reliable indication. As claims data becomes more reliable for a given policy period, more consideration is given to experience methods which review and monitor actual paid and reported development.

A comprehensive actuarial reserve review is performed for each product line at least once a year. The process and methods used for each product line vary depending on the circumstances and include input from claims, underwriting, product and finance. Each quarter the actuarial central estimate for each product line is reviewed and updated based upon development and presented to the reserving committee to conclude on the Company’s best estimate of ultimate claim liabilities.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

Activity in property and casualty unpaid claims and claim adjustment expenses of the Company are summarized as follows:

	2021	2020
Balance as of January 1	\$67,465	\$61,848
Less: unpaid reinsurance recoverables ⁽¹⁾	11,322	11,444
Net balance as of January 1	56,143	50,404
Balance attributable to acquisitions and dispositions ⁽²⁾	(442)	(13)
Incurred attributable to:		
Current year	7,242	6,414
Prior years ⁽³⁾	4	47
Discount accretion attributable to prior years	(12)	12
Total incurred	7,234	6,473
Paid attributable to:		
Current year	2,395	2,386
Prior years	3,438	3,792
Total paid	5,833	6,178
Amortization of deferred retroactive reinsurance gain	1	-
Net adjustment due to foreign exchange	(157)	(378)
Add: unpaid reinsurance recoverables ⁽¹⁾	11,751	11,285
Balance as of March 31	<u>\$68,697</u>	<u>\$61,593</u>

⁽¹⁾ In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements, the Company has recorded retroactive reinsurance recoverable balances of \$3,774 and \$3,541 as of March 31, 2021 and 2020, respectively.

⁽²⁾ The balance attributable to acquisitions and dispositions in 2021 represents the reinsurance to close agreement with Riverstone to dispose of 100.0% of Liberty's remaining position in Syndicate 4000. The balance attributable to acquisitions and dispositions in 2020 represents the disposition of Russian insurance affiliate. On December 24, 2019, UKH entered into an agreement to sell its entire 99.99% interest in its Russian insurance affiliate, Liberty Insurance (JSC) to PJSC Sovcombank. The transaction closed on February 6, 2020.

⁽³⁾ Does not include decreases in allowance related to reinsurance recoverables due to prior year development of \$1 and \$(26) as of March 31, 2021 and 2020, respectively.

In 2021, the change in incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive loss, is primarily attributable to favorable development in Property lines, partially offset by unfavorable development on Casualty runoff reserves. In 2020, the change in incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to unfavorable development on the reinsurance line of business, partially offset by favorable development in personal auto.

In response to the COVID-19 pandemic, several states have passed, and other states are considering, amendments to expand Workers' Compensation coverage to ensure certain workers who contract the virus are eligible for compensation. In addition, some states are exploring legislation that may expand the coverage obligations of certain insurance policies, such as business interruption policies. The Company continues to evaluate the potential exposures, but could experience increased claims frequency and severity depending on the terms and number of states implementing such changes.

Asbestos and Environmental Reserves

The Company's asbestos and environmental reserves for unpaid claims and claim adjustment expenses, net of reinsurance before the NICO Reinsurance Transaction and including uncollectible reinsurance, were \$1,191 and \$1,233 as of March 31, 2021 and December 31, 2020, respectively.

(7) INCOME TAXES

The income tax provision is calculated under the liability method of accounting. The Company recognizes deferred income tax assets and liabilities for the expected future tax effects attributable to temporary differences between the financial statement and tax return bases of assets and liabilities based on enacted tax rates and other provisions of the tax law. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized.

The Company's effective tax rate on continuing operations differs from the U.S. Federal statutory rate of 21% primarily due to the impact of non-U.S. operations partially offset by tax-exempt investment income.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at December 31, 2020	\$69
Additions for tax positions of prior years	1
Translation	<u>(3)</u>
Balance at March 31, 2021	<u>\$67</u>

Included in the tabular roll forward of unrecognized tax benefits are interest and penalties in the amount of \$28 and \$29 as of March 31, 2021 and December 31, 2020, respectively.

Included in the balance at March 31, 2021 is \$59 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in U.S. Federal, state, and foreign income tax expense. For the three months ended March 31, 2021 and 2020, the Company recognized \$0 and \$0 of interest and penalties, respectively. The Company had approximately \$26 and \$26 of interest and penalties accrued as of March 31, 2021 and December 31, 2020, respectively.

The statute of limitations has expired through the 2016 tax year. The Company has foreign entities that are open for examination in their local countries for tax years 2015-2020. Any adjustments that may result from the examinations of these income tax returns are not expected to have a material impact on the financial position, liquidity, or results of operations of the Company.

The Company believes that the balance of unrecognized tax benefits could decrease by \$7 within the next twelve months as a result of potential settlements and lapse of the statute of limitations.

(8) BENEFIT PLANS

The net benefit costs for the three months ended March 31, 2021 and 2020, include the following components:

Three months ended March 31,	Pension Benefits		Supplemental Pension Benefits ⁽¹⁾		Postretirement Benefits	
	2021	2020	2021	2020	2021	2020
Components of net periodic benefit costs:						
Service costs	\$40	\$38	\$2	\$2	\$4	\$4
Interest costs	49	64	2	3	6	8
Expected return on plan assets	(135)	(133)	-	-	-	-
Amortization of unrecognized:						
Net loss	37	53	7	5	5	3
Prior service cost	(6)	(6)	(1)	(1)	(4)	(4)
Net periodic benefit costs ⁽²⁾	<u>\$(15)</u>	<u>\$16</u>	<u>\$10</u>	<u>\$9</u>	<u>\$11</u>	<u>\$11</u>

⁽¹⁾ The Company sponsors non-qualified supplemental pension plans to restore to selected highly compensated employees the pension benefits to which they would be entitled under the Company's U.S. tax qualified, defined benefit pension plan had it not been for limits imposed by the Internal Revenue Code. The supplemental plans are unfunded.

⁽²⁾ All components of net periodic benefit costs are reported in operating costs and expenses on the accompanying consolidated statements of income.

The Company has contributed \$0 to the qualified plans as of March 31, 2021 and does not expect any additional contributions for 2021.

(9) FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses the market approach, which generally utilizes market transaction data for identical or similar instruments.

The hierarchy level assigned to each security in the Company's investments portfolio is based on the Company's assessment of the transparency and reliability of the inputs used in the valuation of each instrument at the measurement date. The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified based on the lowest level of input that is significant to the fair value measurement. The Company recognizes transfers between levels at the end of each reporting period. The three hierarchy levels are defined as follows:

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

- Level 1 — Valuations based on unadjusted quoted market prices in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2 — Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets or liabilities at the measurement date, quoted prices in markets that are not active, or other inputs that are observable, either directly or indirectly.
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement and involve management judgment. The unobservable inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the assets and liabilities.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3.

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance on the overall reasonableness and consistent application of valuation methodologies and inputs and compliance with accounting standards through the execution of various processes and controls designed to ensure that the Company's assets and liabilities are appropriately valued. For fair values received from third parties or internally estimated, the Company's processes are designed to determine that the valuation methodologies and inputs are appropriate and consistently applied, the assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities.

The Company used the following methods and assumptions in estimating the fair value of its financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy:

Fixed Maturities

At each valuation date, the Company uses various valuation techniques to estimate the fair value of its fixed maturities portfolio. The primary method for valuing the Company's securities is through independent third-party valuation service providers. For positions where valuations are not available from independent third-party valuation service providers, the Company utilizes broker quotes and internal pricing methods to determine fair values. The Company obtains a single non-binding price quote from a broker familiar with the security who, similar to the Company's valuation service providers, may consider transactions or activity in similar securities, as applicable, among other information. The brokers providing price quotes are generally from the brokerage divisions of leading financial institutions with market making, underwriting and distribution expertise regarding the security subject to valuation. The evaluation and prioritization of these valuation sources is systematic and predetermined resulting in a single quote or price for each financial instrument. The following describes the techniques generally used to determine the fair value of the Company's fixed maturities by asset class:

U.S. Government and Agency Securities

U.S. government and agency securities consist primarily of bonds issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. As the fair values of the Company's U.S. Treasury securities are based on active markets and unadjusted market prices, they are classified within Level 1. The fair value of U.S. government agency securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, reported trades, bids, offers and credit spreads. Accordingly, the fair value of U.S. government agency securities is primarily classified within Level 2.

Mortgage-Backed Securities

The Company's portfolio of residential and commercial MBS is originated by both agencies and non-agencies, the majority of which are pass-through securities issued by U.S. government agencies. The fair value of MBS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of MBS is primarily classified within Level 2.

Asset-Backed Securities

ABS include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, credit card receivables, and collateralized loan obligation securities originated by a variety of financial institutions. The fair value of ABS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of ABS is primarily classified within Level 2.

Municipal Securities

The Company's municipal portfolio is comprised of bonds issued by U.S. domiciled state and municipal entities. The fair value of municipal securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades and credit spreads. Accordingly, the fair value of municipal securities is primarily classified within Level 2.

Corporate Debt and Other Securities

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair value of corporate and other securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of corporate and other securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

Foreign Government Securities

Foreign government securities include bonds issued or guaranteed by foreign governments. The fair value of foreign government securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades of identical or comparable securities and credit spreads. Accordingly, the fair value of foreign government securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

Equity Securities

Equity securities include common and preferred stocks. Common stocks with fair values based on quoted market prices in active markets are classified within Level 1. Common stocks with fair values determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active are classified within Level 2. The fair value of preferred stock is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active. Accordingly, the fair value of preferred stock is primarily classified within Level 2.

Short-Term Investments

The fair value of short-term investments is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of short-term investments is primarily classified within Level 2 of the fair value hierarchy.

Other Investments

Other investments include primarily foreign cash deposits and equity investments in privately held businesses. Cash deposits are primarily valued using quoted prices for similar instruments in active markets; these assets are categorized within Level 2 of the fair value hierarchy. Equity investments in privately held businesses are valued using internal management estimates; they are categorized within Level 3 of the hierarchy. Loans, limited partnership and other equity method investments, which represent the remainder of the other investment balance on the accompanying consolidated balance sheet are not subject to these disclosures and therefore are excluded from the table in this note.

Other Assets and Other Liabilities

Other assets primarily consist of fixed maturities, short-term investments, and equity securities of captive companies sponsored by the Company. These assets are measured based on the methodology for individual securities as discussed above.

Additionally, other assets and other liabilities classified within Level 2 and Level 3 represent the Company's derivatives which can be exchange-traded or traded over-the-counter ("OTC"). OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. When models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of, and specific risks inherent in the instrument, as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be corroborated by observable market data by correlation or other means, and model selection does not involve significant management judgment.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

Life Insurance Obligations

Life insurance obligations include certain variable annuity contracts that provide guaranteed minimum income benefits. These benefits are accounted for as embedded derivatives and are bifurcated from the host contract and carried at fair value. The fair value of these embedded derivatives is computed on a recurring basis using assumptions predominately classified as Level 3 (significant unobservable) inputs. While some inputs are observable in the market, such as risk free rates, volatility and historical equity returns, the underlying future policyholder behavior inputs are highly unobservable. The significant policyholder behavior assumptions include lapse and the underlying annuitization rate.

The following tables summarize the Company's assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2021 and December 31, 2020:

<i>Assets, at Fair Value</i>	As of March 31, 2021			
	Level 1	Level 2	Level 3	Total
U.S. government and agency securities	\$8,274	\$99	\$ -	\$8,373
Residential MBS	-	6,271	205	6,476
Commercial MBS	-	4,543	112	4,655
Other MBS and ABS	-	5,904	14	5,918
U.S. state and municipal	-	8,450	90	8,540
Corporate and other	-	32,664	770	33,434
Foreign government securities	-	4,959	-	4,959
Total fixed maturities, available for sale	8,274	62,890	1,191	72,355
Common stock	2,574	42	68	2,684
Preferred stock	-	3	7	10
Total equity securities, at fair value	2,574	45	75	2,694
Short-term investments	1	245	13	259
Other investments	-	144	387	531
Other assets	-	-	22	22
Total assets	\$10,849	\$63,324	\$1,688	\$75,861
<i>Liabilities, at Fair Value</i>				
Life insurance obligations	\$ -	\$ -	\$(95)	\$(95)
Other liabilities	-	(4)	-	(4)
Total liabilities	\$ -	\$(4)	\$(95)	\$(99)

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

<i>Assets, at Fair Value</i>	As of December 31, 2020			
	Level 1	Level 2	Level 3	Total
U.S. government and agency securities	\$7,091	\$118	\$ -	\$7,209
Residential MBS	-	5,882	77	5,959
Commercial MBS	-	4,642	85	4,727
Other MBS and ABS	-	5,298	14	5,312
U.S. state and municipal	-	9,195	92	9,287
Corporate and other	-	33,019	759	33,778
Foreign government securities	-	5,029	-	5,029
Total fixed maturities, available for sale	7,091	63,183	1,027	71,301
Common stock	2,451	26	85	2,562
Preferred stock	-	3	7	10
Total equity securities, available for sale	2,451	29	92	2,572
Short-term investments	2	274	-	276
Other investments	(2)	143	387	528
Other assets	-	-	31	31
Total assets	\$9,542	\$63,629	\$1,537	\$74,708
<i>Liabilities, at Fair Value</i>				
Life insurance obligations	\$ -	\$ -	\$(122)	\$(122)
Other liabilities	-	(5)	-	(5)
Total liabilities	\$ -	\$(5)	\$(122)	\$(127)

The following tables summarize the fair values of assets on a recurring basis classified as Level 3 within the fair value hierarchy:

<i>Assets, at Fair Value</i>	As of March 31, 2021			As of December 31, 2020		
	Purchases	Transfer in to Level 3	Transfer out of Level 3	Purchases	Transfer in to Level 3	Transfer out of Level 3
U.S. government and agency securities	\$-	\$ -	\$ -	\$ -	\$ -	\$ -
Residential MBS	-	-	(68)	77	-	-
Commercial MBS	-	28	-	132	-	(123)
Other MBS and ABS	-	-	-	-	7	(7)
U.S. state and municipal	-	-	-	-	50	(50)
Corporate and other	173	-	-	851	45	(7)
Foreign government securities	-	-	-	-	-	-
Total fixed maturities	173	28	(68)	1,060	102	(187)
Common stock	-	-	(15)	22	19	-
Preferred stock	-	-	-	-	-	-
Total equity securities	-	-	(15)	22	19	-
Short-term investments	13	-	-	33	-	-
Other investments	27	-	-	168	-	-
Other assets	-	-	-	2	-	-
Total assets	\$213	\$28	\$(83)	\$1,285	\$121	\$(187)
<i>Liabilities, at Fair Value</i>						
Life insurance obligations	\$3	\$-	\$-	\$11	\$ -	\$ -
Total liabilities	\$3	\$-	\$-	\$11	\$ -	\$ -

Transfers into and out of Level 3 were primarily due to changes in the observability of pricing inputs.

The Company had no material assets or liabilities that were measured at fair value on a nonrecurring basis during the three months ended March 31, 2021.

The Company has not applied ASC 820 to non-financial assets and liabilities.

Liberty Mutual Holding Company Inc.

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

(10) COMMITMENTS AND CONTINGENT LIABILITIES

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

As of March 31, 2021, the Company had unfunded commitments in traditional private equity partnerships, natural resources, real estate, private credit, and other of \$1,393, \$462 (\$61 of which is related to energy investments), \$1,420, \$1,714, and \$171, respectively.

As of March 31, 2021, the Company had commitments to purchase various residential MBS at a cost and fair value of \$1,865 and \$1,860, respectively.

(11) SUBSEQUENT EVENTS

Management has assessed material subsequent events through May 5, 2021, the date the financial statements were available to be issued.