



**Liberty Mutual Holding Company Inc.**

**First Quarter 2004**

**Consolidated Financial Statements**

**(unaudited)**

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	Three Months Ended March 31,	
	2004	2003
<b>Revenues</b>		
Premiums earned	\$ 3,967	\$ 3,153
Net investment income	502	414
Net realized investment gains (losses)	57	(74)
Fee and other revenues	178	137
Total revenues	4,704	3,630
<b>Claims, Benefits and Expenses</b>		
Benefits, claims and claim adjustment expenses	3,119	2,531
Insurance operating costs and expenses	1,225	1,004
Dividends to policyholders	14	21
Other expenses	64	55
Total claims, benefits and expenses	4,422	3,611
Income from continuing operations before income tax expense	282	19
Federal and foreign income tax expense	-	3
Income from continuing operations before discontinued operations	282	16
Discontinued operations, net of tax	2	(2)
Net income	\$ 284	\$ 14

See accompanying notes to the unaudited consolidated financial statements

**Liberty Mutual Holding Company Inc.**

**Consolidated Balance Sheets**

(dollars in millions)

(Unaudited)

	<b>March 31,</b>	<b>December 31,</b>
	<b>2004</b>	<b>2003</b>
<b>Assets:</b>		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of \$32,232 and \$30,873)	\$ 34,256	\$ 32,287
Equity securities, available for sale, at fair value (cost of \$860 and \$813)	1,412	1,346
Trading securities, at fair value (cost of \$206 and \$203)	204	208
Other investments	904	768
Short-term investments	1,094	940
Total investments	37,870	35,549
Cash and cash equivalents	2,831	1,999
Premium and other receivables (net of allowance of \$144 and \$131)	5,821	5,238
Reinsurance recoverables (net of allowance of \$306 and \$306)	12,995	12,227
Deferred income taxes (net of valuation allowance of \$704 and \$800)	709	860
Deferred policy acquisition costs	1,232	1,104
Goodwill and intangible assets	861	762
Prepaid reinsurance premiums	1,594	1,280
Other assets	3,509	3,183
Separate account assets	2,295	2,220
Total assets	\$ 69,717	\$ 64,422
<b>Liabilities:</b>		
Unpaid claims and claim adjustment expense and future policy benefits:		
Property and casualty	\$ 31,845	\$ 30,597
Life	3,706	3,018
Other policyholder funds and benefits payable	2,155	2,090
Unearned premiums	8,438	7,431
Funds held under reinsurance treaties	1,917	1,902
Short-term debt	359	106
Long-term debt	2,150	1,668
Other liabilities and accrued expenses	8,859	8,009
Separate account liabilities	2,295	2,220
Total liabilities	61,724	57,041
<b>Policyholders' Equity:</b>		
Unassigned equity	6,478	6,194
Accumulated other comprehensive income	1,515	1,187
Total policyholders' equity	7,993	7,381
Total liabilities and policyholders' equity	\$ 69,717	\$ 64,422

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>Cash flows from operating activities:</b>		
Net income from continuing operations	\$ 282	\$ 16
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	40	27
Realized investment (gains) losses	(57)	74
Undistributed private equity investment (gains) losses	(28)	10
Premium, other receivables, and reinsurance recoverables	(1,315)	(301)
Deferred policy acquisition costs and distribution costs	(125)	(76)
Liabilities for insurance reserves	2,102	820
Taxes payable, net of deferred	(91)	(22)
Other, net	41	89
Total adjustments	567	621
Net cash provided by operating activities	849	637
<b>Cash flows from investing activities:</b>		
Purchases of investments	(5,740)	(4,579)
Sales and maturities of investments	4,703	3,674
Property and equipment purchased, net	(74)	(58)
Other investing activities	309	(233)
Net cash from acquisitions and dispositions	(57)	15
Net cash used in investing activities	(859)	(1,181)
<b>Cash flows from financing activities:</b>		
Net activity in policyholder accounts	35	29
Debt financing, net	735	5
Net security lending activity and other financing activities	72	71
Net cash provided by financing activities	842	105
Net increase (decrease) in cash and cash equivalents	832	(439)
Cash and cash equivalents, beginning of period	1,999	2,615
Cash and cash equivalents, end of period	\$ 2,831	\$ 2,176

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
Balance at beginning of the year	\$ 7,381	\$ 6,447
Net income	284	14
Other comprehensive income (loss), net of taxes:		
Unrealized gains (losses) on securities	411	(3)
Less: reclassification adjustment for gains and losses included in net income	(37)	48
Foreign currency translation and other adjustments	(46)	23
	<hr/>	<hr/>
Total other comprehensive income, net of taxes	328	68
	<hr/>	<hr/>
Total comprehensive income	612	82
	<hr/>	<hr/>
Balance at March 31	<u>\$ 7,993</u>	<u>\$ 6,529</u>

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. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2003 consolidated financial statements to conform to the 2004 presentation. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the 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 losses and loss expense reserves, including asbestos reserves, (2) reinsurance recoverables, including the bad debt allowance, (3) impairments to the fair value of the investment portfolio, (4) deferred acquisition costs, and (5) the valuation of goodwill. While management believes that the amounts included in the consolidated financial statements reflect their best estimates and assumptions, these amounts could ultimately be materially different from the amounts currently provided for in the consolidated financial statements.

**Adoption of New Accounting Standards**

In July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position 03-1, "*Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*" ("SOP 03-1"). The purpose of the SOP is to provide a conceptual framework that will facilitate the determination of the proper accounting for various life and annuity products. The most significant requirements of the SOP are: (i) the reporting and measurement of separate account assets and liabilities as general account assets and liabilities when specified criteria are not met, (ii) the capitalization of sales inducements that meet specified criteria and amortizing such amounts over the life of the contracts using the same methodology as used for amortizing deferred acquisition costs, but immediately expensing sales inducements accrued or credited if such criteria are not met, and (iii) the classification and valuation of certain nontraditional long-duration contract liabilities. SOP 03-1 was effective on January 1, 2004. The statement did not have a material impact on the Company's results of operations, financial condition or liquidity.

In March 2004, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue 03-1, "*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*" ("EITF 03-1"). EITF 03-1 adopts a three-step impairment model for securities within its scope. The three-step model must be applied on a security-by-security basis as follows:

Step 1: Determine whether an investment is impaired. An investment is impaired if the fair value of the investment is less than its cost basis.

Step 2: Evaluate whether an impairment is other-than-temporary. For debt securities that cannot be contractually prepaid or otherwise settled in such a way that the investor would not

## LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

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recover substantially all of its cost, an impairment is deemed other-than-temporary if the investor does not have the ability and intent to hold the investment until a forecasted market price recovery or it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security.

Step 3: If the impairment is other-than-temporary, recognize an impairment loss equal to the difference between the investment's cost basis and its fair value.

Subsequent to an other-than-temporary impairment loss, a debt security should be accounted for in accordance with Statement of Position ("SOP") 03-3, "*Accounting for Loans and Certain Debt Securities Acquired in a Transfer*." EITF 03-1 does not replace the impairment guidance for investments accounted for under EITF Issue 99-20, "*Recognition of Interest Income and Impairments on Purchased and Retained Beneficial Interests in Securitized Financial Assets*" ("EITF 99-20"), however, investors will be required to determine if a security is other-than-temporarily impaired under EITF 03-1 if the security is determined not to be impaired under EITF 99-20. The Company adopted EITF 03-1 in 2004, which did not have a material impact on the Company's results of operation, financial condition or liquidity.

In March 2004, the EITF reached a final consensus on Issue 03-16, "*Accounting for Investments in Limited Liability Companies*" ("EITF 03-16"). EITF 03-16 will require investors in limited liability corporations that have specific ownership accounts to follow the equity method accounting for investments that are more than minor (e.g. greater than 3% ownership interest) as prescribed in SOP 78-9, "*Accounting for Investments in Real Estate Ventures*" and EITF Topic No. D-46, "*Accounting for Limited Partnership Investments*." Investors that do not have specific ownership accounts or minor ownership interests should follow the significant influence model prescribed in APB Opinion No. 18, "*Accounting for Certain Investments in Debt and Equity Securities*," for corporate investments. EITF 03-16 excludes securities that are required to be accounted for as debt securities based on the guidance in paragraph 14 of SFAS No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*," and EITF 99-20. EITF 03-16 is effective for quarters beginning after June 15, 2004 and should be applied as a change in accounting principle. The adoption of this standard is not expected to have a material impact on the Company's results of operation, financial condition or liquidity.

**Significant Accounting Policies**

See Note 1 of the Notes to Consolidated Financial Statements included in the Company's 2003 Annual Report for a description of accounting policies.

## LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

**Accumulated Other Comprehensive Income**

Other comprehensive income consists of foreign currency translation adjustments, minimum pension liability and unrealized gains and losses on certain investments in debt and equity securities.

The components of accumulated other comprehensive income, net of related deferred acquisition costs and taxes, are as follows:

	<b>March 31, 2004</b>	<b>December 31, 2003</b>
Unrealized gains on securities	\$1,555	\$1,181
Foreign currency translation and other adjustments	(40)	6
Accumulated other comprehensive income	<u>\$1,515</u>	<u>\$1,187</u>

**(2) DIVESTITURES AND DISCONTINUED OPERATIONS****Discontinued Operations**

On April 1, 2004, the Company completed the sale of its Canadian personal lines business, consisting of private passenger automobile, homeowners and personal property insurance, to Meloche Monnex, Inc., a member of TD Bank Financial Group ("Meloche Monnex"). The transaction resulted in the transfer of approximately 350,000 automobile and homeowners insurance policies and \$300 in direct written premiums to Meloche Monnex. The operations were a net gain of \$2 and a net loss of \$(2) for the quarters ended March 31, 2004 and 2003, respectively.

**(3) ACQUISITIONS AND GOODWILL**

Effective January 9, 2004, the Company acquired MetLife's Spanish operations, including its non-life subsidiary, Genesis Seguros Generales, S.A., and its life subsidiary, Seguros Genesis, S.A. The transaction resulted in goodwill of \$61.

**(4) DEBT OUSTANDING**

Debt outstanding at March 31, 2004 and December 31, 2003 includes the following:

Short-term debt:

	<b>2004</b>	<b>2003</b>
Commercial Paper .....	\$80	\$84
Revolving Credit Facilities.....	20	22
Tendered amount of 8.20% Surplus Notes, due 2007 .....	129	-
7.00% Notes—Series A due 2008.....	130	-
Total short-term debt	<u>\$359</u>	<u>\$106</u>

## LIBERTY MUTUAL HOLDING COMPANY INC.

## Notes to Consolidated Financial Statements

(dollars in millions)

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## Long-term debt:

	2004	2003
8.20% Surplus Notes, due 2007 .....	\$121	\$250
6.75% Notes, due 2008.....	15	15
5.00% Notes due 2008.....	30	30
7.00% Notes—Series A due 2008.....	-	130
8.00% Notes—Series B due 2013.....	260	260
5.75% Senior Notes, due 2014.....	500	-
8.50% Surplus Notes, due 2025 .....	150	150
7.875% Surplus Notes, due 2026 .....	250	250
7.63% Notes, due 2028.....	3	3
7.00% Senior Notes, due 2034 .....	250	-
7.697% Surplus Notes, due 2097 .....	500	500
7.10% – 8.10%, Medium Term Notes, with various maturities..	88	88
Subtotal.....	<u>\$ 2,167</u>	<u>\$ 1,676</u>
Unamortized discount.....	(17)	(8)
Total long-term debt excluding current maturities .....	<u><u>\$2,150</u></u>	<u><u>\$1,668</u></u>

**Short-term Debt**

The Company issues commercial paper to meet short-term operating needs. The total facility was \$600 at March 31, 2004 and December 31, 2003 and is backed up by a \$450 line of credit facility. Commercial paper issued and outstanding at March 31, 2004 and December 31, 2003 was \$80 and \$84, respectively. Interest rates ranged from 1.08% to 1.16% for the first three months ended March 31, 2004 and 1.03% to 1.55% in 2003.

On April 12, 2004, Liberty Mutual Insurance Company tendered for \$129 of its 8.20% Surplus Notes due 2007. Liberty Mutual Insurance Company realized a loss of approximately \$18 on the tender which will be recorded in the second quarter of 2004.

On April 16, 2004, LMGI repaid the five-year notes (approximately \$130) that it had issued to Prudential Financial Inc. (“Prudential”) in connection with the October 2003 acquisition of Prudential’s personal lines property-casualty operations.

**Long-term Debt**

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.

On March 23, 2004, the Company issued \$500 of 5.75% unsecured senior notes due 2014 and \$250 of 7.00% unsecured senior notes due 2034. Interest on the Notes is paid semi-annually on March 15 and September 15.

**(5) BENEFIT PLANS**

The components of net periodic cost for the Company’s pension and postretirement plans for the three months ended March 31, 2004 and 2003, are as follows:

## LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

	Pension Benefits		SIRP Benefits		Postretirement Benefits	
	2004	2003	2004	2003	2004	2003
Components of net periodic benefit costs:						
Service cost	\$ 31	23	2	1	4	3
Interest cost	40	35	3	2	9	8
Expected return on plan assets	(52)	(51)	-	-	-	-
Loss recognized due to settlement	-	-	12	-	-	-
Amortization of unrecognized:						
Net (gain)/loss	-	(1)	1	1	-	-
Prior service cost	1	1	1	1	(1)	(1)
Net transition (assets)/obligations	(1)	(1)	-	-	2	2
Net periodic benefit costs	\$ 19	6	19	5	14	12

On April 1, 2004, the Company made a \$100 voluntary contribution into its U.S. qualified defined benefit pension plan.

## (6) 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.

The Company has been in various insurance coverage disputes with Armstrong World Industries ("Armstrong") for over twenty years relating to asbestos liabilities and insurance covering the period 1973 to 1981. In 2003, the Company prevailed in a favorable arbitration ruling before an appellate panel regarding Armstrong's insurance coverage. Armstrong filed a Chapter 11 Bankruptcy petition in the United States Bankruptcy Court for the District of Delaware in December 2000 and is still operating under the protection of Chapter 11. A declaratory judgment action, filed by Armstrong in 2002, is pending in the United States District Court for the Eastern District of Pennsylvania seeking coverage for asbestos claims under insurance policies issued to Armstrong during the period of 1973 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania action is currently in the initial pleading stages and inactive by agreement of the parties. Armstrong has also recently filed, in the same Pennsylvania District Court, a Motion to Vacate the appellate arbitration award that was favorable to the Company. The Company is vigorously defending its position and the Motion to Vacate has been fully briefed. Management believes that the ultimate liability, if any, to Armstrong will not be resolved until at least 2005 and likely may not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and in the event of an adverse outcome, could have a material adverse effect on the Company's results of operations, financial condition and liquidity.

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The Company is involved in litigation arising from the terrorist attack on September 11, 2001. Multiple litigated matters are pending in various jurisdictions, including the so-called "Silverstein Property Damage Coverage" litigation which recently concluded the first phase of a multi phase trial in the U.S. District Court for the Southern District of New York. This first phase was intended to determine which policy language applies to the Silverstein property insurance program. A determination of the applicable language was necessary because Silverstein maintains that the terrorist attack constitutes two occurrences under certain policy forms, essentially seeking to double approximately \$3,200 in coverage allegedly purchased from numerous insurers. The jury ruled that the Company bound coverage under a policy form which defined this loss as one occurrence. The Company is also involved in a property coverage dispute related to Tower 7 at the World Trade Center. The Company participates in the excess layer as a reinsurer of Industrial Risk Insurers, one of the participating insurers and a party to this lawsuit. In addition, a liability insurance coverage dispute is pending between Silverstein and various insurance companies, including the Company as an upper layer excess carrier on liability programs for the World Trade Center Properties LLC and Westfield America, Inc., both of whom were leaseholders in the World Trade Center. In addition to these proceedings, a separate coverage lawsuit arises from 42 underlying actions brought as a result of the September 11, 2001 terrorist attack alleging negligent airport security in Boston and Maine. The Company is a plaintiff in this action. These matters are in various stages of litigation and the Company is comfortable with the reserves that are held.

At March 31, 2004, the Company had unfunded capital commitments to private equity investments of \$684.

At March 31, 2004, the Company had commitments to purchase various mortgage-backed securities settling in 2004, at a cost of \$679 with a fair value of \$681 and are included as fixed maturities in the consolidated balance sheets.