Management's Discussion & Analysis of
Financial Condition and Results of Operations

Quarter Ended June 30, 2004

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc. (the "Company" or "LMG") for the three and six months ended June 30, 2004 and 2003. This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's Annual Report, Second Quarter 2004 Consolidated Financial Statements (unaudited), Second Quarter 2004 Financial Supplement (unaudited), and First Quarter 2004 MD&A located on the Investor Relations web site at www.libertymutual.com/investors. The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are intended to enhance the reader's ability to assess the Company's future financial and business performance. Forward-looking statements include, but are not limited to, statements that represent the Company's beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "may," "expects," "should," "believes," "anticipates," "estimates," "intends" or similar expressions. Because these forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond the Company's control or are subject to change, actual results could be materially different.

In particular, the sufficiency of the Company's reserves for (i) asbestos, (ii) environmental, and (iii) toxic tort (i.e., claims that arise primarily from exposure to chemical or other hazardous substances, including welding rod and silica related claims ((i), (ii), and (iii) together "A&E")), as well as its results of operations, financial condition and liquidity, to the extent impacted by the sufficiency of the Company's A&E reserves, are subject to a number of potential adverse developments including adverse developments involving A&E claims and the related level and outcome of litigation, the willingness of parties, including the Company, to settle disputes, the interpretation of aggregate policy coverage limits, the Company's ability to recover reinsurance for A&E and other claims, the legal, economic, regulatory, and legislative environments, and their impact on the future development of A&E claims, and the impact of bankruptcies of various asbestos producers and related peripheral businesses.

Some of the other factors that could cause actual results to differ include, but are not limited to, the following: the Company's inability to obtain price increases due to competition or otherwise; the performance of the Company's investment portfolios, which could be adversely impacted by adverse developments in U.S. and global financial markets, interest rates and rates of inflation; weakening U.S. and global economic conditions; insufficiency of, or changes in, loss reserves; the occurrence of catastrophic events, both natural and man-made, including terrorist acts, with a severity or frequency exceeding the Company's expectations; exposure to, and adverse developments involving, environmental claims and related litigation; the impact of claims related to exposure to potentially harmful products or substances, including, but not limited to, lead paint, silica and other potentially harmful substances; adverse changes in loss cost trends, including inflationary pressures in medical costs and auto and home repair costs; developments relating to coverage and liability for mold claims; the effects of corporate bankruptcies on surety bond claims; adverse developments in the cost, availability and/or ability to collect reinsurance; the ability of the Company's subsidiaries to pay dividends to the Company; adverse outcomes in legal proceedings; judicial expansion of policy coverage and the impact of new theories of liability; the impact of legislative actions, including Federal and state legislation related to asbestos liability reform; larger than expected assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings; the loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of Personal Lines policies; and amendments and changes to the risk-based capital requirements. The Company's forward-looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs. The Company undertakes no obligation to update these forward-looking statements.

EXECUTIVE SUMMARY

The following highlights do not address all of the matters covered in the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to the investing public. This summary should be read in conjunction with the other sections of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Three Months Ended June 30, 2004 - Consolidated Results of Operations

- Revenues for the three months ended June 30, 2004 were $4.781 billion, a $660 million or 16.0% increase over the same period in 2003.
- Net income for the three months ended June 30, 2004 was $407 million, a $210 million or 106.6% increase over the same period in 2003.
- The combined ratio for the three months ended June 30, 2004 was 98.8%, a 6.5 percentage point improvement over the same period in 2003.
- Net incurred losses attributable to prior years[1] were $37 million and $114 million for the three months ended June 30, 2004 and 2003, respectively.
- Cash flow from operations for the three months ended June 30, 2004 was $704 million, a $43 million or 6.5% increase over the same period in 2003.

Six Months Ended June 30, 2004 - Consolidated Results of Operations

- Revenues for the six months ended June 30, 2004 were $9.485 billion, a $1.734 billion or 22.4% increase over the same period in 2003.
- Net income for the six months ended June 30, 2004 was $691 million, a $480 million or 227.5% increase over the same period in 2003.
- The combined ratio for the six months ended June 30, 2004 was 101.0%, a 4.5 percentage point improvement over the same period in 2003.
- Net incurred losses attributable to prior years[1] were $141 million and $213 million for the six months ended June 30, 2004 and 2003, respectively.
- Cash flow from operations for the six months ended June 30, 2004 was $1.553 billion, a $255 million or 19.6% increase over the same period in 2003.

Financial Condition as of June 30, 2004

- Total assets increased to $68.638 billion as of June 30, 2004, a $4.216 billion or 6.5% increase from December 31, 2003.
- Policyholders' equity as of June 30, 2004 was $7.470 billion, an $89 million or 1.2% increase from December 31, 2003.
- Net unrealized gains on fixed maturities as of June 30, 2004 was $537 million, an $877 million or 62.0% decrease from December 31, 2003.

[1] Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years including retroactive reinsurance gain amortization and net of earned premium attributable to prior years and excluding discount accretion.

Other 2004 2nd Quarter Highlights

Rating Actions

- On June 17, 2004, A.M. Best Co. affirmed its financial strength ratings of A (Excellent) on Liberty Mutual Insurance Company ("LMIC") and its related property/casualty entities. The rating outlook was revised to stable from negative for all of the property/casualty companies. For a complete list of ratings, visit the Company's Investor Relations web site at www.libertymutual.com/investors.

Dispositions

- 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 approximately $300 million (C$390 million) in direct written premiums to Meloche Monnex. Neither party has disclosed the financial terms of the transaction, which the Company believes is not material to its business, financial condition or results of operations.

Debt Transaction

- On April 12, 2004, LMIC retired approximately $129 million of its $250 million of 8.20% Surplus Notes due 2007 and realized a loss of approximately $19 million on the tender.

- On April 16, 2004, Liberty Mutual Group Inc. ("LMGI") repaid at par approximately $130 million of notes due in 2008 to Prudential Financial Inc. ("Prudential") issued in connection with its acquisition of Prudential's U.S. personal lines property and casualty business ("PruPac"), which was completed in the fourth quarter of 2003.

Capital Contribution to Insurance Subsidiaries

- In the second quarter of 2004, LMGI made a series of capital contributions totaling approximately $688 million to its wholly owned insurance subsidiaries LMIC, Liberty Mutual Fire Insurance Company ("LMFIC") and Employers Insurance Company of Wausau ("EICOW") using proceeds primarily from LMGI's March 23, 2004 debt issuance.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI") and net written premium as non-GAAP financial measures. PTOI is defined by the Company as net income excluding net realized gains (losses), Federal and foreign income taxes, extraordinary items, discontinued operations and cumulative effect of a change in accounting principle. PTOI is considered by the Company to be an appropriate indicator of underwriting and operating results and is consistent with the way the Company internally evaluates performance. Net realized investment gains (losses) are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results. Federal and foreign income taxes are significantly impacted by permanent differences including valuation allowances. References to "direct written premium" represent the amount of premium recorded for policies issued during a fiscal period, excluding assumed reinsurance and ignoring the effects of ceded reinsurance. References to "net written premium" represent the amount of premium recorded for policies issued during a fiscal period, plus reinsurance assumed and net of reinsurance ceded. "Premium earned," which is the portion of premium that applies to the expired part of the policy period, is a GAAP measure. The Company believes that net written premium is a performance measure useful to investors as it reflects current trends in the Company's sale of property and casualty insurance products.

The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

(1) Overview – Consolidated

Consolidated net written premium by significant line of business was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Private Passenger Automobile	$1,471	$1,081	36.1%	$2,821	$2,082	35.5%
Workers' Compensation	825	728	13.3	1,989	1,810	9.9
Homeowners	389	256	52.0	695	461	50.8
Commercial Multiple Peril	276	236	16.9	539	477	13.0
Commercial Automobile	241	217	11.1	532	457	16.4
LIU[1] – Reinsurance	218	107	103.7	508	319	59.2
General Liability	305	207	47.3	502	384	30.7
International Local Businesses[2]	189	222	(14.9)	403	421	(4.3)
LIU[1] – Third Party	92	94	(2.1)	173	166	4.2
LIU[1] – First Party	63	68	(7.4)	130	124	4.8
Group Disability	64	66	(3.0)	124	129	(3.9)
Fire	54	30	80.0	95	64	48.4
Assumed Reinsurance	30	52	(42.3)	66	85	(22.4)
Other	202	188	7.4	412	378	9.0
Total net written premium	$4,419	$3,552	24.4%	$8,989	$7,357	22.2%

1 Liberty International Underwriters (LIU)
2 Small commercial and other personal; excludes private passenger automobile.

Consolidated net written premium by strategic business unit was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Personal Market	$1,426	$ 985	44.8%	$2,672	$1,897	40.9%
Commercial Markets	1,148	1,002	14.6	2,600	2,343	11.0
Regional Agency Markets	1,024	893	14.7	2,003	1,755	14.1
International	837	677	23.6	1,786	1,373	30.1
Corporate and Other	(16)	(5)	NM	(72)	(11)	NM
Total net written premium	$4,419	$3,552	24.4%	$8,989	$7,357	22.2%

NM = Not meaningful (represents increases or decreases greater than 200%, or changes from a net gain to a net loss, or vice versa).

Net written premium for the three and six months ended June 30, 2004 was $4.419 billion and $8.989 billion, respectively, representing an $867 million and $1.632 billion increase over the same periods in 2003. The increase in the quarter and year-to-date reflects acquisition activity, including dispositions and an increase in the retention of business from OneBeacon Insurance Company and its insurance affiliates (collectively, "OneBeacon"), of $420 million and $769 million, respectively. In November of 2001, the Company acquired the business of OneBeacon. The balance of the increase in both periods reflects new business growth, rate increases and a general improvement in retention levels on renewal business across many of the Company's major product lines.

For a full description of the Company's business operations, products and distribution channels, please visit the Company's Investor Relations web site at www.libertymutual.com/investors.

(2) Results of Operations – Consolidated

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Revenues	$4,781	$4,121	16.0%	$9,485	$7,751	22.4%
PTOI before catastrophes and incurred attributable to prior years	$471	$269	75.1%	$863	$518	66.6%
Catastrophes[1]:						
- Natural	(54)	(68)	(20.6)	(93)	(109)	(14.7)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	(4)	(23)	(82.6)	(4)	(69)	(94.2)
- All other[2]	(33)	(91)	(63.7)	(137)	(144)	(4.9)
Discount accretion[3]	(24)	(15)	60.0	(48)	(31)	54.8
Pre-tax operating income	356	72	NM	581	165	NM
Realized investment gains (losses), net	37	148	(75.0)	94	74	27.0
Federal and foreign income tax expense	-	(35)	(100.0)	-	(38)	(100.0)
Discontinued operations, net of tax	14	12	16.7	16	10	60.0
Net income	$407	$197	106.6%	$691	$211	NM

[1] Excludes catastrophes assumed through voluntary reinsurance programs.
[2] Net of earned premium attributable to prior years of $38 million and $58 million for the three and six months ended June 30, 2004, respectively; $77 million and $94 million for the comparable periods of 2003.
[3] The Company discounts the long-term indemnity portion of its workers' compensation claims as permitted by insurance regulations. The discount accretion on these claims flows through underwriting results as the loss reserves accrete to nominal value. Asbestos settlements are discounted at 4.5%.
NM = Not Meaningful

Revenues for the three and six months ended June 30, 2004 were $4.781 billion and $9.485 billion, respectively, representing a $660 million and $1.734 billion increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income, net realized investment gains/losses, and fee and other revenues.

Net premium earned for the three and six months ended June 30, 2004 was $4.069 billion and $8.036 billion, respectively, representing a $671 million and $1.485 billion increase over the same periods in 2003. The increase in the quarter and year-to-date reflects acquisition activity, including dispositions and an increase in the retention on the OneBeacon business, of $323 million and $712 million, respectively. The balance of the increase in both periods reflects new business growth, rate increases and a general improvement in retention levels on renewal business across many of the Company's major product lines.

Net investment income for the three and six months ended June 30, 2004 was $520 million and $1.022 billion, respectively, representing an $82 million and $170 million increase over the same periods in 2003. The increase in both periods reflects an increase in average invested assets resulting from acquisition activity and improved cash flow from operations, partially offset by lower investment yields. Limited partnership results (largely venture capital and leverage buyout funds) also accounted for $32 million and $70 million of the improvement in the quarter and year-to-date results, respectively.

Net realized investment gains for the three and six months ended June 30, 2004 were $37 million and $94 million, respectively, representing a $111 million decrease and a $20 million increase over the same periods in 2003. In the first quarter of 2004, the Company contributed one of its energy holdings to a new limited partnership in exchange for an interest in the new partnership. The final valuation underlying the accounting by the general partner are expected to be completed in the third quarter of 2004. Upon completion of the merger accounting, the Company could realize a gain on the transaction.

Fee and other revenues for the three and six months ended June 30, 2004 were $155 million and $333 million, respectively, representing a $18 million and $59 million increase over the same periods in 2003.

The increase in both periods was primarily attributable to higher fee revenues from the Company's involuntary market servicing carrier operations.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $4.388 billion and $8.810 billion, respectively, representing a $487 million and $1.298 billion increase over the same periods in 2003. The increase in the quarter and year-to-date primarily reflects acquisition activity, including dispositions and an increase in the retention on the OneBeacon business (including other underwriting expenses), of $314 million and $721 million, respectively, and the non-renewal of certain workers' compensation excess of loss reinsurance treaties, of $46 million and $71 million, respectively. Partially offsetting these increases in the quarter and year-to-date was a decrease in incurred losses attributable to prior years of $107 million and $91 million, respectively, and a decrease in catastrophe losses of $14 million and $16 million, respectively. The balance of the increase in both periods primarily reflects business growth and general cost increases.

	Three Months Ended June 30,			Six Months Ended June 30,		
CONSOLIDATED	**2004**	**2003**	**Change (Points)**	**2004**	**2003**	**Change (Points)**
Combined ratio before catastrophes and incurred attributable to prior years						
Claims and claim adjustment expense ratio	70.2%	71.9%	(1.7)	71.2%	72.3%	(1.1)
Underwriting expense ratio	25.3	26.7	(1.4)	25.8	27.0	(1.2)
Dividend ratio	0.3	0.5	(0.2)	0.3	0.5	(0.2)
Subtotal	95.8	99.1	(3.3)	97.3	99.8	(2.5)
Catastrophes:						
- Natural	1.4	2.2	(0.8)	1.2	1.8	(0.6)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	0.1	0.7	(0.6)	0.1	1.1	(1.0)
- All other	0.9	2.8	(1.9)	1.8	2.3	(0.5)
Discount accretion	0.6	0.5	0.1	0.6	0.5	0.1
Total combined ratio[1]	98.8%	105.3%	(6.5)	101.0%	105.5%	(4.5)

[1] The combined claim and expense ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined claim and expense ratio, expressed as a percentage, is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less fee income and less installment charges; and the ratio of policyholder dividends to earned premium. Provisions for uncollectible premium and reinsurance are not included in the combined ratio. Beginning in the second quarter of 2004, results of the Company's Group Market operations have been excluded from the above table and related discussion on the combined ratio. Prior periods have been restated to conform to the current presentation.

The consolidated combined ratio for the three and six months ended June 30, 2004 was 98.8% and 101.0%, respectively, representing a 6.5 percentage point and 4.5 percentage point improvement over the same periods in 2003. The improvement in both periods reflects the favorable impact of underwriting and pricing actions taken, a decrease in the amount of catastrophe losses and net incurred losses attributable to prior years and a reduction in claims frequency across major product lines. In addition, higher premium revenue and an increase in revenues related to the Company's involuntary market servicing carrier operations had a positive impact in reducing the expense ratio for both periods.

PTOI for the three and six months ended June 30, 2004 was $356 million and $581 million, respectively, representing a $284 million and $416 million increase over the same periods in 2003.

Net income for the three and six months ended June 30, 2004 was $407 million and $691 million, respectively, representing a $210 million and $480 million increase over the same periods in 2003. The Company recognized no Federal and foreign income tax expense during the first six months of 2004 as it continues to reduce its deferred tax asset valuation allowance. Net income from discontinued operations for 2004 and 2003 primarily reflects the net income from the Company's Canadian personal lines business sold to Meloche Monnex on April 1, 2004.

PERSONAL MARKET

(1) Overview – Personal Market

Personal Market net premium written by line of business was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Private Passenger Automobile	$1,071	$768	39.5%	$2,037	$1,508	35.1%
Homeowners and Other	355	217	63.6	635	389	63.2
Total net written premium	$1,426	$985	44.8%	$2,672	$1,897	40.9%

Net written premium for the three and six months ended June 30, 2004 was $1.426 billion and $2.672 billion, respectively, representing a $441 million and $775 million increase over the same periods in 2003. The increase reflects $357 million and $624 million of net written premium related to the PruPac acquisition completed in the fourth quarter of 2003 in the quarter and year-to-date, respectively. New business growth, rate increases, and improved retention levels also contributed to the increase in both periods.

Private passenger automobile net written premium for the three and six months ended June 30, 2004 was $1.071 billion and $2.037 billion, respectively, representing a $303 million and $529 million increase over the same periods in 2003. Approximately $254 million and $431 million of the increase in net written premium in the quarter and year-to-date, respectively, was related to the PruPac acquisition. New business growth, rate increases, and improved retention levels also contributed to the increase in both periods.

Homeowners and other net written premium for the three and six months ended June 30, 2004 was $355 million and $635 million, respectively, representing a $138 million and $246 million increase over the same periods in 2003. Approximately $103 million and $193 million of the increase in net written premium in the quarter and year-to-date, respectively, was related to the PruPac acquisition. New business growth, rate increases, and improved retention levels also contributed to the increase in both periods.

(2) Results of Operations – Personal Market

$ in Millions	Three Months Ended June 30, 2004	2003	Change	Six Months Ended June 30, 2004	2003	Change
Revenues	$1,321	$964	37.0%	$2,640	$1,885	40.1%
PTOI before catastrophes and incurred attributable to prior years	$231	$111	108.1%	$358	$194	84.5%
Catastrophes:						
- Natural	(32)	(42)	(23.8)	(62)	(61)	1.6
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	-	(9)	NM	-	(17)	NM
Discount accretion	-	-	-	-	-	-
Pre-tax operating income	199	60	NM	296	116	155.2
Realized investment gains (losses), net	-	-	-	-	-	-
Federal and foreign income tax expense	(70)	(20)	NM	(104)	(40)	160.0
Discontinued operations, net of tax	14	12	16.7	15	10	50.0
Net income	$143	$ 52	175.0%	$207	$ 86	140.7%

NM = Not meaningful

Revenues for the three and six months ended June 30, 2004 were $1.321 billion and $2.640 billion, respectively, representing a $357 million and $755 million increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three and six months ended June 30, 2004 was $1.234 billion and $2.468 billion, respectively, representing a $336 million and $714 million increase over the same periods in 2003. The increase reflects $251 million and $532 million of earned premium in the quarter and year-to-date, respectively, related to the PruPac acquisition. New business growth, rate increases, and improved retention levels also contributed to the increase in both periods.

Net investment income for the three and six months ended June 30, 2004 was $73 million and $144 million, respectively, representing a $20 million and $38 million increase over the same periods in 2003. Approximately $16 million and $32 million of the increase in investment income in the quarter and year-to-date was related to the PruPac acquisition. The balance of the increase in both periods reflects an increase in invested assets resulting from acquisition activity and improved cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and six months ended June 30, 2004 were $14 million and $28 million, respectively, representing negligible increases over the same periods in 2003. Premium installment fees represent the majority of the revenues in this category.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $1.122 billion and $2.344 billion, respectively, representing a $218 million and $575 million increase over the same periods in 2003. Approximately $227 million and $510 million of the increase in the quarter and year-to-date, respectively, was related to the PruPac acquisition. The balance of the increase in both periods was primarily due to business growth and general cost increases over the comparable periods in 2003.

PERSONAL MARKET	Three Months Ended June 30, 2004	2003	Change (Points)	Six Months Ended June 30, 2004	2003	Change (Points)
Combined ratio before catastrophes and incurred attributable to prior years						
Claims and claim adjustment expense ratio	66.1%	71.5%	(5.4)	70.4%	73.4%	(3.0)
Underwriting expense ratio	20.6	21.0	(0.4)	20.6	20.7	(0.1)
Dividend ratio	-	-	-	-	-	-
Subtotal	86.7	92.5	(5.8)	91.0	94.1	(3.1)
Catastrophes:						
- Natural	2.6	4.7	(2.1)	2.5	3.5	(1.0)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	-	1.0	(1.0)	-	1.0	(1.0)
Discount accretion	-	-	-	-	-	-
Total combined ratio	89.3%	98.2%	(8.9)	93.5%	98.6%	(5.1)

Personal Market's combined ratio for the three and six months ended June 30, 2004 was 89.3% and 93.5%, respectively, representing an 8.9 percentage point and 5.1 percentage point improvement over the same periods in 2003. Approximately 5.4 percentage points and 3.0 percentage points of the improvement in the quarter and year-to-date, respectively, reflects the favorable impact of underwriting and pricing actions taken in both periods, in conjunction with a corresponding reduction in claim frequency. Lower catastrophe losses and the absence of net incurred losses attributable to prior years improved the combined ratio by 3.1 percentage points and 2.0 percentage points in the quarter and year-to-date, respectively.

PTOI for the three and six months ended June 30, 2004 was $199 million and $296 million, respectively, representing a $139 million and $180 million increase over the same periods in 2003. Consistent with the increase in profitability, Federal income taxes were $70 million and $104 million in the quarter and year-to-date, respectively, representing a $50 million and $64 million increase over the same periods in 2003.

Net income for the three and six months ended June 30, 2004 was $143 million and $207 million, respectively, representing a $91 million and $121 million increase over the same periods in 2003. Net income from discontinued operations for 2004 and 2003 primarily reflects the net income from the Company's Canadian personal lines business sold to Meloche Monnex on April 1, 2004.

COMMERCIAL MARKETS

(1) Overview – Commercial Markets

Commercial Markets net written premium by market segment was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
National Market	$ 461	$ 351	31.3%	$ 829	$ 761	8.9%
Business Market	285	239	19.2	753	654	15.1
Wausau Commercial Market	153	159	(3.8)	492	442	11.3
Group Market	86	85	1.2	168	169	(0.6)
Specialty Risks	91	76	19.7	167	132	26.5
Other Markets	72	92	(21.7)	191	185	3.2
Total net written premium	$1,148	$1,002	14.6%	$2,600	$2,343	11.0%

Commercial Markets net written premium by line of business was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Workers' Compensation	$ 551	$ 491	12.2%	$1,456	$1,342	8.5%
General Liability	252	166	51.8	400	303	32.0
Commercial Automobile	98	96	2.1	261	224	16.5
Group Disability	64	66	(3.0)	124	129	(3.9)
Fire	38	23	65.2	70	49	42.9
Surety	33	28	17.9	66	45	46.7
Assumed Voluntary Reinsurance	30	52	(42.3)	66	85	(22.4)
Commercial Multiple Peril	23	35	(34.3)	52	72	(27.8)
Other	59	45	31.1	105	94	11.7
Total net written premium	$1,148	$1,002	14.6%	$2,600	$2,343	11.0%

Net written premium for the three and six months ended June 30, 2004 was $1.148 billion and $2.6 billion, respectively, representing a $146 million and $257 million increase over the same periods in 2003. The increase in both periods reflects new business growth, rate increases, a general improvement in retention levels on renewal business primarily in the Company's National Market and Business Market segments, and the non-renewal of certain workers' compensation excess of loss reinsurance treaties in the second quarter of 2003. The Commercial Market continues to experience a shift of products away from traditional "first dollar" coverage toward more loss sensitive, service-oriented products such as large dollar deductible ("LDD") policies and self insurance plans, particularly in the National Market segment. Under a LDD plan, a policyholder is responsible for reimbursing the insurer for claim payments made up to the deductible level. An insurer provides additional coverage above the deductible amount and services the claims. While LDD policies generate less premium than traditional coverage, the Company benefits from a decrease in exposure and the timing of loss payments.

(2) Results of Operations – Commercial Markets

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Revenues	$1,381	$1,299	6.3%	$2,708	$2,491	8.7%
PTOI before catastrophes and incurred attributable to prior years	$103	$100	3.0%	$206	$203	1.5%
Catastrophes:						
- Natural	(5)	(1)	NM	(5)	(10)	(50.0)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other[1]	(14)	(17)	(17.6)	(28)	(35)	(20.0)
Discount accretion[2]	(21)	(15)	40.0	(42)	(31)	35.5
Pre-tax operating income	63	67	(6.0)	131	127	3.1
Realized investment gains (losses), net	-	-	-	-	-	-
Federal and foreign income tax expense	(22)	(24)	(8.3)	(46)	(45)	2.2
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$41	$43	(4.7%)	$85	$82	3.7%

[1] Net of earned premium attributable to prior years of $30 million and $45 million for the three and six months ended June 30, 2004, respectively; $72 million and $82 million for the comparable periods of 2003.

[2] The Company discounts the long-term indemnity portion of its workers' compensation claims as permitted by insurance regulations. The discount accretion on these claims flows through underwriting results as the loss reserves accrete to nominal value. Asbestos settlements are discounted at 4.5%.

NM= Not meaningful

Revenues for the three and six months ended June 30, 2004 were $1.381 billion and $2.708 billion, respectively, representing an $82 million and $217 million increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three and six months ended June 30, 2004 was $1.116 billion and $2.166 billion, respectively, representing a $59 million and $158 million increase over the same periods in 2003. The increase in both periods reflects new business growth, rate increases and a general improvement in retention levels on renewal business primarily in the Company's National Market and Business Market segments, and the non-renewal of certain workers' compensation excess of loss reinsurance treaties in the second quarter of 2003.

Net investment income for the three and six months ended June 30, 2004 was $174 million and $346 million, respectively, representing a $10 million and $19 million increase over the same periods in 2003. The increase in both periods reflects an increase in invested assets resulting from improved cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and six months ended June 30, 2004 were $91 million and $196 million, respectively, representing a $13 million and $40 million increase over the same periods in 2003. The increase in both periods was primarily due to higher fee revenues from involuntary market servicing carrier operations. As a servicing carrier, the Company is required to perform certain administrative duties such as issuing policies, collecting premiums, paying losses and providing loss control services on behalf of all participating involuntary pool members. Fee revenues earned are directly related to the growth in the involuntary pools and associations. Other sources of fee revenue come from the Company's subsidiary, Helmsman Management Services LLC, a third party administrator, and from other miscellaneous services provided by the Company.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $1.318 billion and $2.577 billion, respectively, representing an $86 million and $213 million increase over the same periods in 2003. The increase in both periods reflects the non-renewal of certain workers' compensation excess of loss reinsurance treaties in the second quarter of 2003. The non-renewal of those treaties resulted in a $46 million and $71 million increase in retained claims, benefits and expenses in the quarter and year-to-date results, respectively. Other factors contributing to the increase were approximately $20 million in incurred losses attributable to prior years related to the anticipated reapportionment of involuntary market liabilities due to potential insolvencies, new business growth over the comparable periods and general cost increases.

	Three Months Ended June 30,			**Six Months Ended June 30,**		
COMMERCIAL MARKETS	**2004**	**2003**	**Change (Points)**	**2004**	**2003**	**Change (Points)**
Combined ratio before catastrophes and incurred attributable to prior years						
Claims and claim adjustment expense ratio	79.6%	80.2%	(0.6)	79.9%	78.3%	1.6
Underwriting expense ratio	21.1	23.6	(2.5)	21.6	24.2	(2.6)
Dividend ratio	0.1	0.6	(0.5)	0.3	0.7	(0.4)
Subtotal	100.8	104.4	(3.6)	101.8	103.2	(1.4)
Catastrophes:						
- Natural	0.5	0.1	0.4	0.3	0.6	(0.3)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	1.3	1.2	0.1	1.2	1.7	(0.5)
Discount accretion	2.1	1.7	0.4	2.2	1.8	0.4
Total combined ratio	104.7%	107.4%	(2.7)	105.5%	107.3%	(1.8)

Note: Beginning in the second quarter of 2004, results of the Company's Group Market operations have been excluded from the above table and related discussion on the combined ratio. Prior periods have been restated to conform to the current presentation.

The Commercial Markets combined ratio for the three and six months ended June 30, 2004 was 104.7% and 105.5%, respectively, representing a 2.7 percentage point and 1.8 percentage point improvement over the same periods in 2003. The improvement in both periods reflects the favorable impact of underwriting and rating actions taken, and a decrease in the impact of losses related to catastrophes and net incurred attributable to prior years. In addition, the underwriting expense ratio improved by 2.5 percentage points and 2.6 percentage points in the quarter and year-to-date, respectively, largely due to the effects of higher premium volumes and an increase in revenues related to the Company's servicing carrier operations. Partially offsetting these favorable trends was the non-renewal of the aforementioned workers' compensation excess of loss reinsurance treaties, which reduced the benefit to the claims and claim adjustment expense ratio by approximately 2.9 points and 2.5 points in the quarter and year-to-date, respectively.

PTOI for the three and six months ended June 30, 2004 was $63 million and $131 million, respectively, representing a $4 million decrease and $4 million increase over the same periods in 2003. Improved underwriting results and higher investment income in both periods were offset by higher other expenses, driven primarily by higher interest charges related to funds held balances on reinsurance treaties. Consistent with the changes in profitability, Federal income taxes were $22 million and $46 million, respectively, representing a $2 million decrease and $1 million increase over the same periods in 2003.

Net income for the three and six months ended June 30, 2004 was $41 million and $85 million, respectively, representing a $2 million decrease and $3 million increase over the same periods in 2003.

REGIONAL AGENCY MARKETS (RAM)

(1) Overview – RAM

RAM net written premium by market segment was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Standard Regional Companies	$701	$605	15.9%	$1,336	$1,182	13.0%
Specialty Operations	218	199	9.5	465	401	16.0
Liberty Northwest	105	89	18.0	202	172	17.4
Total net written premium	$1,024	$893	14.7%	$2,003	$1,755	14.1%

RAM net written premium by line of business was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Commercial Lines						
Workers' compensation	$338	$298	13.4%	$696	$601	15.8%
Commercial multi-peril	251	202	24.3	485	403	20.3
Commercial automobile	143	120	19.2	271	232	16.8
General liability	39	31	25.8	76	62	22.6
Other	36	32	12.5	70	63	11.1
Subtotal	$807	$683	18.2%	$1,598	$1,361	17.4%
Personal Lines						
Private passenger automobile	$137	$142	(3.5%)	$266	$272	(2.2%)
Homeowners	70	64	9.4	126	115	9.6
Other	10	4	NM	13	7	85.7
Subtotal	217	210	3.3	405	394	2.8
Total net written premium	$1,024	$893	14.7%	$2,003	$1,755	14.1%

NM = Not Meaningful

Net written premium for the three and six months ended June 30, 2004 was $1.024 billion and $2.003 billion, respectively, representing a $131 million and $248 million increase over the same periods in 2003. Approximately $54 million and $95 million of the increase in the quarter and year-to-date, respectively, was due to the reduction in ceded business to OneBeacon (in accordance with the terms of the transaction to acquire the business in November 2001). Additionally, $27 million and $77 million of the increase was related to Summit Holding Southeast Inc. ("Summit"), a workers' compensation subsidiary operating primarily in Florida. The balance of the increase in both periods reflects new business growth, rate increases and a general improvement in retention levels across most of the RAM companies.

(2) Results of Operations – RAM

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Revenues	$956	$808	18.3%	$1,864	$1,585	17.6%
PTOI before catastrophes and incurred attributable to prior years	$ 74	$ 69	7.2%	$ 161	$ 122	32.0%
Catastrophes:						
- Natural	(17)	(25)	(32.0)	(26)	(38)	(31.6)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other [1]	9	(4)	NM	9	(4)	NM
Discount accretion	-	-	-	-	-	-
Pre-tax operating income	66	40	65.0	144	80	80.0
Realized investment gains (losses), net	-	2	NM	(2)	2	NM
Federal and foreign income tax expense	(24)	(15)	60.0	(51)	(29)	75.9
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$ 42	$ 27	55.6%	$ 91	$ 53	71.7%

1 Net of earned premium attributable to prior years of $5 million and $7 million for the three and six months ended June 30, 2004, respectively; $0 million and $0 million for the comparable periods of 2003.
NM = Not Meaningful

Revenues for the three and six months ended June 30, 2004 were $956 million and $1.864 billion, respectively, representing a $148 million and $279 million increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three and six months ended June 30, 2004 was $877 million and $1.710 billion, respectively, representing a $144 million and $276 million increase over the same periods in 2003. Approximately $67 million and $144 million of the increase in the quarter and year-to-date, respectively, was due to the reduction in ceded business to OneBeacon. Summit net premium earned for the three and six months ended June 30, 2004 were $128 million and $241 million, respectively, representing a $28 million and $50 million increase over the same periods in 2003. The balance of the increase in both periods reflects new business growth, rate increases and a general improvement in retention levels across most product lines.

Net investment income for the three and six months ended June 30, 2004 was $66 million and $130 million, respectively, representing a $5 million and $7 million increase over the same periods in 2003. The increase in both periods reflects an increase in invested assets resulting from improved cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and six months ended June 30, 2004 were $13 million and $26 million, respectively, which was essentially unchanged from the same periods in 2003. The primary source of fee revenue is derived from Summit, a provider of insurance administrative services to workers' compensation self insurance funds.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $890 million and $1.722 billion, respectively, representing a $124 million and $219 million increase over the same periods in 2003. Approximately $79 million and $167 million of the increase in the quarter and year-to-date, respectively, was related to the reduction in ceded business to OneBeacon. The balance of the increase in both periods reflects business growth and general cost increases over the comparable periods, partially offset by a lower amount of catastrophe losses.

REGIONAL AGENCY MARKETS	Three Months Ended June 30, 2004	2003	Change (Points)	Six Months Ended June 30, 2004	2003	Change (Points)
Combined ratio before catastrophes and incurred attributable to prior years						
Claims and claim adjustment expense ratio	65.9%	65.4%	0.5	65.3%	66.9%	(1.6)
Underwriting expense ratio	32.4	32.7	(0.3)	32.2	32.1	0.1
Dividend ratio	1.2	1.2	-	0.9	1.2	(0.3)
Subtotal	99.5	99.3	0.2	98.4	100.2	(1.8)
Catastrophes:						
- Natural	2.0	3.4	(1.4)	1.5	2.6	(1.1)
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	(1.1)	0.7	(1.8)	(0.5)	0.4	(0.9)
Discount accretion	-	-	-	-	-	-
Total combined ratio	100.4%	103.4%	(3.0)	99.4%	103.2%	(3.8)

RAM's combined ratio for the three and six months ended June 30, 2004 was 100.4% and 99.4%, respectively, representing a 3.0 percentage point and 3.8 percentage point improvement over the same periods in 2003. The improvement in the quarter and year-to-date results, respectively, primarily reflects a decrease in the impact of catastrophe losses and favorable development of net incurred losses attributable to prior years. The balance of the improvement year-to-date reflects underwriting actions and rate increases earned over the comparable period.

PTOI for the three and six months ended June 30, 2004 was $66 million and $144 million, respectively, representing a $26 million and $64 million increase over the same periods in 2003. Consistent with the increase in profitability, Federal income taxes were $24 million and $51 million, respectively, representing a $9 million and $22 million increase over the same periods in 2003.

Net income for the three and six months ended June 30, 2004 was $42 million and $91 million, respectively, representing a $15 million and $38 million increase over the same periods in 2003.

INTERNATIONAL

(1) Overview – International

International net written premium by market segment was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
International Local Businesses	$452	$393	15.0%	$921	$722	27.6%
Liberty International Underwriters	385	284	35.6	865	651	32.9
Total net written premium	$837	$677	23.6%	$1,786	$1,373	30.1%

The Company's International operations provide insurance products and services through 1) Local Businesses or wholly owned local insurance companies which sell personal and small commercial lines products and 2) Liberty International Underwriters (LIU) which sells specialty commercial lines worldwide.

International's five major lines of business are as follows:

(1) Local Businesses - Personal and Small Commercial insurance;
(2) LIU Reinsurance: includes Multi-line insurance and reinsurance with an emphasis on property, treaty casualty, personal accident, aviation and reinsurance through Lloyd's Syndicates 190 and 282;
(3) LIU Third Party: includes Casualty, Excess Casualty, D&O, E&O and Professional Liability;
(4) LIU First Party: includes Marine, Energy, Engineering, Aviation and Property; and
(5) LIU Other: includes Workers' Compensation, Commercial Auto, and Residual Value.

For the three months ended June 30, 2004 and 2003, net written premium by major product line was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Local Businesses	$452	$393	15.0%	$921	$722	27.6%
LIU Reinsurance	218	107	NM	508	319	59.2
LIU Third Party	92	94	(2.1)	173	166	4.2
LIU First Party	63	68	(7.4)	130	124	4.8
LIU Other	12	15	(20.0)	54	42	28.6
Total net written premium	$837	$677	23.6%	$1,786	$1,373	30.1%

NM = Not Meaningful

Net written premium for the three and six months ended June 30, 2004 was $837 million and $1.786 billion, respectively, representing a $160 million and $413 million increase over the same periods in 2003. Approximately $87 million and $193 million of the increase in the quarter and year-to-date, respectively, reflects the acquisitions the Company made in Spain, Portugal, and Thailand. An additional $38 million and $120 million of the increase in the quarter and year-to-date, respectively, reflects organic growth from the Company's operations in Venezuela, Brazil and Spain. Partially offsetting these increases was the sale of the Company's Canadian health business in July 2003, which accounted for $78 million and $143 million of net written premiums in the quarter and year-to-date respectively. The remainder of the increase in both periods reflects growth in the Company's Lloyd's operations and net new business growth in other lines. Net written premium related to the Company's Lloyd's Syndicates increased $110 million and $188 million in the quarter and year-to-date, respectively.

(2) Results of Operations – International

$ in Millions	Three Months Ended June 30, 2004	2003	Change	Six Months Ended June 30, 2004	2003	Change
Revenues	$891	$716	24.4%	$1,780	$1,333	33.5%
PTOI before catastrophes and incurred attributable to prior years	$ 87	$ 42	107.1%	$ 196	$ 94	108.5%
Catastrophes:						
- Natural	-	-	-	-	-	-
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other [1]	13	(30)	(143.3)	(25)	(52)	(51.9)
Discount accretion	-	-	-	-	-	-
Pre-tax operating income	100	12	NM	171	42	NM
Realized investment gains (losses), net	11	2	NM	11	(12)	NM
Federal and foreign income tax expense	(22)	(18)	22.2	(43)	(31)	38.7
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$89	$ (4)	NM	$139	$ (1)	NM

[1] Net of earned premium attributable to prior years of $3 million and $6 million for the three and six months ended June 30, 2004, respectively; $5 million and $12 million for the comparable periods of 2003.

NM = Not Meaningful

Revenues for the three and six months ended June 30, 2004 were $891 million and $1,780 million, respectively, representing a $175 million and $447 million increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three and six months ended June 30, 2004 was $795 million and $1.599 billion, respectively, representing a $146 million and $372 million increase over the same periods in 2003. Approximately $80 million and $178 million of the increase in the quarter and year-to-date, respectively, reflects the acquisitions the Company made in Spain, Portugal, and Thailand. An additional $30 million and $81 million of the increase in the quarter and year-to-date, respectively, reflects organic growth from the Company's operations in Venezuela, Brazil and Spain. Partially offsetting these increases was the sale of the Company's Canadian health business in July 2003, which accounted for $75 million and $142 million of net premium earned in the quarter and year-to-date, respectively. The remainder of the increase in both periods reflects growth in the Company's Lloyd's operations and net new business growth in other lines. Net premium earned related to the Company's Lloyd's Syndicates increased $81 million and $167 million in the quarter and year-to-date, respectively.

Net investment income for the three and six months ended June 30, 2004 was $78 million and $155 million, respectively, representing a $23 million and $53 million increase over the same periods in 2003. Approximately $10 million and $24 million of the increase in the quarter and year-to-date, respectively, was due to acquisition activity. The balance of the increase in both periods reflects an increase in invested assets due to improved cash flow from operations.

Net realized investment gains for the three and six months ended June 30, 2004 were $11 million representing a $9 million and $23 million increase, respectively, over the same periods in 2003. Net realized investment gains in the first half of 2004 reflect normal trading activity while the net realized investment loss in the first half of 2003 reflect actions taken by the Company to realign and reduce the risk of holding certain asset classes at its United Kingdom and Venezuela operations.

Fee and other revenues for the three and six months ended June 30, 2004 were $7 million and $15 million, respectively, representing a $3 million and $1 million decrease over the same periods in 2003. The decrease in fees and other revenues in both periods was related to the sale of the Company's Canadian health business partially offset by an increase in premium financing activity in the personal insurance lines of business.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $780 million and $1.598 billion, respectively, representing a $78 million and $295 million increase over the same periods in 2003. Approximately $79 million and $182 million of the increase in the quarter and year-to-date, respectively, reflects the acquisitions the Company made in Spain, Portugal, and Thailand. An additional $11 million and $66 million of the increase in the quarter and year-to-date, respectively, reflects organic growth from the Company's operations in Venezuela, Brazil and Spain. Partially offsetting this increase was the sale of the Company's Canadian health business in July of 2003, which accounted for $71 million and $138 million of claims, benefits and expenses in the quarter and year-to-date, respectively. The remainder of the increase in both periods reflects growth in the Company's Lloyd's operations, net new business growth in other lines, and general cost increases. Claims, benefits and expenses related to the Company's Lloyd's Syndicates increased $74 million and $153 million in the quarter and year-to-date, respectively.

	Three Months Ended June 30,			Six Months Ended June 30,		
INTERNATIONAL	**2004**	**2003**	**Change (Points)**	**2004**	**2003**	**Change (Points)**
Combined ratio before catastrophes and incurred attributable to prior years						
Claims and claim adjustment expense ratio	67.5%	69.5%	(2.0)	66.7%	68.9%	(2.2)
Underwriting expense ratio	28.9	28.5	0.4	29.2	28.4	0.8
Dividend ratio	-	-	-	-	-	-
Subtotal	96.4	98.0	(1.6)	95.9	97.3	(1.4)
Catastrophes:						
- Natural	-	-	-	-	-	-
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	(1.7)	4.8	(6.5)	1.6	4.4	(2.8)
Discount accretion	-	-	-	-	-	-
Total combined ratio	94.7%	102.8%	(8.1)	97.5%	101.7%	(4.2)

International's combined ratio for the three and six months ended June 30, 2004 was 94.7% and 97.5%, respectively, representing an 8.1 percentage point and 4.2 percentage point improvement over the same periods in 2003. Approximately 2.0 percentage points and 2.2 percentage points of the improvement in the quarter and year-to-date, respectively, reflects the favorable impact of underwriting and pricing actions. There was an additional 6.5 percentage point and 2.8 percentage point improvement in the quarter and year-to-date, respectively, due to reduced net incurred losses attributable to prior years. Favorable development of net incurred losses attributable to prior years in the current quarter was primarily related to the automobile line in Spain. Partially offsetting these favorable trends was an increase in the underwriting expense ratio of 0.4 percentage points and 0.8 percentage points in the quarter and year-to-date, respectively, related primarily to increased reinsurance and marketing costs.

PTOI for the three and six months ended June 30, 2004 was $100 million and $171 million, respectively, representing an $88 million and $129 million increase over the same periods in 2003. Federal and foreign income taxes reflect volatility associated with different tax structures within countries in which the International segment operates and also reflect net reductions of the deferred tax asset valuation allowance. Federal and foreign income taxes for the three and six months ended June 30, 2004 were $22 million and $43 million, respectively, representing a $4 million and $12 million increase over the same periods in 2003.

Net income for the three and six months ended June 30, 2004 was $89 million and $139 million, respectively, representing a $93 million and $140 million increase over the same periods in 2003.

CORPORATE and OTHER

(1) Overview – Corporate and Other

Corporate and other includes the following significant items:

- Individual Life, which provides life insurance and annuities for individuals and also issues structured settlement contracts and administers separate account contracts. Individual Life is licensed and sells its products in all 50 states, the District of Columbia and Canada.
- Discontinued operations, which is composed of the Company's asbestos, environmental, and toxic tort exposure and other internal discontinued operations, primarily the run-off of the California workers' compensation business of Golden Eagle Insurance Corporation ("Golden Eagle").
- Interest expense on the Company's outstanding debt and gain or loss on extinguishment of debt.
- Certain internal reinsurance programs.
- Costs associated with certain long-term compensation plans, and other corporate costs not allocated to the business units. For presentation in this Management's Discussion and Analysis, domestic property and casualty operations' investment income was allocated based upon planned ordinary investment income returns by investment type allocated to the strategic business units. For the Company's internal reporting purposes, investments are allocated as follows: fixed income equal to liabilities net of insurance assets (reinsurance, premiums receivable, etc.) and a combination of fixed income, equity and nontraditional investments supporting allocated statutory policyholders' surplus. For internal reporting purposes, the Company allocates expected long-term returns on invested assets, including realized investment gains. Under this internal reporting view, the difference between actual investment income and allocated investment income is included in Corporate and Other.
- Federal and foreign income taxes, which represent the difference between the consolidated income tax expense and the amounts recognized by the Personal, Commercial, RAM, and International segments. Domestic operations included in the segments reflect income tax at the 35% marginal Federal tax rate, while the International segment reflects the actual tax expense of each country.

(2) Results of Operations – Corporate and Other

	Three Months Ended June 30,			Six Months Ended June 30,		
$ in Millions	**2004**	**2003**	**Change**	**2004**	**2003**	**Change**
Revenues	$232	$334	(30.5%)	$493	$457	7.9%
PTOI before catastrophes and incurred attributable to prior years	$ (24)	$ (53)	54.7%	$ (58)	$ (95)	38.9%
Catastrophes:						
- Natural	-	-	-	-	-	-
- September 11, 2001	-	-	-	-	-	-
Net incurred attributable to prior years:						
- Asbestos	(4)	(23)	(82.6)	(4)	(69)	(94.2)
- All other	(41)	(31)	32.3	(93)	(36)	158.3
Discount accretion[1]	(3)	-	NM	(6)	-	NM
Pre-tax operating income	(72)	(107)	32.7	(161)	(200)	19.5
Realized investment gains (losses), net	26	144	(81.9)	85	84	1.2
Federal and foreign income tax benefit	138	42	NM	244	107	128.0
Discontinued operations, net of tax	-	-	-	1	-	NM
Net income (loss)	$ 92	$ 79	16.5%	$169	$ (9)	NM

[1] The Company discounts the long-term indemnity portion of its workers' compensation claims as permitted by insurance regulations. The discount accretion on these claims flows through underwriting results as the loss reserves accrete to nominal value. Asbestos settlements are discounted at 4.5%.
NM = Not Meaningful

Revenues for the three and six months ended June 30, 2004 were $232 million and $493 million, respectively, representing a $102 million decrease and $36 million increase over the same periods in 2003. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses and fee and other revenue.

Net premium earned for the three and six months ended June 30, 2004 was $47 million and $93 million, respectively, representing a $14 million and $35 million decrease over the same periods in 2003. The decrease in both periods reflects a decline in structured settlement sales.

Net investment income for the three and six months ended June 30, 2004 was $129 million and $247 million, respectively, representing a $24 million and $53 million increase over the same periods in 2003. The improvement in net investment income was primarily due to improved limited partnership gains of $32 million and $70 million in the quarter and year-to-date, respectively, as well as improved cash flow from operations in both periods. Partially offsetting the increase in net investment income were lower yields on fixed maturities as compared to 2003.

Realized investment gains for the three and six months ended June 30, 2004 were $26 million and $85 million, respectively, representing a $118 million decrease and $1 million increase over the same periods in 2003. The decrease in the quarter reflects lower net realized gains of $44 million and $64 million from fixed maturities and equities, respectively.

Claims, benefits and expenses for the three and six months ended June 30, 2004 were $278 million and $569 million, respectively, representing a $19 million and $4 million decrease over the same periods in 2003. The declines in both periods were primarily due to lower structured settlement sales. Incurred losses attributable to prior years decreased $6 million and $2 million in the quarter and year-to-date, respectively. In 2004, incurred losses attributable to prior years were primarily related to other liability lines and the workers' compensation business of Golden Eagle. In 2003, incurred losses attributable to prior years were primarily related to asbestos and the workers' compensation business of Golden Eagle. Additionally, interest expense increased $15 million and $24 million, in the quarter and year-to-date respectively, due to LMGI's $750 million senior debt issuance in March of 2004 and the tender of approximately $129 million of surplus notes in April of 2004. The Company recognized a $19 million loss from the early extinguishment of debt in the three months ended June 30, 2004. Higher interest expense and the loss on the extinguishment of debt were offset by lower expenses in the second quarter.

Federal and foreign income tax benefit for the three and six months ended June 30, 2004 was $138 million and $244 million, respectively, representing a $96 million and $137 million increase over the same periods in 2003. The Company's improved operating performance has allowed the Company to lower its tax valuation allowance, thereby reducing its effective tax rate to 0% and 16% in the six months ended June 30, 2004 and 2003, respectively. The valuation allowance was $570 million and $800 million as of June 30, 2004 and December 31, 2003, respectively.

Net income for the three and six months ended June 30, 2004 was $92 million and $169 million, respectively, representing a $13 million and $178 million increase over the same periods in 2003. The year-to-date increase in net income was primarily due to a $36 million increase in revenue and $137 million increase in Federal income tax benefits.

INVESTMENTS

General

The Company's investment strategy seeks long-term returns through disciplined security selection, portfolio diversity and an integrated approach to risk management. The Company selects and monitors investments to balance the goals of safety, stability, liquidity, growth and after-tax total return with its need to comply with regulatory investment requirements. Diversity is achieved by maintaining a broadly based portfolio composed primarily of higher quality bonds, common stocks and limited partnerships (largely venture capital and leveraged buyout funds). These core holdings are supplemented by investments in additional asset types with the objective of further enhancing the portfolio's diversification and expected returns. These additional assets types include non-investment-grade bonds, foreign securities, limited partnerships including co-investments and direct investments in oil and gas ventures. Risk management is accomplished through asset liability management (including both interest rate risk and foreign currency risk), diversification, credit limits and careful analytic review of each investment decision.

The Company's policy and strategy are reviewed and approved by the Investment Committee of its Board of Directors. The Investment Committee meets regularly to review investment activities and tactics. The Company has an experienced investment staff that is responsible for managing and administering the investment portfolios of its domestic and foreign insurance operations.

Invested Assets

The following table summarizes the Company's invested assets by asset category at June 30, 2004 and December 31, 2003:

$ in Millions	**As of June 30, 2004**		**As of December 31, 2003**	
Invested Assets by Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$33,033	90.7%	$32,287	90.8%
Equity securities, available for sale, at fair value	1,481	4.1	1,346	3.8
Trading securities, at fair value	409	1.1	208	0.6
Other investments (see table below)	860	2.4	768	2.2
Short-term investments	625	1.7	940	2.6
Total invested assets	$36,408	100.0%	$35,549	100.0%
Other Investments, at carrying value				
Limited partnerships (excluding Liberty Energy)	$658	76.5%	$564	73.4%
Liberty Energy limited partnerships	83	9.7	108	14.1
Other investments	119	13.8	96	12.5
Total other investments	$860	100.0%	$768	100.0%

Invested assets increased $859 million in the first six months of 2004 to $36.408 billion from $35.549 billion at December 31, 2003. The increase in invested assets was primarily attributable to strong cash flow from operations of $1.553 billion, approximately $600 million of assets, net of the purchase price, acquired in the Spain acquisition, and $500 million of proceeds from LMGI's March 23, 2004 debt offering. This was partially offset by a $371 million reduction in invested assets associated with the sale of the Canadian personal lines business, and a net decrease of approximately $365 million in forward purchase agreements (primarily on mortgage-backed securities). Also affecting the increase was a decline in the market value of fixed maturities associated with the overall increase in market yields.

The Company's investments in limited partnerships are long-term in nature and highly illiquid. The Company makes allocations to these investments because the Company believes that they offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio. As of June 30, 2004, the Company had unfunded energy and non-energy commitments of $142 million and $533 million, respectively.

As of June 30, 2004, no single issuer accounted for more than 1.57% of invested assets.

The following tables summarizes the Company's fixed income portfolio by security type, credit quality and maturity as of June 30, 2004 and December 31, 2003:

$ in Millions	**As of June 30, 2004**		**As of December 31, 2003**	
Fixed Maturities by Security Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
U.S. Treasury securities	$ 2,300	7.0%	$ 2,717	8.4%
Mortgage and asset-backed securities of government and corporate agencies	11,750	35.6	11,499	35.6
State and municipal	1,352	4.1	1,250	3.9
Corporate and other	17,631	53.3	16,821	52.1
Total fixed maturities	$33,033	100.0%	$ 32,287	100.0%

Fixed maturities increased $746 million from December 31, 2003. The increase reflects the acquisition in Spain and an increase in cash available to invest, including proceeds related to the Company's first quarter debt issuance. This increase was partially offset by the sale of the Canadian personal lines business, the decrease in forward purchase activity and the decline in market values associated with the overall increase in market yields.

During the first half of 2004, the Company reduced its allocation to U.S. Treasuries from 8.4% to 7.0%. This was offset by a 1.2% increase in the allocation to Corporate and other bonds and by a 0.2% increase in State and municipal bonds.

$ in Millions		**As of June 30, 2004**		**As of December 31, 2003**	
Fixed Maturities by Credit Quality	**NAIC Designation**	**Market Value**	**% of Total**	**Market Value**	**% of Total**
A- or higher	1	$ 26,908	81.5%	$26,912	83.4%
BBB- to BBB+	2	3,795	11.5	3,084	9.5
BB- to BB+	3	967	2.9	1,039	3.2
B- to B+	4	1,096	3.3	988	3.1
CCC or lower	5	266	0.8	253	0.8
In or near default	6	1	0.0	11	0.0
Total fixed maturities		$ 33,033	100.0%	$32,287	100.0%

The Company increased its allocation of investment grade bonds to 93.0% at June 30, 2004 from 92.9% at December 31, 2003. The Company defines an investment grade bond as a security with a rating designation from the National Association of Insurance Commissioners (NAIC) of Class 1 or Class 2. The Class 1 designation is equivalent to the Standard & Poor's rating of A- or higher. The Class 2 designation is equivalent to the Standard & Poor's BBB rating category. Within the investment grade sector, the Company increased its allocation to NAIC 2s by 2.0% during the first half of 2004. This was primarily offset by a 1.9% reduction in NAIC 1s from 83.4% to 81.5%.

The remaining 7.0% of the Company's investment in fixed maturities are rated below investment grade. The Company's investment in below investment grade securities consists of two main components: (1) a diversified portfolio of high yield bonds within the domestic insurance portfolios and (2) investments in individual emerging market sovereigns that support the Company's international insurance companies located in Argentina, Colombia and Venezuela.

$ in Millions	As of June 30, 2004		As of December 31, 2003	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$ 708	2.1%	$ 877	2.7%
Over 1yr through 5yrs	5,138	15.6	4,985	15.4
Over 5yrs through 10yrs	7,478	22.6	7,086	22.0
Over ten years	7,959	24.1	7,840	24.3
Mortgage and asset backed securities	11,750	35.6	11,499	35.6
Total fixed maturities	$33,033	100.0%	$32,287	100.0%

During the first half of 2004, the Company left the average life of its fixed maturity portfolio relatively unchanged after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment.

Net Investment Income

The following table summarizes the Company's second quarter and year-to-date net investment income at June 30, 2004 and June 30, 2003:

$ in Millions	Three Months Ended June 30,		Six Months Ended June 30,	
Net Investment Income	**2004**	**2003**	**2004**	**2003**
Interest income	$492	$444	$962	$867
Dividends	27	17	48	35
Limited partnerships	19	(13)	47	(23)
Other investment income	1	-	2	1
Gross investment income	539	448	1,059	880
Investment expenses	(19)	(10)	(37)	(28)
Net investment income	$520	$438	$1,022	$852

Net investment income for the three months and six months ended June 30, 2004 was $520 million and $1.022 billion, respectively, representing an $82 million and $170 million increase over the same periods in 2003. The $48 million and $95 million increase in interest income in the quarter and year-to-date, respectively, reflects the increase in income-bearing fixed maturity assets during the period as a result of improved cash flow and acquisition activity. The balance of the increase in both periods came from the Company's investments in limited partnerships. Income from limited partnerships increased $32 million and $70 million in the quarter and year-to-date, respectively. Partially offsetting the increase in invested assets in both periods was the lower interest rate environment.

Net Realized Investment Gains

The following table summarizes the Company's second quarter and year-to-date net realized investment gains (losses) at June 30, 2004 and June 30, 2003:

$ in Millions **Net Realized Investment Gains**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended June 30, 2004:				
Fixed maturities	$ 59	$ -	$ -	$ 59
Common and preferred stock	(5)	(15)	-	(20)
Other	(2)	-	-	(2)
Total	$ 52	$(15)	$ -	$ 37
Three Months Ended June 30, 2003:				
Fixed maturities	$ 98	$ (3)	$ -	$ 95
Common and preferred stock	59	(7)	3	55
Other	(2)	-	-	(2)
Total	$155	$(10)	$ 3	$148
Six Months Ended June 30, 2004:				
Fixed maturities	$115	$(5)	$ -	$110
Common and preferred stock	21	(24)	(8)	(11)
Other	(5)	-	-	(5)
Total	$131	$(29)	$ (8)	$ 94
Six Months Ended June 30, 2003:				
Fixed maturities	$ 77	$(19)	$ -	$ 58
Common and preferred stock	31	(18)	3	16
Other	-	-	-	-
Total	$108	$(37)	$ 3	$ 74

$ in Millions	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
Components of Net Realized Investment Gains	**2004**	**2003**	**2004**	**2003**
Fixed maturities:				
Gross realized gains	$ 73	$ 95	$139	$128
Gross realized losses	(14)	-	(29)	(70)
Equities:				
Gross realized gains	22	64	48	73
Gross realized losses	(42)	(9)	(59)	(57)
Other:				
Gross realized gains	1	-	1	2
Gross realized losses	(3)	(2)	(6)	(2)
Total investments	$ 37	$148	$ 94	$ 74

Net realized investment gains for the three months and six months ended June 30, 2004 were $37 million and $94 million, respectively, representing a $111 million decrease and $20 million increase over the same periods in 2003. The Company realized $39 million and $99 million of gains from the sale of fixed maturities and equities in the quarter and year-to-date, respectively, compared to $150 million and $74 million in the same periods a year ago. Included in the 2004 amounts were $15 million and $29 million of impairment losses for the quarter and year-to-date, respectively.

LIQUIDITY AND CAPITAL RESOURCES

General

The liquidity requirements of the insurance subsidiaries are met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims, claim adjustment expenses and operating expenses (underwriting and corporate benefit costs). There are certain cash outflows such as catastrophes and continued settlements of asbestos reserves that are unpredictable in nature and could create increased liquidity needs. The Company believes that the insurance subsidiaries' future business liquidity needs will be met from all the above sources.

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. For ongoing business, the Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of June 30, 2004 totaled $36.408 billion.

Short-term debt outstanding at June 30, 2004 and December 31, 2003 was as follows:

$ in Millions	**As of June 30, 2004**	**As of December 31, 2003**
Commercial Paper	$126	$ 84
Revolving Credit Facilities	19	22
Medium Term Notes, maturing within one year	61	-
Total short-term debt	$206	$106

Long-term debt outstanding at June 30, 2004 and December 31, 2003 was as follows:

$ in Millions	**As of June 30, 2004**	**As of December 31, 2003**
8.20% Surplus Notes, due 2007	$ 121	$250
6.75% Notes, due 2008	15	15
5.00% Prudential Notes due 2008	30	30
7.00% Prudential Notes—Series A due 2008	-	130
8.00% Prudential 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	27	88
Subtotal	2,106	1,676
Unamortized discount	(15)	(8)
Total long-term debt excluding current maturities	$2,091	$1,668

The Company issues commercial paper from Liberty Mutual Capital Corporation (Boston), a subsidiary of LMIC, to meet short-term operating cash flow needs. The total amount authorized for this program is $600 million and the program is backed by a $450 million 364-day revolving credit facility. To date, no funds have been borrowed under the revolving credit facility.

The Company also has a Venezuelan subsidiary, Inversora Segucar, C.A., which has entered into a revolving credit facility to provide liquidity for working capital purposes. Inversora Segucar also has short-term loans outstanding. As of June 30, 2004, total short-term loans and borrowings under the Venezuelan credit facility were approximately $19 million.

The $430 million increase in long-term debt outstanding before the unamortized discount is the result of the March 23, 2004 offering whereby LMGI issued $750 million of senior notes. Approximately $277 million of the net proceeds were used to retire existing financing obligations.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its subsidiaries. This means that the Company depends on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. The subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of June 30, 2004, the Company through its downstream subsidiary LMGI had $1.157 billion of debt outstanding.

In addition, the ability of the Company's insurance subsidiaries (the "Insurance Subsidiaries") to pay dividends is restricted under applicable insurance law and regulations. Under the insurance laws of the domiciliary states of the Insurance Subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC and LMFIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Therefore, without regulatory approval, LMIC could pay a maximum of $612 million in dividends to the Company in 2004. Because LMFIC paid a dividend of approximately $283 million to LMGI on December 8, 2003, LMFIC cannot pay dividends to the Company prior to December 8, 2004, but could pay a maximum of $73 million in dividends to LMGI during the period between December 8 and December 31, 2004. Under the insurance laws of Wisconsin, the domiciliary state of EICOW, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Therefore, EICOW could pay a maximum of $7 million in dividends to the Company in 2004 without regulatory approval. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC and EICOW could negatively affect LMGI's ability to pay principal and interest on the Notes. Additionally, in connection with the Company's reorganization in 2001 into a mutual holding company structure, the Company entered into Keep Well Agreements with the Massachusetts Commissioner of Insurance, LMIC, LMFIC and certain other affiliates which effectively limit LMIC and LMFIC from paying any dividends to The Company when the "total adjusted capital" of the respective insurer is below 300% of the "authorized control level," as such terms are defined in the Massachusetts risk-based capital regulations as of June 13, 2001. The Keep Well Agreements will terminate automatically upon the earlier of (i) the date that is five years from the effective date of the respective reorganization (November 28, 2006 as to LMIC and March 19, 2007 as to LMFIC), or (ii) the date upon which the Company, the respective insurer or LMHC Massachusetts Holdings Inc. becomes subject to the public reporting requirements of the SEC. At December 31, 2003, LMIC and LMFIC were above 300% of the "authorized control level."

The principal service businesses of the subsidiaries of Liberty Corporate Services LLC ("Corporate Services") are claims administration and agency services for affiliated insurance entities as well as for third party customers. Management expects Corporate Services could pay dividends of over $100 million to the Company in 2004.

In summary, the estimated dividend capacity of the Company's subsidiaries for 2004 not subject to regulatory approval is approximately $792 million.

Statutory Surplus

Statutory surplus as regards the policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $7.829 billion and $7.216 billion at June 30, 2004 and December 31, 2003, respectively. The increase in surplus in the first six months of 2004 reflects $207 million of net income and $688 million of capital contributions, of which $148 million was used to retire surplus notes. Partially offsetting this increase was $118 million of unrealized affiliated capital losses for non-admitted statutory goodwill relating to the Company's acquisition of Genesis Seguros Generales, S.A. and its subsidiary Seguros Genesis S.A. (collectively, "Genesis"), foreign exchange losses and higher deferred commission expense due to growth in the Company's International operations.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company 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:

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and recoverables on premium attributable to prior years;
- reinsurance recoverables, including bad debt provision;
- impairments to the fair value of the investment portfolio;
- the valuation of goodwill;
- deferred acquisition costs; and
- deferred income tax valuation allowance.

While the Company believes the amounts included in the consolidated financial statements reflect best estimates and appropriate assumptions, these amounts could ultimately be materially different from the amounts currently provided for in the consolidated financial statements.

Certain reclassifications have been made to the 2003 tables to conform to the 2004 tables.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $32.151 billion and $30.597 billion at June 30, 2004 and December 31, 2003, respectively. The increase was due to growth less the on-going settlement of claims and incurred losses attributable to prior years including discount accretion. For the three and six months ended June 30, 2004 and 2003, incurred losses attributable to prior years including discount accretion were $99 million and $247 million, respectively, compared to $206 million and $338 million for the same periods in 2003.

Property-casualty insurance unpaid claims and claim adjustment expenses represent the Company's best estimate of amounts necessary to settle all outstanding claims, including claims that are incurred but not reported as of the reporting date. The Company's reserve projections are based primarily on detailed analysis of the facts in each case, experience with similar cases and various historical development patterns. Consideration is given to such historical patterns as field reserving trends and claims settlement practices, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes. All of these factors can affect the estimation of reserves.

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 litigated cases, medical costs, and cost of repair materials and labor rates can all affect ultimate claim costs. In addition, the span of time between the incidence of a loss and the payment or settlement of the claim can be a critical part of reserving determinations and will cause more variability in the ultimate claim cost. 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 in some cases, 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.

Asbestos and Environmental

The Company's asbestos and environmental reserves for unpaid claims and claim adjustment expenses were $1.413 billion and $1.441 billion at June 30, 2004 and December 31, 2003, respectively, net of reinsurance and including the related allowance for doubtful accounts.

Some of the Company's loss reserves are for asbestos and environmental claims and related litigation. While the estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties, the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding asbestos and environmental related claims could result in liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

Reinsurance Recoverables

The Company reported reinsurance recoverables of $13.290 billion and $12.227 billion at June 30, 2004 and December 31, 2003, respectively, net of allowance for doubtful accounts of $308 million and $306 million, respectively. The majority of the increase in the first six months was due to an increase in reinsurance recoverables from Nationwide Indemnity Co. and the state mandated involuntary pools and associations.

The reinsurance recoverables from Nationwide Indemnity Co. have been fully guaranteed by its parent, Nationwide Mutual Insurance Co., which has a financial strength rating of A+ from Standard & Poor's and Aa3 from Moody's Investors Service. The reinsurance recoverables from state mandated involuntary pools and associations represent the Company's servicing carrier business. As a servicing carrier, the Company retains no direct underwriting risk but instead cedes 100% of the involuntary market premium and losses back to the pool. Payment of losses is shared by the pool participants in proportion to their pool participation. Credit risk with respect to any given pool or association is the composite of the cumulative creditworthiness of all participants.

As part of its reinsurance security oversight, the Company has established a Standing Reinsurance Credit Committee (SRC) that meets quarterly to monitor and review the credit quality of the existing reinsurance portfolio, discuss emerging trends in the reinsurance marketplace and ensure that the current portfolio of reinsurance is in compliance with the committee's security standards. The SRC is directly responsible for establishing the rating, collateral and diversification requirements governing the Company's purchase and use of reinsurance.

Approximately 93% of the Company's reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at June 30, 2004. Collateral held against outstanding reinsurance recoverables balances was $3.6 billion and $3.3 billion at June 30, 2004 and December 31, 2003, 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 income statement charges.

Impairment Losses on Investments

Total impairment losses on investments for the three and six months ended June 30, 2004 were $15 million and $29 million, respectively. Management regularly reviews the Company's fixed maturity and equity portfolios to evaluate the necessity of recording impairment losses for other than temporary declines in the fair value of investments. A number of criteria are considered during this process, including the length of time and the extent to which the fair value has been below cost, the financial condition and near-term prospects of the issuer and the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. Other-than-temporary impairment losses result in a reduction of the cost basis of the underlying investment.

Significant changes in the factors the Company considers when evaluating investments for impairment losses and/or a material change in prevailing market levels for bonds and stocks could result in a significant change in impairment losses reported in the consolidated financial statements.

Goodwill & Intangibles

Goodwill and intangible assets were $859 million and $762 million at June 30, 2004 and December 31, 2003, respectively. The majority of the increase was related to the Company's acquisition of Genesis on January 9, 2004.

Deferred Policy Acquisition Costs

Total deferred policy acquisition costs were $1.303 billion and $1.104 billion as of June 30, 2004 and December 31, 2003, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses.

Deferred Income Taxes

The net deferred income tax asset was $1.296 billion and $860 million as of June 30, 2004 and December 31, 2003, respectively, net of a valuation allowance of $570 million and $800 million, respectively. The increase reflects a significant decrease in unrealized investment gains and other changes to accumulated other comprehensive income, and a decrease in the tax valuation allowance. Partially offsetting this increase is a deferred tax expense related to operating activities.

The income tax provision is calculated under the liability method. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax bases of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are unrealized capital gains and losses on certain investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs and employee benefits.

The Company provides for Federal and foreign income taxes based on amounts that it believes it ultimately will owe. Inherent in the provision for Federal and foreign income taxes are estimates regarding the deductibility of certain expenses and the realization of certain tax credits. In the event the ultimate deductibility of certain expenses or the realization of certain tax credits differs from estimates, the Company may be required to significantly change the provision for Federal and foreign income taxes recorded in the consolidated financial statements.

About Liberty Mutual Holding Company Inc. and its affiliates

Boston-based Liberty Mutual Holding Company Inc. ("LMG") is a leading global insurer and sixth largest property and casualty insurer in the U.S. whose largest line of business is personal auto based on 2003 direct written premium. As of December 31, 2003, LMG had $64.4 billion in consolidated assets and $16.6 billion in annual consolidated revenue and ranked 116th on the Fortune 500 list of largest corporations in the United States for 2003.

In 2001 and 2002 LMG reorganized into a mutual holding company structure. The three principal mutual companies of the group, Liberty Mutual Insurance Company, Liberty Mutual Fire Insurance Company and Employers Insurance Company of Wausau, each became separate stock insurance companies under the indirect ownership of Liberty Mutual Holding Company Inc. This structure provides LMG with better capital market access and greater strategic flexibility to pursue acquisitions and alliances, while aligning its legal structure with its operating structure and preserving mutuality.

LMG offers a wide range of insurance products and services, including personal automobile, homeowners, workers' compensation, commercial multiple peril, commercial automobile, general liability, global specialty, group disability, assumed reinsurance, fire and surety.

LMG employs nearly 38,000 people in nearly 900 offices throughout the world.

The Company has five reporting segments: Commercial Markets; Personal Market; Regional Agency Markets (RAM); International; and Corporate and Other (which includes Individual Life Products). For a full description of the Company's business operations, products and distribution channels please visit the Company's investor relations web site at www.libertymutual.com/investors.