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

Quarter Ended March 31, 2005

Management's Discussion & 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 parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three months ended March 31, 2005 and 2004. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's Annual Report, First Quarter 2005 Consolidated Financial Statements and First Quarter 2005 Financial Supplement (unaudited) located on the Company's 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.

Index

Cautionary Statement Regarding 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 results or other consequences from legal proceedings; the impact of regulatory investigations or reforms, including governmental actions regarding the compensation of brokers and agents and the sale of nontraditional products and related disclosures; unusual loss activity resulting from adverse weather conditions, including storms, hurricanes, hail, snowfall and winter conditions; the tax impact of the repatriation of foreign earnings; 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. For a detailed discussion of these and other cautionary statements, visit the Company's Investor Relations web site at www.libertymutual.com/investors. 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 & 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 & Analysis of Financial Condition and Results of Operations.

Three Months Ended March 31, 2005 - Consolidated Results of Operations

- Revenues for the three months ended March 31, 2005 were $4.971 billion, a $267 million or 5.7% increase over the same period in 2004.

- Net income for the three months ended March 31, 2005 was $396 million, a $112 million or 39.4% improvement over the same period in 2004.

- Cash flow from operations for the three months ended March 31, 2005 was $858 million, a $9 million or 1.1% increase from the same period in 2004.

- The combined ratio before catastrophes[1], net incurred losses attributable to prior years[2] and discount accretion for the three months ended March 31, 2005 was 96.9%, a 2.0 point improvement over the same period in 2004. Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the Company's combined ratio improved 4.2 points to 99.1% in 2005.

Financial Condition as of March 31, 2005

- Total assets increased to $74.146 billion as of March 31, 2005, a $1.787 billion or 2.5% increase over December 31, 2004.

- Policyholders' equity as of March 31, 2005 was $8.719 billion, a $22 million increase over December 31, 2004.

- Net unrealized gains on fixed maturities as of March 31, 2005 were $741 million, a $581 million or 43.9% decline from December 31, 2004.

- Statutory surplus as regards policyholders for the combined operations of Liberty Mutual Insurance Company ("LMIC") and its U.S. affiliates including international branches was $9.538 billion, a $799 million or 9.1% increase over December 31, 2004.

- The consolidated debt to capital ratio including accumulated other comprehensive income ("AOCI") as of March 31, 2005 was 22.9%, a 1.8 point increase over December 31, 2004. Excluding AOCI, the consolidated debt to capital ratio was 24.9%, a 1.1 point increase over December 31, 2004.

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1 Catastrophes, net of reinstatement premium, exclude losses related to the Company's reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472 (formerly Lloyd's Syndicates 282 and 190)), except for losses related to Hurricanes Charley, Frances, Ivan and Jeanne ("four hurricanes") and September 11, 2001, which had a material impact on the Company's results.

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

Other 2005 1st Quarter Highlights

Rating Actions

- On February 16, 2005, Moody's Investors Service confirmed its A2 insurer financial strength rating on LMIC and its related property/casualty companies, Baa2 rating on LMIC's surplus notes and Baa3 rating on Liberty Mutual Group Inc.'s ("LMGI") senior unsecured notes. The outlook for all of these ratings remains negative. This announcement concluded a review by Moody's of the Company's ratings for possible downgrade that was initiated on August 13, 2004. For a detailed list of ratings, visit the Company's Investor Relations web site at www.libertymutual.com/investors.

Acquisitions

- On March 21, 2005, the Company announced its acquisition of the property casualty operations of ING Chile Seguros Generales. The transaction is expected to close in the second quarter of 2005. 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 March 22, 2005, LMGI issued $500 million of 6.50% unsecured senior notes due 2035. Approximately $266 million and $220 million of the proceeds from the offering were contributed to LMGI's wholly owned insurance subsidiaries, LMIC and Employers Insurance Company of Wausau ("EICOW"), respectively.

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 changes in accounting principles. 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, except that limited partnership results recognized on the equity method are not included in internal PTOI. 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 and 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 including reinsurance assumed, and audit and retrospectively rated premium related to loss sensitive policies less reinsurance ceded. In addition, the majority of workers compensation premium is adjusted to the "booked as billed" method through the Corporate & Other segment. "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 generally 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 March 31,		
$ in Millions	**2005**	**2004**	**Change**
Private passenger automobile	$1,325	$1,381	(4.1)%
Workers compensation	1,242	1,164	6.7
Commercial multiple peril / Fire	337	305	10.5
Homeowners	326	306	6.5
Commercial automobile	289	291	(0.7)
LIU[1] reinsurance	271	290	(6.6)
International local businesses [2]	206	182	13.2
General liability	187	200	(6.5)
LIU[1] third party	94	81	16.0
Group disability	85	82	3.7
LIU[1] first party	74	90	(17.8)
Surety	48	33	45.5
Assumed voluntary reinsurance	27	36	(25.0)
Other	146	129	13.2
Total net written premium	$4,657	$4,570	1.9%

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 March 31,		
$ in Millions	**2005**	**2004**	**Change**
Personal Market	$1,161	$1,246	(6.8)%
Commercial Markets	1,462	1,452	0.7
Regional Agency Markets	1,082	979	10.5
International	1,011	949	6.5
Corporate and Other	(59)	(56)	5.4
Total net written premium	$4,657	$4,570	1.9%

Net written premium for the three months ended March 31, 2005 was $4.657 billion, an $87 million or 1.9% increase over the same period in 2004. Significant changes include a $78 million increase in workers compensation net written premium due to stronger premium renewals from Regional Agency Market's ("RAM") Florida specialty workers compensation company, Summit Holdings Southeast Inc. and affiliates ("Summit"), and new business growth and higher audit and retrospectively rated policy premium from the Company's Commercial Markets segment. In addition, commercial multiple peril / fire net written premium increased $32 million, primarily due to strong premium renewals and new business growth in RAM. Net written premium for International's local businesses segment excluding private passenger automobile increased $24 million, over the same period in 2004 due to strong organic growth in the Company's European and Latin American local operations. Partially offsetting these increases was a decrease in private passenger automobile net written premium of $56 million, which reflects a $101 million decrease in Personal Market primarily due to the conversion of PruPac[1] six-month term auto policies to twelve-month term policies during 2004 and a $14 million decrease in RAM due to re-underwriting efforts, expanded rating tiers and active non-renewal of certain classes of business. These decreases in private passenger automobile net written premium were partially offset by a $59 million increase in International's local businesses operations. More detailed explanations of the changes in net written premium by line of business are included in the related discussion of financial results for each strategic business unit.

For a fuller 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.

[1] The Company acquired Prudential Financial Inc.'s U.S. personal lines property and casualty business ("PruPac") in the fourth quarter of 2003.

(2) Results of Operations – Consolidated

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$4,971	$4,704	5.7%
PTOI before catastrophes and incurred attributable to prior years	$476	$392	21.4%
Catastrophes[1]:			
- Four hurricanes 2004	(5)	-	NM
- September 11, 2001	-	-	-
- All other	(34)	(41)	(17.1)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- Pollution	-	-	-
- All other[2]	(29)	(102)	(71.6)
Discount accretion[3]	(24)	(24)	-
Pre-tax operating income	384	225	70.7
Realized investment gains, net	21	57	(63.2)
Federal and foreign income tax benefit	-	-	-
Discontinued operations, net of tax	(9)	2	NM
Extraordinary items, net of tax	-	-	-
Net income	$396	$284	39.4%

[1] The Company does not typically identify catastrophe losses from assumed reinsurance lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

[2] Net of earned premium attributable to prior years of $8 million and $20 million for the three months ended March 31, 2005 and 2004, respectively and amortization of deferred gains on retroactive reinsurance of $12 million and $11 million for the three months ended March 31, 2005 and 2004, respectively.

[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 structured settlements are discounted at 4.5%.

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

Revenues for the three months ended March 31, 2005 were $4.971 billion, a $267 million or 5.7% increase over the same period in 2004. 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 months ended March 31, 2005 was $4.205 billion, a $238 million or 6.0% increase over the same period in 2004. The increase reflects new business growth, a general improvement in retention levels on renewal business and earned rate increases across many of the Company's major segments.

Net investment income for the three months ended March 31, 2005 was $555 million, a $53 million or 10.6% increase over the same period in 2004. The improvement primarily reflects a $41 million increase in interest and dividend income and a $23 million increase in limited partnership income from both private equity and energy investments. The increase in interest and dividend income is primarily due to a higher invested asset base as the Company continues to achieve strong cash flow from operations across all business units, with cash flow from operations of over $4 billion over the past fifteen months. Partially offsetting these increases were lower investment yields and higher investment management expenses due to higher variable compensation expenses and fixed cost allocations.

Net realized investment gains for the three months ended March 31, 2005 were $21 million, a $36 million or 63.2% decrease from the same period in 2004. The decrease primarily reflects a decline in realized capital gains related to fixed maturities and equities, partially offset by a $13 million reduction in impairment losses from the comparable period in 2004.

Fee and other revenues for the three months ended March 31, 2005 were $190 million, a $12 million or 6.7% increase over the same period in 2004. The increase reflects higher fee revenues from the Company's involuntary market servicing carrier operations and other fee-related businesses.

Claims, benefits and expenses for the three months ended March 31, 2005 were $4.566 billion, a $144 million or 3.3% increase over the same period in 2004. Business growth and general cost increases, including higher interest expense and variable compensation expense, contributed to the increase. Partially offsetting these increases were a general improvement in current underwriting results and an $85 million decrease in incurred losses attributable to prior years[1].

	Three Months Ended March 31,		
CONSOLIDATED	**2005**	**2004**	**Change (Points)**
Combined ratio before catastrophes and net incurred attributable to prior years			
Claims and claim adjustment expense ratio	69.5%	72.6%	(3.1)
Underwriting expense ratio	27.3	26.0	1.3
Dividend ratio	0.1	0.3	(0.2)
Subtotal	96.9	98.9	(2.0)
Catastrophes[1]:			
- Four hurricanes 2004	0.1	-	0.1
- September 11, 2001	-	-	-
- All other	0.9	1.1	(0.2)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- Pollution	-	-	-
- All other	0.6	2.7	(2.1)
Discount accretion	0.6	0.6	-
Total combined ratio[2]	99.1%	103.3%	(4.2)

1 The Company does not typically identify catastrophe losses from assumed reinsurance lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

2 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 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 of the combined ratio. Prior periods have been restated to conform to the current presentation.

The consolidated combined ratio for the three months ended March 31, 2005 was 99.1%, a 4.2 point improvement over the same period in 2004. The improvement primarily reflects the favorable impact of underwriting and pricing actions taken and a 2.1 point improvement in net incurred losses attributable to prior years. Partially offsetting these improvements was a 1.3 point increase in the expense ratio, which was primarily due to an increase in expenses associated with variable compensation and other benefit plans and higher amortization of deferred acquisition costs in 2005 as compared to 2004 related to the PruPac acquisition. Upon acquisition, the PruPac deferred policy acquisition costs were written off against the negative goodwill, in accordance with GAAP accounting, which resulted in less amortization of deferred acquisition cost in 2004 as compared to 2005. The combined ratio before catastrophes, net incurred losses

1 Incurred losses attributable to prior years is defined as net incurred losses attributable to prior years gross of earned premium attributable to prior years and including discount accretion and amortization of retroactive reinsurance gain.

attributable to prior years and discount accretion was 96.9%, representing a 2.0 point improvement over 2004.

PTOI for the three months ended March 31, 2005 was $384 million, a $159 million or 70.7% increase over the same period in 2004. The Company recognized no Federal or foreign income tax expense during 2005 as it continues to reduce its deferred tax asset valuation allowance.

Net income for the three months ended March 31, 2005 was $396 million, a $112 million or 39.4% increase over the same period in 2004. Results from discontinued operations in 2005 reflect a loss on the disposal of certain pension business in Spain, which was a part of the acquisition of Genesis Seguros Generales, S.A. and its subsidiary Seguros Genesis S.A. (collectively, “Genesis”). Results from discontinued operations in 2004 primarily reflect a gain on the Company’s Canadian personal lines business, which was sold to Meloche Monnex Inc., a member of TD Bank Financial Group (“Meloche Monnex”), on April 1, 2004.

PERSONAL MARKET

(1) Overview – Personal Market

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

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Private passenger automobile	$865	$966	(10.5%)
Homeowners and other	296	280	5.7
Total net written premium	$1,161	$1,246	(6.8%)

Net written premium for the three months ended March 31, 2005 was $1.161 billion, a $85 million or 6.8% decrease from the same period in 2004. The decrease in net written premium is a result of the conversion of PruPac six-month term auto policies to twelve-month term policies during 2004, partially offset by modest rate increases.

Private passenger automobile net written premium for the three months ended March 31, 2005 was $865 million, a $101 million or 10.5% decrease from the same period in 2004. The decrease is related to the aforementioned PruPac policy conversion, partially offset by modest rate increases.

Homeowners and other net written premium for the three months ended March 31, 2005 was $296 million, a $16 million or 5.7% increase over the same period in 2004. The increase is primarily due to rate increases.

(2) Results of Operations – Personal Market

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$1,341	$1,319	1.7%
PTOI before catastrophes and incurred attributable to prior years	$189	$118	60.2%
Catastrophes:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	(27)	(30)	(10.0)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[1]	7	-	NM
Discount accretion	-	-	-
Pre-tax operating income[2]	169	88	92.0
Realized investment gains, net	-	-	-
Federal and foreign income tax expense	(59)	(31)	90.3
Discontinued operations, net of tax	-	1	(100.0)
Extraordinary items, net of tax	-	-	-
Net income	$110	$58	89.7%

1 Net of earned premium attributable to prior years of ($5) million for the three months ended March 31, 2005.

2 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

NM = Not meaningful

Revenues for the three months ended March 31, 2005 were $1.341 billion, a $22 million or 1.7% increase over the same period in 2004. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2005 was $1.257 billion, a $23 million or 1.9% increase over the same period in 2004. The increase is primarily due to rate increases.

Net investment income for the three months ended March 31, 2005 was $69 million, a $2 million or 2.8% decrease from the same period in 2004. The decrease was primarily due to lower investment yields partially offset by positive cash flow from operations.

Claims, benefits and expenses for the three months ended March 31, 2005 were $1.172 billion, a $59 million or 4.8% decrease from the same period in 2004. The primary drivers of the decrease were lower claim frequency trends in the auto and homeowners lines of business due in part to generally favorable weather, partially offset by higher policy acquisition expenses. The increase in acquisition expenses is a result of the purchase accounting associated with the acquisition of PruPac. Upon acquisition, the PruPac deferred policy acquisition costs were written off against the negative goodwill, in accordance with GAAP accounting, which resulted in less amortization of deferred acquisition cost in 2004 as compared to 2005. Favorable development attributable to prior years relates to business assumed from involuntary pools.

	Three Months Ended March 31,		
PERSONAL MARKET	**2005**	**2004**	**Change (Points)**
Combined ratio before catastrophes and net incurred attributable to prior years			
Claims and claim adjustment expense ratio[1]	68.3%	75.6%	(7.3)
Underwriting expense ratio[1]	21.9	20.4	1.5
Dividend ratio	-	-	-
Subtotal	90.2	96.0	(5.8)
Catastrophes:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	2.1	2.4	(0.3)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	(0.6)	-	(0.6)
Discount accretion	-	-	-
Total combined ratio[2]	91.7%	98.4%	(6.7%)

1 Personal Markets reclassified certain integration expenses in 2004 related to the PruPac acquisition between the claims and claim adjustment expense ratio and the underwriting expense ratio. The impact was a 0.6 point reclassification from the underwriting expense ratio to the claims and claims adjustment expense ratio.

2 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

Personal Market's combined ratio for the three months ended March 31, 2005 was 91.7%, a 6.7 point improvement over the same period in 2004. The improvement reflects the favorable impact of underwriting and pricing actions taken, a 0.3 point decrease in catastrophe losses, a 0.6 point improvement in net incurred losses attributable to prior years relating to business assumed from involuntary pools, partially offset by an increase in amortization of deferred policy acquisition costs. The combined ratio before catastrophes and net incurred losses attributable to prior years was 90.2%, a 5.8 point improvement over the same period in 2004.

PTOI for the three months ended March 31, 2005 was $169 million, $81 million or 92.0% higher than the same period in 2004. Consistent with the change in profitability, Personal Market's Federal and foreign income tax expense for the three months ended March 31, 2005 was $59 million, a $28 million or 90.3% increase over the same period in 2004.

Net income for the three months ended March 31, 2005 was $110 million, a $52 million or 89.7% increase over the same period in 2004. Results from discontinued operations primarily reflect the Company's Canadian personal lines business, which was 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 March 31,		
$ in Millions	**2005**	**2004**	**Change**
Business Market	$482	$468	3.0%
National Market	373	368	1.4
Wausau Commercial Market	358	339	5.6
Specialty Risks	95	76	25.0
Group Market	85	82	3.7
Other Markets	69	119	(42.0)
Total net written premium	$1,462	$1,452	0.7%

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

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Workers compensation	$934	$905	3.2%
Commercial automobile	147	163	(9.8)
General liability	135	148	(8.8)
Group disability / life	85	82	3.7
Commercial multiple peril / Fire	57	61	(6.6)
Surety	48	33	45.5
Assumed voluntary reinsurance	27	36	(25.0)
Other	29	24	20.8
Total net written premium	$1,462	$1,452	0.7%

Net written premium for the three months ended March 31, 2005 was $1.462 billion, a $10 million or 0.7% increase over the same period in 2004. The increase in workers compensation net written premium in 2005 reflects new business growth and recognition of additional audit and retrospectively rated policy premium in the Company's National Market, Business Market and Wausau Commercial Market segments. These increases were partially offset by lower assumed involuntary written premium in the Other Markets segment. The decrease in both commercial automobile and general liability net written premium reflects timing differences due to changes in policy effective dates of two large National Market accounts. The increase in Specialty Risks surety premium is due to a combination of increased work program utilization by existing customers and targeted new business growth in several new office locations. The decrease in assumed voluntary reinsurance net written premium reflects the Company's selective underwriting and pricing of the business. Overall, new business and customer retention levels remained consistent with 2004, while rate levels continued to moderate.

Results of Operations – Commercial Markets

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$1,399	$1,327	5.4%
PTOI before catastrophes and incurred attributable to prior years	$114	$94	21.3%
Catastrophes[1]:			
- Four hurricanes 2004	(5)	-	NM
- September 11, 2001	-	-	-
- All other	-	(2)	NM
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[2]	7	(12)	NM
Discount accretion[3]	(21)	(21)	-
Pre-tax operating income[4]	95	59	61.0
Realized investment gains, net	-	-	-
Federal and foreign income tax expense	(33)	(21)	57.1
Discontinued operations, net of tax	-	-	-
Extraordinary items, net of tax	-	-	-
Net income	$62	$38	63.2%

1 The Company does not typically identify catastrophe losses from assumed voluntary reinsurance lines in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

2 Net of earned premium attributable to prior years of $9 million and $15 million for the three months ended March 31, 2005 and 2004, respectively, and amortization of deferred gains on retroactive reinsurance of $7 million and $7 million for the three months ended March 31, 2005 and 2004, respectively.

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.

4 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

NM= Not meaningful

Revenues for the three months ended March 31, 2005 were $1.399 billion, a $72 million or 5.4% increase over the same period in 2004. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three months ended March 31, 2005 was $1.122 billion, a $72 million or 6.9% increase over the same period in 2004. The increase reflects the earned premium recognition of rate increases, new business growth and improved customer retention levels over the last twelve months, primarily in the Company's National Market, Business Market and Wausau Commercial Market segments.

Net investment income for the three months ended March 31, 2005 was $169 million, a $3 million or 1.7% decrease from the same period in 2004. The decrease reflects lower investment yields partially offset by a higher investment asset base and positive cash flow from operations.

Fee and other revenues for the three months ended March 31, 2005 were $108 million, a $3 million or 2.9% increase over the same period in 2004. The increase 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.

Claims, benefits and expenses for the three months ended March 31, 2005 were $1.304 billion, a $36 million or 2.8% increase over the same period in 2004. The increase is the result of overall growth in the business and general cost increases. These increases were partially offset by a general improvement in current year underwriting results and a decrease in incurred losses attributable to prior years over the comparable period in 2004. The decrease in incurred losses attributable to prior years primarily reflects a large subrogation recovery in Specialty Risks surety business.

	Three Months Ended March 31,		
COMMERCIAL MARKETS	**2005**	**2004**	**Change (Points)**
Combined ratio before catastrophes and net incurred attributable to prior years			
Claims and claim adjustment expense ratio	78.1%	80.7%	(2.6)
Underwriting expense ratio	22.6	22.6	-
Dividend ratio	(0.1)	0.5	(0.6)
Subtotal	100.6	103.8	(3.2)
Catastrophes[1]:			
- Four hurricanes 2004	0.4	-	0.4
- September 11, 2001	-	-	-
- All other	0.1	0.2	(0.1)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	(0.7)	1.1	(1.8)
Discount accretion	2.0	2.2	(0.2)
Total combined ratio[2]	102.4%	107.3%	(4.9)

1 The Company does not typically identify catastrophe losses from assumed voluntary reinsurance lines in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

2 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

The Commercial Markets combined ratio for the three months ended March 31, 2005 was 102.4%, a 4.9 point improvement over the same period in 2004. The improvement reflects the favorable impact of underwriting and pricing actions taken, a reduction in net incurred losses attributable to prior years of 1.8 points and a lower dividend ratio. The improvement in the 2005 claim and claim adjustment expense ratio before catastrophes, net incurred losses attributable to prior years and discount accretion reflects the favorable impact of underwriting and pricing actions taken. The 1.8 point improvement in net incurred losses attributable to prior years was driven primarily by a large subrogation recovery in Specialty Risks surety business. The improvement in the dividend ratio reflects the recoupment of a previously paid dividend. Partially offsetting these improvements was an increase in catastrophes from the four hurricanes, which added 0.4 points to the combined ratio. The combined ratio before catastrophes and net incurred losses attributable to prior years including discount accretion was 100.6%, representing a 3.2 point improvement over 2004.

PTOI for the three months ended March 31, 2005 was $95 million, a $36 million or 61.0% increase over the same period in 2004. Improved underwriting results and the favorable development of net incurred losses attributable to prior years were slightly offset by higher catastrophes from the four hurricanes. Consistent with the change in profitability, Federal and foreign income tax expense for the three months ended March 31, 2005 was $33 million, a $12 million or 57.1% increase over the same period in 2004.

Net income for the three months ended March 31, 2005 was $62 million, a $24 million or 63.2% increase over the same period in 2004.

REGIONAL AGENCY MARKETS (RAM)

(1) Overview – RAM

RAM net written premium by market segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Standard Regional Companies[1]	$796	$752	5.9%
Specialty Operations[2]	286	227	26.0
Total net written premium	$1,082	$979	10.5%

1 Results of Liberty Northwest included in Standard Regional Companies.
2 Includes Summit and Business Solutions Group. Restated to exclude GoAmerica which is now included in Standard Regional Companies.

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

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Commercial Lines			
Workers compensation	$426	$358	19.0%
Commercial multiple peril	259	232	11.6
Commercial automobile	142	128	10.9
General liability	37	37	-
Other	38	34	11.8
Subtotal	$902	$789	14.3%
Personal Lines			
Private passenger automobile	$114	$128	(10.9%)
Homeowners	58	56	3.6
Other	8	6	33.3
Subtotal	$180	$190	(5.3%)
Total net written premium	$1,082	$979	10.5%

Net written premium for the three months ended March 31, 2005 was $1.082 billion, a $103 million or 10.5% increase over the same period in 2004. Approximately $56 million of the increase was related to Summit, a workers compensation specialty business with operations primarily in Florida, due to strong premium renewals. The balance of the increase reflects modest rate increases and a general improvement in retention levels across most lines. The increase was partially offset by a decrease in private passenger automobile net written premium due to the Company's re-underwriting efforts, expanded rating tiers and active non-renewal of certain classes of business.

(2) Results of Operations – RAM

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$1,045	$908	15.1%
PTOI before catastrophes and incurred attributable to prior years	$111	$83	33.7%
Catastrophes:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	(7)	(9)	(22.2)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other [1]	1	-	NM
Discount accretion	-	-	-
Pre-tax operating income[2]	105	74	41.9
Realized investment gains, net	-	(2)	NM
Federal and foreign income tax expense	(37)	(25)	48.0
Discontinued operations, net of tax	-	-	-
Extraordinary items, net of tax	-	-	-
Net income	$68	$47	44.7%

1 Net of earned premium attributable to prior years of $1 million and $2 million for the three months ended March 31, 2005 and 2004, respectively.

2 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

NM = Not Meaningful

Revenues for the three months ended March 31, 2005 were $1.045 billion, a $137 million or 15.1% increase over the same period in 2004. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2005 was $959 million, a $126 million or 15.1% increase over the same period in 2004. Approximately $39 million of the increase over the same period in 2004 relates to growth at Summit. The balance of the increase reflects modest rate increases and a general improvement in retention levels across most lines, offset by a decrease in private passenger automobile business due to the Company’s re-underwriting efforts, expanded rating tiers and non-renewal of certain classes of business.

Net investment income for the three months ended March 31, 2005 was $70 million, a $6 million or 9.4% increase over the same period in 2004. The increase reflects a higher invested asset base and positive cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three months ended March 31, 2005 were $940 million, a $104 million or 12.4% increase over the same period in 2004. The increase is primarily due to business growth and general cost increases.

	Three Months Ended March 31,		
REGIONAL AGENCY MARKETS	**2005**	**2004**	**Change (Points)**
Combined ratio before catastrophes and net incurred attributable to prior years			
Claims and claim adjustment expense ratio	63.6%	64.8%	(1.2)
Underwriting expense ratio	31.3	32.4	(1.1)
Dividend ratio	0.8	0.6	0.2
Subtotal	95.7%	97.8%	(2.1)
Catastrophes:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	0.8	1.1	(0.3)
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	(0.1)	-	(0.1)
Discount accretion	-	-	-
Total combined ratio[1]	96.4%	98.9%	(2.5)

1 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

RAM's combined ratio for the three months ended March 31, 2005 was 96.4%, a 2.5 point improvement over the same period in 2004. The improvement primarily reflects the favorable impact of underwriting and pricing actions taken and a 1.1 point improvement in the expense ratio as premium growth more than offset increased underwriting expenses. In addition, catastrophe losses decreased 0.3 points largely due to favorable winter weather in the Midwest and Northeast. The combined ratio before catastrophes and net incurred losses attributable to prior years was 95.7%, a 2.1 point improvement over the same period in 2004.

PTOI for the three months ended March 31, 2005 was $105 million, a $31 million or 41.9% increase over the same period in 2004. Consistent with the change in profitability, Federal and foreign income taxes for the three months ended March 31, 2005 were $37 million, a $12 million or 48.0% increase over the same period in 2004.

Net income for the three months ended March 31, 2005 was $68 million, a $21 million or 44.7% increase over the same period in 2004.

INTERNATIONAL

(1) Overview – International

International net written premium by market segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
International local businesses	$552	$469	17.7%
Liberty International Underwriters	459	480	(4.4)
Total net written premium	$1,011	$949	6.5%

The Company's International operations provide insurance products and services through 1) local businesses which sell personal and small commercial lines products and 2) Liberty International Underwriters ("LIU") which sells specialty commercial lines insurance and reinsurance products 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 Syndicate 4472 (formerly 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.

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

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Local businesses	$552	$469	17.7%
LIU reinsurance	271	290	(6.6)
LIU third party	94	81	16.0
LIU first party	74	90	(17.8)
LIU other	20	19	5.3
Total net written premium	$1,011	$949	6.5%

NM = Not Meaningful

Net written premium for the three months ended March 31, 2005 was $1.011 billion, a $62 million or 6.5% increase over the same period in 2004. Approximately $75 million of the increase reflects organic growth from the Company's local operations in Europe and Latin America which also includes $7 million of written premium from the Company's acquisition of the Chilean operations of AGF Allianz Chile S.A. ("AGF Allianz") in the third quarter of 2004. The increase of $13 million in the LIU third party segment is primarily driven by a reduction in the Company's utilization of reinsurance as compared to the prior period. Partially offsetting these increases are decreases of $16 million and $19 million respectively in the LIU first party and reinsurance segments primarily in response to a less attractive rate environment. The reduction in LIU Reinsurance segment writings was in part offset by the inclusion of profit sharing of $16 million on ceded reinsurance estimated and accrued in the first quarter of 2005 as a reduction of ceded written and earned premium.

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Results of Operations – International

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$899	$889	1.1%
PTOI before catastrophes and incurred attributable to prior years	$78	$109	(28.4)%
Catastrophes[1]:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other [2]	-	(38)	NM
Discount accretion	-	-	-
Pre-tax operating income	78	71	9.9
Realized investment gains, net	1	-	NM
Federal and foreign income tax (expense) benefit	(26)	(21)	23.8
Discontinued operations, net of tax	(9)	-	NM
Extraordinary items, net of tax	-	-	-
Net income	$44	$50	(12.0)%

1 The Company does not typically identify catastrophe losses from reinsurance assumed through Lloyd's Syndicate 4472 in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

2 Net of earned premium attributable to prior years of $3 million and $3 million for the three months ended March 31, 2005 and 2004, respectively.

NM = Not Meaningful

Revenues for the three months ended March 31, 2005 were $899 million, a $10 million or 1.1% increase over the same period in 2004. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2005 was $806 million, a $2 million or 0.2% increase over the same period in 2004. Earned premium for the local business increased by $85 million. Approximately $81 million of the increase reflects organic growth principally from the Company's local operations in Europe and Latin America which also includes $8 million of earned premium from the Company's acquisition of AGF Allianz in Chile in the third quarter of 2004. These increases, however, were partially offset by a decrease in net premium earned related to LIU's reinsurance segment due to underlying changes in the exposure periods of the business written resulting from a change in business mix. The balance of the change reflects reductions from the LIU first party segment consistent with the net written premium change.

Net investment income for the three months ended March 31, 2005 was $81 million, a $4 million or 5.2% increase over the same period in 2004. This increase reflects a higher invested asset base and positive cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three months ended March 31, 2005 were $820 million, a $2 million or 0.2% increase over the same period in 2004. This small increase reflects increased underwriting expenses and reduced foreign exchange gains partially offset by the non-recurrence of incurred losses attributable to prior years and lower acquisition expenses. Underwriting expenses for the three months ended March 31, 2005 increased $9 million from the same period in 2004 as organic growth in the local businesses resulted in higher acquisitions costs and historical business growth in LIU resulted in increased staffing, partially offset by lower acquisition costs in LIU's reinsurance business due to a change in business mix. Also, foreign exchange gains in the first quarter of 2005 were $35 million lower than the same period in 2004 because of the impact of the weakening U.S. dollar on the Company's Euro- and Sterling-denominated investments. Partially offsetting these increases was the non-recurrence of $41 million of incurred loss attributable to prior years recorded in the three months ended March 31, 2004.

	Three Months Ended March 31,		
INTERNATIONAL	**2005**	**2004**	**Change (Points)**
Combined ratio before catastrophes and net incurred attributable to prior years			
Claims and claim adjustment expense ratio	66.5%	65.8%	0.7
Underwriting expense ratio	30.2	29.5	0.7
Dividend ratio	-	-	-
Subtotal	96.7	95.3	1.4
Catastrophes[1]:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	-	4.9	(4.9)
Discount accretion	-	-	-
Total combined ratio	96.7%	100.2%	(3.5)

1 The Company does not typically identify catastrophe losses from reinsurance assumed through Lloyd's Syndicate 4472 in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the four hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been separately identified in the tables above. Catastrophe losses include the impact of reinstatement premiums.

International's combined ratio for the three months ended March 31, 2005 was 96.7%, a 3.5 point improvement over the same period in 2004. The improvement in the combined ratio primarily reflects the non-recurrence of incurred losses attributable to prior years related to run-off business within LIU and a 2.1 point improvement related to the Company's estimated profit share accrual on ceded reinsurance in 2005. The claim and claim adjustment expense ratio also benefited from favorable underwriting results on automobile business written in Spain and automobile and other business written in Venezuela. The underwriting expense ratio for the three months ended March 31, 2005 was 30.2%, a 0.7 point deterioration over the comparable period in 2004 principally due to increased staffing costs in LIU's segments. This increase was partially offset by an improvement in the acquisition expense ratio in the LIU reinsurance segment due to changing business mix.

PTOI for the three months ended March 31, 2005 was $78 million, a $7 million or 9.9% increase over the same period in 2004. Results for both periods reflect strong performance across all segments. Federal and foreign income taxes for the three months ended March 31, 2005 were $26 million, a $5 million or 23.8% increase over the same period in 2004. 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.

Net income for the three months ended March 31, 2005 was $44 million, a $6 million or 12.0% decrease from the same period in 2004. The Company recorded a loss of $9 million, net of tax, in discontinued operations related to the disposal of certain pension business in Spain, which was a part of the Genesis acquisition.

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.

- Certain discontinued operations, 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.

- Internal reinsurance programs.

- Costs associated with certain long-term compensation plans and other corporate costs not allocated to the business units. In 2005, pension expense previously included in Corporate/Other was reallocated to the business segments. For consistency, 2004 has been restated to reflect the pension expense allocation. Domestic property and casualty operations' investment income was allocated based on planned ordinary investment income returns by investment category allocated to the strategic business units. 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 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 U.S. Federal tax rate and do not reflect changes in the domestic valuation allowance (included in Corporate & Other), while the International segment reflects the actual tax expense of each country including changes in the international valuation allowance.

- Net income (loss) related to energy and non-energy related limited partnership investments.

- Substantially all realized gains (losses) from the domestic property-casualty investment portfolio.

- Fee and other revenues from the Company's wholly owned subsidiary, Liberty Energy Holdings, LLC ("Liberty Energy"). Liberty Energy generates revenue from the production and sale of oil and gas.

(2) Results of Operations – Corporate and Other

	Three Months Ended March 31,		
$ in Millions	**2005**	**2004**	**Change**
Revenues	$287	$261	10.0%
Pre-tax operating loss before catastrophes and incurred attributable to prior years	($16)	($12)	33.3%
Catastrophes:			
- Four hurricanes 2004	-	-	-
- September 11, 2001	-	-	-
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- Pollution	-	-	-
- All other	(44)	(52)	(15.4)
Discount accretion[1]	(3)	(3)	-
Pre-tax operating loss	(63)	(67)	(6.0)
Realized investment gains, net	20	59	(66.1)
Federal and foreign income tax benefit	155	98	58.2
Discontinued operations, net of tax	-	1	NM
Net income	$112	$91	23.1%

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%.

2 In the first quarter of 2005, the Company changed its methodology for allocating pension expenses. Historically, pension expenses were recorded in the Corporate and Other segment but hereinafter will be allocated to each of the Company's business units. Results for 2004 reflect this reclassification.

NM = Not Meaningful

Revenues for the three months ended March 31, 2005 were $287 million, a $26 million or 10.0% increase over the same period in 2004. 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 months ended March 31, 2005 was $61 million, a $15 million or 32.6% increase over the same period in 2004. The increase is primarily due to earned premium on property catastrophe internal reinsurance programs.

Net investment income for the three months ended March 31, 2005 was $166 million, a $48 million or 40.7% increase over the same period in 2004. The increase in net investment income was primarily due to a $23 million increase in limited partnership income and higher interest and dividend income due to a higher invested asset base as the Company continues to achieve strong cash flow from operations. Partially offsetting these increases was a lower investment yield and higher investment expenses.

Realized investment gains for the three months ended March 31, 2005 were $20 million, a $39 million or 66.1% decrease from the same period in 2004. The decrease primarily reflects a decline in realized capital gains related to fixed maturities and equities, partially offset by a $13 million reduction in impairment losses over the comparable period in 2004.

Claims, benefits and expenses for the three months ended March 31, 2005 were $330 million, a $61 million or 22.7% increase over the same period in 2004. The increase is primarily related to an increase in policyholder benefits related to discontinued variable annuity reinsurance business, an increase in variable compensation and other benefit plans, and interest expense related to the Company's debt issuances. Included in these results were $47 million and $55 million of incurred losses attributable to prior years for the three months ended 2005 and 2004, respectively. Incurred losses attributable to prior years were primarily related to other liability lines and workers compensation business of Golden Eagle.

Pre-tax operating loss for the three months ended March 31, 2005 was $63 million, a $4 million or 6.0% decrease from the same period in 2004. Corporate and Other recognized a Federal and foreign income tax benefit for the three months ended March 31, 2005 of $155 million. The Company's improved operating performance has allowed the Company to lower its tax valuation allowance, thereby reducing its effective tax rate to 0% in the three months ended March 31, 2005. The total valuation allowance on deferred tax assets for both domestic and international operations was $207 million and $704 million as of March 31, 2005 and March 31, 2004, respectively.

Net income for the three months ended March 31, 2005 was $112 million, a $21 million or 23.1% increase over the same period in 2004.

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 asset 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 investment policy and strategy are reviewed and approved by the Investment Committee of its Board of Directors. The Investment Committee meets on a regular basis to review investment activities and tactics. The Company has an experienced investment staff 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 March 31, 2005 and December 31, 2004:

$ in Millions	**As of March 31, 2005**		**As of December 31, 2004**	
Invested Assets by Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$36,627	91.0%	$35,601	90.0%
Equity securities, available for sale, at fair value	1,797	4.5	1,802	4.6
Trading securities, at fair value	262	0.6	457	1.2
Limited partnerships	928	2.3	881	2.2
Short-term investments	515	1.3	687	1.7
Other investments	111	0.3	109	0.3
Total invested assets	$40,240	100.0%	$39,537	100.0%

Total invested assets as of March 31, 2005 were $40.240 billion, a $703 million or 1.8% increase over December 31, 2004. The increase was primarily attributable to strong cash flow from operations of $858 million and approximately $486 million of net proceeds from LMGI's March 22, 2005 debt offering.

Fixed maturities as of March 31, 2005 were $36.627 billion, a $1.026 billion or 2.9% increase over December 31, 2004. The increase reflects an increase in cash available to invest, including proceeds related to the Company's first quarter 2005 debt issuance.

Net unrealized gains on fixed maturities as of March 31, 2005 were $741 million, a $581 million or 43.9% decrease from December 31, 2004. Gross unrealized gains related to fixed maturities decreased $327 million between December 31, 2004 and March 31, 2005 primarily due to an increase in interest rates. The gross unrealized loss increased by $254 million between December 31, 2004 and March 31, 2005 primarily due to an increase in interest rates.

Equity securities as of March 31, 2005 were $1.797 billion, a $5 million decrease from December 31, 2004. This decrease was due primarily to a decline in the equity markets combined with no additional commitments to the asset class in the first quarter.

Trading securities as of March 31, 2005 were $262 million, a $195 million or 42.7% decrease from December 31, 2004. The large decline was primarily attributable to the disposal of certain pension business in Spain, which was a part of the Genesis acquisition.

Limited partnerships as of March 31, 2005 were $928 million, a $47 million or 5.3% increase over December 31, 2004. 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 March 31, 2005, the Company had unfunded energy and non-energy commitments of $147 million and $574 million, respectively.

As of March 31, 2005, no single issuer accounted for more than 1.11% of invested assets.

The following tables summarize the Company's fixed income portfolio by security type, credit quality and maturity at March 31, 2005 and December 31, 2004:

$ in Millions	**As of March 31, 2005**		**As of December 31, 2004**	
Fixed Maturities by Security Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
U.S. Treasury securities	$ 3,284	9.0%	$ 2,703	7.6%
Mortgage and asset-backed securities	13,037	35.6	12,933	36.3
State and municipal	1,235	3.4	1,141	3.2
Corporate and other	15,343	41.8	15,033	42.2
Foreign	3,728	10.2	3,791	10.7
Total fixed maturities	$36,627	100.0%	$35,601	100.0%

During the first quarter of 2005, the Company after consideration of investment opportunities and the current and prospective business environment increased its tactical allocation in U.S. Treasuries and other domestic securities.

$ in Millions	**As of March 31, 2005**		**As of December 31, 2004**	
Fixed Maturities by Credit Quality	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$19,981	54.6%	$19,265	54.1%
AA+, AA, AA-	2,903	7.9	2,889	8.1
A+, A, A-	7,169	19.5	6,977	19.6
BBB+, BBB, BBB-	4,319	11.8	4,124	11.6
BB+, BB, BB-	1,220	3.3	1,235	3.5
B+, B, B-	976	2.7	1,058	3.0
CCC or lower	59	0.2	53	0.1
Total fixed maturities	$36,627	100.0%	$35,601	100.0%

For purposes of this disclosure, credit quality is primarily based upon Standard & Poor's ratings.

The Company increased its allocation of investment grade bonds to 93.8% at March 31, 2005 from 93.4% at December 31, 2004 due primarily to the acquisition of U.S. Treasury securities. The Company defines an investment grade bond as a security with a rating equivalent to the Standard and Poor's rating of BBB- or higher.

The remaining 6.2% of the Company's investments in fixed maturities are rated below investment grade. The Company's holdings of below investment grade securities primarily consist 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 March 31, 2005**		**As of December 31, 2004**	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$ 967	2.6%	$ 890	2.5%
Over 1yr through 5yrs	6,029	16.5	5,543	15.6
Over 5yrs through 10yrs	8,631	23.6	8,148	22.9
Over ten years	7,928	21.6	8,052	22.6
Mortgage and asset backed securities	13,072	35.7	12,968	36.4
Total fixed maturities	$36,627	100.0%	$35,601	100.0%

During the first quarter of 2005, the Company did not make any significant change to the average life of its fixed maturity portfolio 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 net investment income at March 31, 2005 and 2004:

$ in Millions	**Three Months Ended March 31,**	
Net Investment Income	**2005**	**2004**
Interest income	$507	$468
Dividends	24	22
Limited partnerships	51	28
Other investment income	3	2
Gross investment income	585	520
Investment expenses	(30)	(18)
Net investment income	$555	$502

Net investment income for the three months ended March 31, 2005 was $555 million, a $53 million or 10.6% increase over the same period in 2004. The improvement primarily reflects a $41 million increase in interest and dividend income and a $23 million increase in limited partnership income from both private equity and energy investments. The increase in interest and dividend income is primarily due to a higher invested asset base as the Company continues to achieve strong cash flow from operations across all business units, with cash flow from operations of approximately $4 billion over the past fifteen months. Partially offsetting these increases were lower investment yields and higher investment management expenses due to higher variable compensation expenses and fixed cost allocations.

Net Realized Investment Gains (Losses)

The following tables summarize the Company’s net realized investment gains (losses) at March 31, 2005 and 2004:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended March 31, 2005:				
Fixed maturities	$22	$ -	$ -	$22
Common and preferred stock	12	(1)	(14)	(3)
Other	2	-	-	2
Total	$36	$(1)	$(14)	$21
Three Months Ended March 31, 2004:				
Fixed maturities	$56	$ (5)	$ -	$51
Common and preferred stock	26	(9)	(8)	9
Other	(3)	-	-	(3)
Total	$79	$(14)	$(8)	$57

$ in Millions	**Three Months Ended March 31,**	
Components of Net Realized Investment Gains (Losses)	**2005**	**2004**
Fixed maturities:		
Gross realized gains	$34	$66
Gross realized losses	(12)	(15)
Equities:		
Gross realized gains	18	33
Gross realized losses	(21)	(24)
Other:		
Gross realized gains	2	-
Gross realized losses	-	(3)
Total net realized investment gains	$21	$57

Net realized investment gains for the three months ended March 31, 2005 were $21 million, a $36 million or 63.2% decrease from the same period in 2004. The decrease primarily reflects a decline in realized capital gains related to fixed maturities and equities, partially offset by a $13 million reduction in impairment losses over the comparable period in 2004.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment at March 31, 2005:

$ in Millions	**Less Than 12 Months**		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Treasury securities	$ (38)	$ 2,170	$ (7)	$ 130
Mortgage and asset-backed securities	(94)	6,303	(36)	677
State and municipal	(5)	411	(2)	48
Corporate and other	(148)	6,166	(50)	851
Foreign	(18)	639	(2)	66
Equities	(20)	175	(5)	26
Total	$(323)	$15,864	$(102)	$1,798

Unrealized losses increased from $169 million as of December 31, 2004 to $425 million as of March 31, 2005 primarily due to an increase in rates and relative weakness in the debt and equity markets during that period. The Company frequently monitors the difference between the cost and estimated fair value of investments, which involves uncertainty as to whether declines in value are temporary in nature. The Company employs a systematic methodology to evaluate declines in fair values below amortized cost for all investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in shareholders' equity. If the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to market and a realized loss is recorded. As a result of this review, the Company has concluded that the gross unrealized losses of fixed maturity securities as of March 31, 2005 are temporary.

The gross unrealized losses recorded on common equity securities and other investments at March 31, 2005 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. Therefore, these decreases are also viewed as being temporary in accordance with the Company's policy with respect to recognizing impairments in the investment portfolio.

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 March 31, 2005 totaled $40.240 billion.

Short-term debt outstanding at March 31, 2005 and December 31, 2004 was as follows:

$ in Millions	**As of March 31, 2005**	**As of December 31, 2004**
Commercial paper	$ -	$147
Revolving credit facilities	28	29
Current maturities of long-term debt	-	77
Total short-term debt	$28	$253

Long-term debt outstanding at March 31, 2005 and December 31, 2004 was as follows:

$ in Millions	**As of March 31, 2005**	**As of December 31, 2004**
8.20% Surplus notes, due 2007	$121	$121
6.75% Notes, due 2008	15	15
5.00% Prudential notes due 2008	14	14
8.00% Prudential notes—series B due 2013	260	260
5.75% Senior notes, due 2014	500	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	250
6.50% Senior notes, due 2035	500	-
7.697% Surplus notes, due 2097	500	500
6.76% – 8.10%, Medium term notes, with various maturities	27	27
Subtotal	2,590	2,090
Unamortized discount	(26)	(16)
Total long-term debt excluding current maturities	$2,564	$2,074

The Company issues commercial paper from LMGI. 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 March 31, 2005, total short-term loans and borrowings under the Venezuelan credit facility were approximately $28 million.

The $225 million decrease in short-term debt outstanding is primarily due to the redemption of $147 million of commercial paper, $61 million of maturing medium term notes and $16 million of 5% notes due in 2008 to Prudential Financial Inc. issued in connection with the PruPac acquisition.

The $490 million increase in long-term debt outstanding is primarily the result of the March 22, 2005 offering by LMGI of $500 million of 30-year senior notes. The proceeds were contributed to its wholly owned subsidiaries, LMIC and EICOW.

Consolidated interest expense for the three months ended March 31, 2005 was $41 million, a $6 million or 17.1% increase over the same period in 2004. The increase is primarily due to the March 2004 and 2005 debt offerings.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, 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 March 31, 2005, the Company, through its downstream subsidiary LMGI, had $1.532 billion of debt outstanding.

The insurance subsidiaries ability 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 Liberty Mutual Fire Insurance Company ("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. 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. 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, as could a redomestication, merger or consolidation of LMIC, LMFIC or EICOW to a different domiciliary state. 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 Securities and Exchange Commission.

As of December 31, 2004, the authorized control level risk-based capital and 2005 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio [1]**			**Dividend Capacity[2]**
RBC Ratios and Dividend Capacity	**2004**	**2003**	**Change**	**2005**
LMIC	459%	360%	99 points	$726
LMFIC	473%	425%	48 points	$67
EICOW	346%	303%	43 points	$84

Note: In the first quarter of 2005, the Company made certain intercompany pooling reclassifications among its legal entities. These reclassifications had no impact on Consolidated Statutory or GAAP financial results, but did have an immaterial impact on the RBC ratio and dividend capacity of LMIC, LMFIC and EICOW from what the Company reported in the Q4 2004 MD&A.
[1] Authorized control level risk-based capital as defined by the NAIC.
[2] Represents maximum allowable dividend without prior regulatory approval in the state of domicile.

In addition, management expects the Company's subsidiary, Liberty Corporate Services LLC (the "service companies") to generate approximately $150 million of funding, which would be available to service the holding company obligations of LMGI in 2005. The service companies, which include Helmsman Insurance Agency, Summit Consulting and Helmsman Management Services, collect fees and other revenues for claims administration and agency services rendered for affiliated and non-affiliated insurance entities.

Statutory Surplus
Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $9.538 billion and $8.739 billion at March 31, 2005 and December 31, 2004, respectively. The increase in statutory surplus in the first three months of 2005 is primarily due to $232 million of net income and $486 million of capital contributions related to the March 2005 debt offering. The balance of the increase in statutory surplus primarily reflects changes in affiliated and unaffiliated unrealized gains, deferred taxes, foreign exchange and non-admitted assets.

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 2004 tables to conform to the 2005 tables.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $34.154 billion and $33.884 billion at March 31, 2005 and December 31, 2004, 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 months ended March 31, 2005 and 2004, incurred losses attributable to prior years including discount accretion were $61 million and $146 million, respectively.

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 (A&E) reserves for unpaid claims and claim adjustment expenses were $1.543 billion and $1.641 billion at March 31, 2005 and December 31, 2004, respectively, net of reinsurance and including the related allowance for doubtful accounts. More than half of the decrease in A&E reserves was related to the resolution of environmental claims with a single policyholder.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. The Company's acquisition of PruPac included $175 million and $118 million of gross and net asbestos reserves, respectively. Any increase in asbestos reserves is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial Inc.

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 $14.424 billion and $14.209 billion at March 31, 2005 and December 31, 2004, respectively, net of allowance for doubtful accounts of $349 million and $349 million, respectively. The majority of the increase reflects growth in LIU and increased cessions to state mandated involuntary pools and associations, partially offset by a reduction in the estimated ultimate recoverable balance for Nationwide Indemnity Company.

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 A+ from A.M. Best. 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 94% 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 March 31, 2005. Collateral held against outstanding reinsurance recoverable balances was $3.672 billion and $3.589 billion at March 31, 2005 and December 31, 2004, respectively.

The remaining 6% of the Company's reinsurance recoverable balance is well diversified. With the exception of Converium, no single reinsurer rated B++ or below accounts for more than 1% of policyholder surplus. The average reinsurance recoverable balance of the remaining 6% is approximately $1 million as of March 31, 2005.

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.

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million as of March 31, 2005 and December 31, 2004) that are amortized into income using the effective interest method over the estimated settlement periods. At March 31, 2005 and December 31, 2004, the deferred gains related to these retroactive reinsurance arrangements were $961 million and $973 million, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three months ended March 31, 2005 and 2004 was $24 million and $22 million, respectively. Amortization of deferred gain was $12 million and $11 million for the three months ended March 31, 2005 and 2004, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2.209 billion and $2.219 billion as of March 31, 2005 and December 31, 2004, respectively.

Impairment Losses on Investments

The total impairment losses on investments for the three months ended March 31, 2005 were $1 million, a $13 million or 92.9% decrease from the same period in 2004. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company's accounting policy for other-than-temporary impairment recognition requires other-than-temporary impairment charges to be recorded when it is determined that the Company is unlikely to recover its cost basis in an investment in the near-term. Factors considered in evaluating whether a decline in value is other-than-temporary include: (a) the length of time and extent to which the fair value has been below cost; (b) the financial condition and near-term prospects of the issuer; and (c) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

The Company employs a systematic methodology to evaluate declines in fair value below the book value for equity securities and other investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below carrying value is evaluated in a disciplined manner. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy.

Goodwill and Intangibles

Goodwill and intangible assets were $807 million and $824 million at March 31, 2005 and December 31, 2004, respectively.

Deferred Policy Acquisition Costs

Total deferred policy acquisition costs were $1.442 billion and $1.354 billion as of March 31, 2005 and December 31, 2004, 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 $1.250 billion and $938 million as of March 31, 2005 and December 31, 2004, respectively, net of a valuation allowance of $207 million and $340 million, respectively. Management believes it is more likely than not that the Company's net deferred tax assets will be realized based on the Company's ability and likelihood of generating future taxable income. The increase in the Company's net deferred income tax asset is the result of a decrease in deferred tax liabilities resulting from a decrease in unrealized investment gains and a reduction in the tax valuation allowance, partially offset by 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, employee benefits, net operating losses and alternative minimum tax credits.

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.

The American Jobs Creation Act of 2004 ("The Act") introduced a special one-time 85% dividends received deduction on the repatriation of certain foreign earnings to a United States taxpayer, provided certain criteria are met. The maximum amount of foreign earnings eligible for the deduction is limited to the greater of $500 million or the amount shown in the Company's most recent audited financial statements filed prior to June 30, 2003 as earnings permanently reinvested outside of the United States. As of March 31, 2005, management had not yet decided on whether, and to what extent, there might be a repatriation of foreign earnings under The Act, and accordingly, the financial statements do not reflect any provision for taxes on unremitted earnings. Since that time, however, management completed its analysis of the impact of The Act on the Company's plans for repatriation and received board approval of the Company's Domestic Reinvestment Plan. Based on this analysis, the Company plans to repatriate $196 million in extraordinary dividends, as defined in The Act, during 2005 and accordingly will record a tax liability of $22 million during the quarter ending June 30, 2005. In addition, it is reasonably possible that the Company will repatriate some additional amount between $0 and $85 million beyond the $196 million previously mentioned, with the respective tax liability ranging from $0 to $4 million. The Company expects to be in a position to finalize its assessment of any additional repatriation amount during the quarter ending September 30, 2005.

About the Company

Boston-based Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of entities ("LMG" or the "Company"), is a diversified global insurer and sixth largest property and casualty insurer in the U.S. based on 2004 direct written premium. The Company also ranks 111th on the Fortune 500 list of largest corporations in the United States based on 2004 revenue. As of December 31, 2004, LMG had $72.4 billion in consolidated assets and $19.6 billion in annual consolidated revenue.

LMG, through its subsidiaries and affiliated companies, offers a wide range of property-casualty insurance products and services to individuals and businesses alike. In 2001 and 2002, the Company formed a mutual holding company structure, whereby the three principal mutual insurance companies, LMIC, LMFIC and EICOW, each became separate stock insurance companies under the ownership of Liberty Mutual Holding Company.

Functionally, the Company conducts its business through four strategic business units: Personal Market, Commercial Markets, Regional Agency Markets (RAM) and International. Each business unit operates independently of the others and has dedicated sales, underwriting, claims, actuarial, financial and certain information technology resources. Management believes this structure allows each business unit to execute its business strategy and/or to make acquisitions without impacting or disrupting the operations of the Company's other business units.

LMG employs over 38,000 people in nearly 900 offices throughout the world. For a full description of the company's business operations, products and distribution channels please visit the Liberty Mutual's investor relations web site at www.libertymutual.com/investors.