LIBERTY MUTUAL GROUP | 2005 ANNUAL REPORT

LIBERTY MUTUAL GROUP

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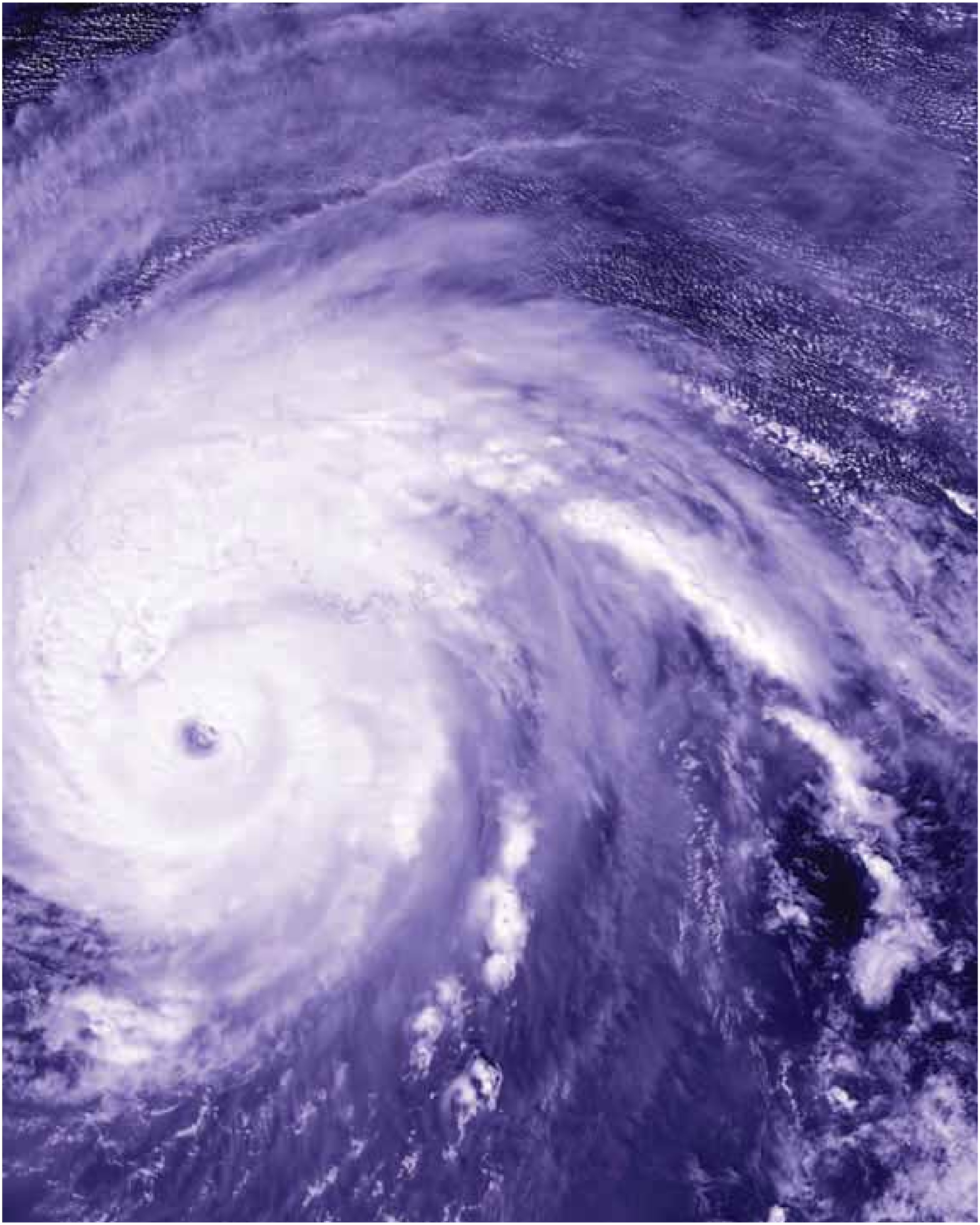


Disasters strike. And they'll strike again.

And when the big ones hit, they will kill or injure hundreds of people, displace thousands more, and cause billions of dollars in property damage.

But when we respond to something as devastating as Hurricane Katrina, or Rita, or Wilma, we don't focus on the aggregate damage. We deal with individuals — people who have an insurance contract and trust that when disaster strikes, we have the financial strength, talent and experience to put their lives and businesses back together.

At Liberty Mutual, we deal with people's loss and uncertainty every day, whether it's a fender bender, a kitchen fire or a workplace accident. In fact, it's only because our people have experience handling these situations, day in and day out, that we can effectively respond to a significant hurricane.

But it's not just the aftermath. We invest an immense amount of time and energy helping our policyholders prepare for the possibility of auto, home and workplace accidents. Safe-driving tips, identity-theft seminars, workplace safety and disaster-preparedness training — these Liberty Mutual programs, and hundreds more, help our policyholders avoid injury and damage.

So, no matter what nature or chance throw at us, we're there to help our policyholders rebuild and restore their lives and businesses.

Any given day, disasters strike and accidents happen. Every given day, we meet the need, claim by claim.

FINANCIAL HIGHLIGHTS

{DOLLARS IN MILLIONS}

DECEMBER 31,		2005	2004	2003
LIBERTY MUTUAL GROUP	Revenues	$ 21,161	$ 19,641	$ 16,618
	Pre-tax operating income	399	766	405
	Net income	1,027	1,245	851
	Cash flow from operations	3,464	3,237	2,684
	Total assets	78,824	72,457	64,387
	GAAP combined ratio	105.7%	102.9%	104.5%
PERSONAL MARKETS	Revenues	$ 6,083	$ 5,931	$ 4,690
	Pre-tax operating income	636	613	397
	Cash flow from operations, pre-tax	869	990	934
	Total assets	15,271	13,810	14,660
	GAAP combined ratio	94.7%	95.5%	97.9%
COMMERCIAL MARKETS	Revenues	$ 4,437	$ 4,408	$ 4,235
	Pre-tax operating income	191	308	364
	Cash flow from operations, pre-tax	790	960	750
	Total assets	22,354	21,428	22,079
	GAAP combined ratio	108.7%	105.3%	104.6%
AGENCY MARKETS	Revenues	$ 5,830	$ 5,185	$ 4,494
	Pre-tax operating income	564	417	350
	Cash flow from operations, pre-tax	1,445	1,189	884
	Total assets	14,471	13,281	10,122
	GAAP combined ratio	98.3%	100.6%	102.7%
INTERNATIONAL	Revenues	$ 3,908	$ 3,620	$ 2,926
	Pre-tax operating income	(244)	273	130
	Cash flow from operations, pre-tax	967	768	750
	Total assets	14,515	12,680	9,672
	GAAP combined ratio	117.0%	97.9%	101.8%
OTHER	Revenues	$ 903	$ 497	$ 273
	Pre-tax operating income	(748)	(845)	(836)
	Cash flow from operations	(607)	(670)	(634)

Pre-tax operating income is defined as net income in accordance with Generally Accepted Accounting Principles (GAAP) excluding net realized gains (losses), results from private equity investments, federal and foreign income taxes, extraordinary items, discontinued operations and cumulative effect of changes in accounting principles. Investment income is allocated to the major businesses on a total return basis and differs from the methodology utilized in the Company's debt offering memoranda and its financial reporting on the Company's website. Pre-tax operating income is the basis used by management for measuring operating performance internally. However, analysis of the Company's results should be used only in conjunction with data presented in accordance with GAAP.

Other includes discontinued operations (including asbestos and environmental), interest expense, internal reinsurance programs, net investment income after allocations to business units, certain expenses not allocated to the business units, net realized gains and losses from domestic operations and other revenues from corporate subsidiaries.

Liberty Mutual Group results include all significant business units of Liberty Mutual. Personal Markets reported above includes Individual Life, which differs from the financial reporting on the Company's website where Individual Life is included in Corporate and Other. Each business unit is reported in accordance with generally accepted accounting principles.

While many recognized the possibility, no one expected that the costly and devastating 2004 hurricane season would ultimately seem relatively moderate in comparison to that in 2005.

I am proud of the insurance industry's response to these events, and particularly proud of your company's response. Once again, hundreds of Liberty Mutual Group employees worked long hours, seven days a week, to meet the insurance and risk management needs of policyholders whose homes, businesses and cars were damaged or destroyed by Hurricanes Katrina, Rita or Wilma.

As in 2004, our response reaffirmed the importance of our being ready to respond to the needs of our policyholders. The needs in the face of widespread disaster are dramatic, and our Catastrophe Response teams were ready to meet them. This preparedness is based on our efforts in handling the less dramatic, but still important, day-to-day claim — the fender bender, the roof leak, the slip and fall.

Our response is also predicated on our having the financial strength to absorb the massive cost of disasters such as the 2005 hurricanes. We build and maintain that strength by making sure the fundamentals of our businesses are sound: we underwrite with discipline; we manage our exposure in disaster-prone regions; we have a diversified mix of business; and most important, we maintain an exceptionally strong balance sheet.

This served us well in 2005. We sustained $1.5 billion in hurricane-related losses, but still reported very acceptable results. For the year, group-wide revenues were $21.2 billion, up almost 8 percent year-to-year, and cash flow was up 7 percent to $3.5 billion. Our net income was $1.03 billion, down from $1.24 billion in 2004. Policyholder equity was $8.9 billion as of December 31, 2005.

A significant contributor to our results in 2005 was the exceptional performance of our investment operation. While they are to a large degree hidden from you, our policyholders, they play a major role in our ability to provide your coverage at a fair price. In recent years, their ability to get return in an era of very low interest rates, but at the same time keeping investment risk controlled, has been very important to our success.

We are pleased with the financial results. However, we are very aware that the financial impact of disasters, be they natural or man-made, is a poor proxy description of the human hardship and tragedy the events cause. We are in the business of helping people recover from adverse events, and in helping them put their lives back together. It's what we do, and our financial strength allows us to do it.

So, despite the costs of the hurricanes, Liberty Mutual Group is in very good shape. Each of our business units — Personal Markets, Commercial Markets, Agency Markets and Liberty International — has a fundamentally strong, profitable and growing franchise. From this position of strength, we look forward to continuing to meet the insurance and risk management needs of our policyholders and our distribution and business partners.

EDMUND F. KELLY *Chairman, President and Chief Executive Officer*

Several non-financial events in 2005 positioned us to do this better. The most significant organizational change was the combination of Regional Agency Markets, Wausau Insurance and Liberty Mutual Surety into a new business unit, Agency Markets. This bringing together of the companies distributing products through Independent Agencies gives us better alignment, and our agent partners access to a broader array of products and services.

In the international area, we acquired the property and casualty operations of ING Chile, our second acquisition in that country. In June we were honored to host Phan Van Khai, prime minister of the Socialist Republic of Vietnam, on his visit to Boston. We believe that as Vietnam moves towards a more open market economy, it will be a very attractive market for insurance. We have opened a representative office there and are working to get a license to do business.

Domestically, we are excited about our sponsorship of Big Ten football and basketball. We have affinity marketing relationships with all 11 schools in the Conference, the oldest college athletic conference in the country; this sponsorship will raise our profile with more than three million alumni of the Big Ten universities.

Close to home, we are proud to sponsor the Boston Pops Fourth of July Concert and fireworks display and its national television broadcast. We bring the fireworks uninterrupted by commercials so that viewers can enjoy this great tradition to the greatest extent possible.

In March 2005, we were honored to be the first insurance company to receive the Green Cross for Safety Medal from the National Safety Council. This award was in recognition of the dedication to safe workplaces showed by our loss prevention people and our policyholders. This dedication to safety is at the very core of our mission, so we say a special thanks to the Council for the honor.

At the start of my letter, I said how proud I am of the industry's response to the hurricanes. That pride does not stand in the way of our desire to compete day-to-day in the marketplace. Fortunately for now, market pricing and underwriting remain fairly rational. There is upward pressure on both homeowners and commercial property rates in catastrophe-prone areas, driven partly by increased reinsurance costs. However, in other areas there is no such upward pressure. Personal auto premiums are flat to slightly down in most parts of the country; there is price competition but it is still within the bounds of reasonableness. In workers compensation, some states give us a little concern, but in general, the market and regulatory environments allow us to write and retain business at an acceptable price.

Looking forward, we have concerns that this relatively stable state of affairs will not sustain. The most significant problem is the debate as to how to provide homeowners insurance in catastrophe-prone areas. It is our belief that there is plenty of capacity, but the political pressure for rate suppression keeps that capacity from the market. Six major hurricanes in roughly 12 months, and the fact that the ensuing demand for repairs has driven up material and labor costs over 200 percent, has changed everyone's view of catastrophic risk. If insurance rates are not adequate to finance

J. PAUL CONDRIN III *President, Personal Markets*

GARY R. GREGG *President, Agency Markets*

THOMAS C. RAMEY *President, Liberty International*

DAVID H. LONG *President, Commercial Markets*

A. ALEXANDER FONTANES *Executive Vice President & Chief Investment Officer* hurricane losses, private capital will not be available to underwrite the risks. Existing pricing models do not reflect the increased incidence or cost. This needs to change. We need to resolve the conflict between true costs and political views of affordability.

There are those in catastrophe-prone states and a very small number of companies in the industry who are pushing hard for federal government involvement in insuring for national catastrophes. We believe that not only is such involvement unnecessary, it would be a mistake. While such proposals have obvious allure in the immediate aftermath of Katrina, over the longer term federal involvement will distort the market, hide the true cost of risk, and have the taxpayer support risky practices. The best solution is to mitigate risk through enforcement of proper building codes, effective land-use management and the better allocation of costs through actuarially sound pricing.

Those arguing for federal intervention point to the Terrorism Risk Insurance Act (TRIA) as a model. However, terrorism is totally different. Normal insurance mechanisms cannot work for terrorism. First, the risk is completely unpredictable; second, it is easy to construct scenarios with costs far in excess of anything from national disaster and well in excess of capital available.

The last-minute extension of TRIA through December 31, 2007 was welcome, but inadequate. Liberty Mutual's commercial businesses can breathe a very temporary sigh of relief; temporary because the calendar-year basis for TRIA means that, de facto, the federal reinsurance coverage begins to expire for policy years beginning January 1, 2007. On a policy level, the extension defers discussion of the very important and difficult issue as to the proper long-term balance between the private sector and federal government in meeting this risk. We believe that given the magnitude of possible losses there will always be a need for federal reinsurance, but that, through increasing private sector retention or otherwise, it is desirable that there is increased pressure for the private market to develop responses.

How these regulatory and legislative issues are resolved will have a large effect on our ability to meet your insurance and safety needs in a timely and economically sound way.

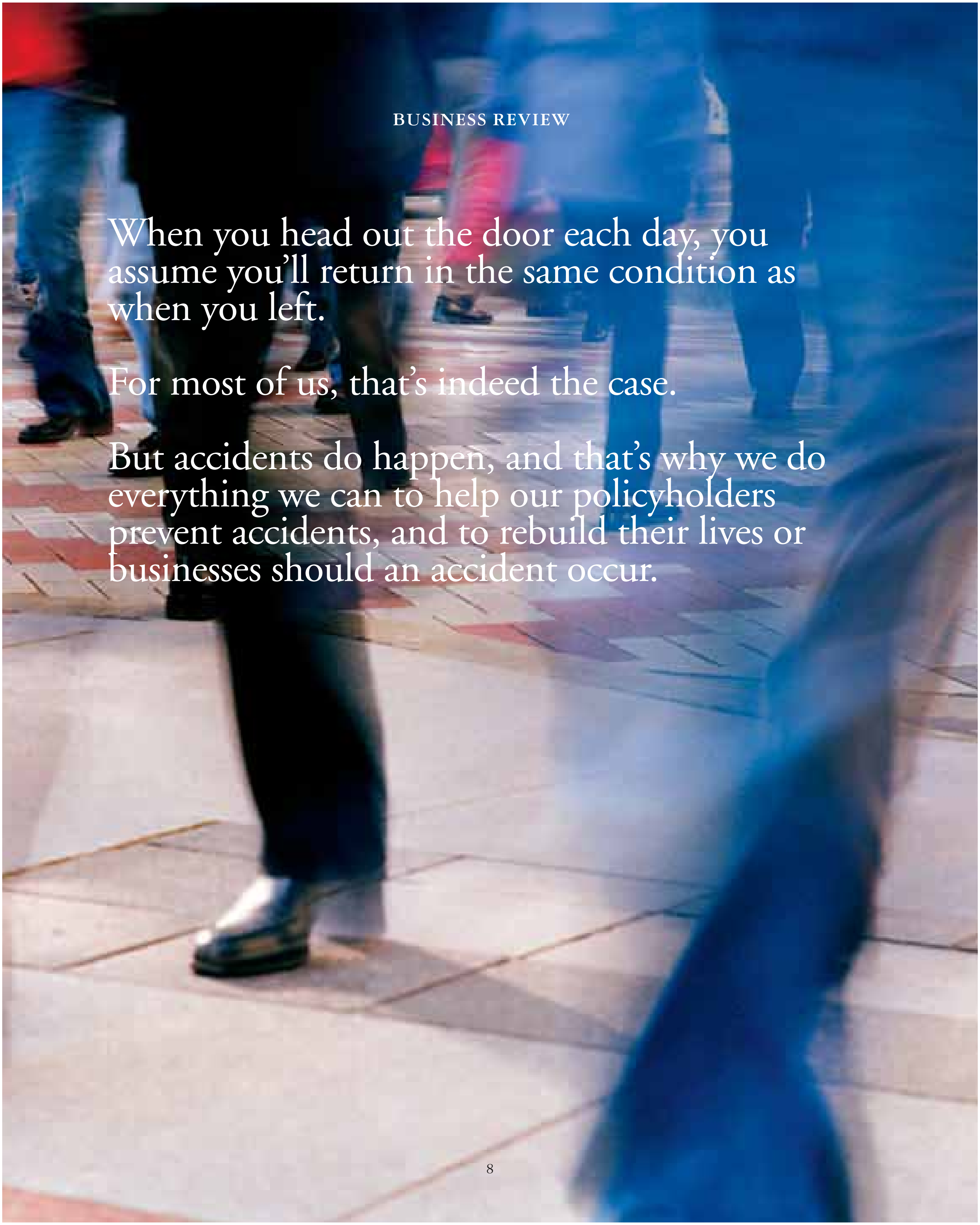
As I conclude, I want to say "thank you and farewell" to Roger Jean, who led our Regional Agency Markets business for the last six years and helped us build that business into a major provider of capacity in the independent agency system.

I also want to thank our board of directors for their continued counsel and encouragement, our business partners for their business and support, and our employees for their dedication. This year in particular I thank our claims people, who for the second year in a row, spent long periods away from family and friends, working countless hours to settle our policyholders' hurricane-related claims fairly and quickly.

And finally, one more time I thank you, our policyholders, for your business. I look forward to continuing to serve you in the future.

Edmund F. Kelly

Edmund F. Kelly
Chairman, President and Chief Executive Officer



When you head out the door each day, you assume you'll return in the same condition as when you left.

For most of us, that's indeed the case.

But accidents do happen, and that's why we do everything we can to help our policyholders prevent accidents, and to rebuild their lives or businesses should an accident occur.

LIBERTY MUTUAL GROUP

AN OVERVIEW

Liberty Mutual Group is a leading global multi-line group of insurance companies whose largest line of business is private passenger auto, based on 2005 net written premium. On December 31, 2005, Liberty Mutual Group had $78.8 billion in consolidated assets and $21.2 billion in consolidated revenue. Liberty Mutual ranks 102nd on the Fortune 500 list of largest U.S. corporations based on 2005 revenue, and is the 8th-largest personal lines writer and 4th-largest commercial lines writer in the U.S. based on 2004 direct written premium. Headquartered in Boston, Mass., Liberty Mutual Group employs more than 39,000 people in nearly 900 offices throughout the world.

Liberty Mutual Group operates under a mutual holding company structure. As a mutual company, it has no stockholders and is managed for the benefit of its policyholders. The three principal insurance companies of the group, Liberty Mutual Insurance Company, Liberty Mutual Fire Insurance Company and Employers Insurance Company of Wausau, each are stock insurance companies under the ownership of Liberty Mutual Holding Company Inc.

Liberty Mutual Group has four strategic business units — Personal Markets, Commercial Markets, Agency Markets and Liberty International — with no single unit contributing more than 30 percent of net written premium.

The company offers a wide range of insurance products and services, including private passenger automobile, homeowners, workers compensation, commercial multiple peril/fire, commercial automobile, general liability, global specialty products, group disability and surety.

Liberty Mutual Group revenues for 2005 were $21.2 billion, a 7.7 percent increase over 2004. Net investment income increased by $78 million to $2.0 billion, due in part to cash flow from operations of $3.5 billion in 2005. Pre-tax operating income for 2005 was $399 million, a decrease of $367 million from 2004. The Group's GAAP — Generally Accepted Accounting Principles — property and casualty combined ratio increased to 105.7 percent in 2005 from 102.9 percent in 2004, and GAAP policyholders' equity increased by approximately $.2 billion to $8.9 billion. Significantly higher hurricane losses adversely affected net income, the combined ratio and policyholders' equity in 2005.

PERSONAL MARKETS

AT-A-GLANCE

Liberty Mutual's largest business unit provides full lines of coverage for private passenger automobile, homeowners, valuable possessions and personal liability through its own sales force in more than 350 offices throughout the U.S., two direct response centers, appointed Prudential agents and the internet. It also offers a wide range of traditional and variable life insurance and annuity products. Personal Markets' largest source of new business is its more than 9,000 affinity group relationships, including employers, credit unions, and professional and alumni associations. Liberty Mutual's affinity program is the industry's most-sponsored voluntary auto and home insurance benefit.

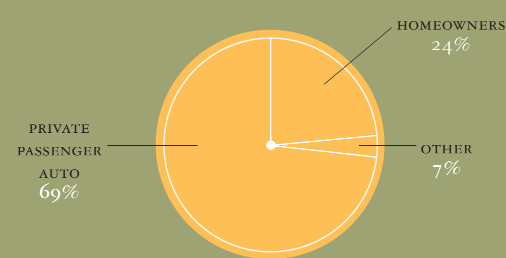
Distribution

- DIRECT SALES FORCE
- DIRECT RESPONSE CENTERS
- INTERNET
- PRUDENTIAL AGENTS

By The Numbers

- 4.3 MILLION AUTO AND HOME POLICIES
- 11,303 EMPLOYEES
- 9,100 AFFINITY RELATIONSHIPS
- 1,400 FIELD SALES REPRESENTATIVES
- 360 TELESALES COUNSELORS
- 1,400 PRUDENTIAL AGENTS

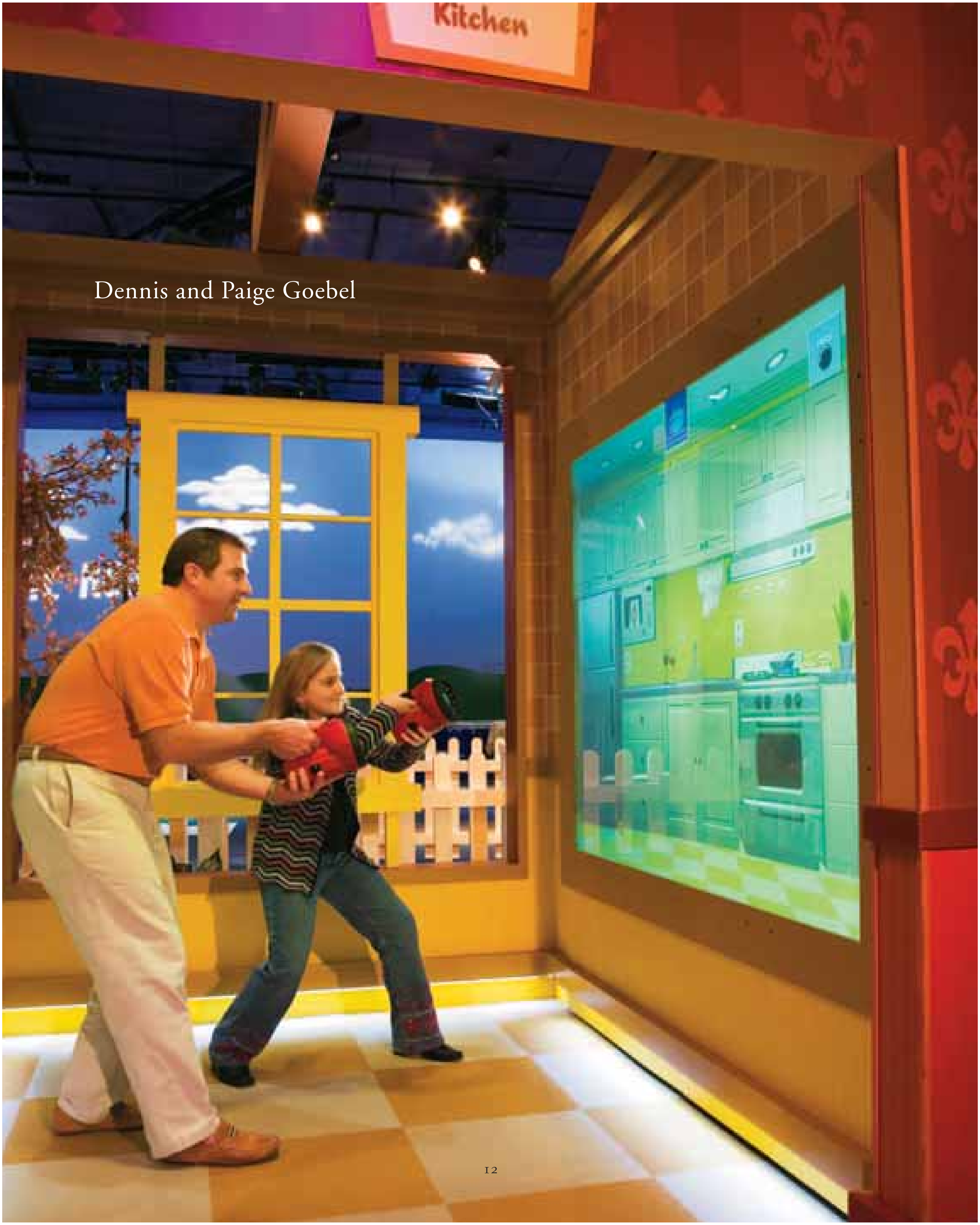
Product Mix | PERCENTAGE 2005 NET WRITTEN PREMIUM



Financial Results

	2005	2004	2003
REVENUES	$6.1 BILLION	$5.9 BILLION	$4.7 BILLION
PRE-TAX OPERATING INCOME	$636 MILLION	$613 MILLION	$397 MILLION
CASH FLOW FROM OPERATIONS	$869 MILLION	$990 MILLION	$934 MILLION
GAAP COMBINED RATIO	94.7%	95.5%	97.9%
POLICIES IN FORCE	4,673,255	4,565,412	4,552,166

“I’ll put in a new battery tomorrow.”



Dennis and Paige Goebel

Where's the Fire?™

Dennis Goebel prided himself on being safety conscious, but that was before he visited Liberty Mutual's "Where's the Fire?" exhibit at INNOVENTIONS at *Epcot*® at the *Walt Disney World*® Resort in Florida.

"The message is serious, but the delivery is a unique, interactive experience. And today we talk about safety more than ever before…things like staying low to the ground and not opening hot doors," he said. Since visiting the exhibit, he and his wife, Michelle, and their two children, seven-year-old Grant and nine-year-old Paige, regularly deep clean the dryer lint hoses and exhausts, and keep gas containers, paint and other combustible materials in the garage on a high shelf.

In fact, the 4,000-square-foot "Where's the Fire?" exhibit is a fun, hands-on experience that educates families on the fire hazards that may exist in their homes. Since its opening in October 2004, several hundred thousand *Epcot*® guests have played the main-show game, and young children from around the globe have learned how to escape from a home fire in the adjacent "Play It Safe" house.

The attraction also includes a 30-foot, interactive fire engine built by Liberty Mutual customer W.S. Darley & Sons, three "Burning Questions" touch-screen kiosks, and a "Badges of Honor" display recognizing hundreds of local fire departments from around the world.

The "Where's the Fire?" exhibit is perhaps the most dramatic example of Liberty Mutual's proactive approach to helping its customers live safer, more secure lives. Another vehicle communicating the safety message is the company's 30-year-old consumer magazine, Liberty Lines, distributed three times a year to nearly 3.5 million households. Furthermore, the company's partnership with Students Against Destructive Decisions (SADD), and Recording Artists, Athletes and Actors Against Drunk Driving (RADD) resulted in an effective and hugely popular teen driving video and family kit, "The Road Ahead: Stay Safe at the Wheel." Available through the Liberty Mutual website or branch offices, the program video features excerpts from the powerful HBO documentary —"Smashed: Toxic Tales of Teens and Alcohol."

Perhaps most important, Liberty Mutual employees conduct educational seminars — 2,500 such seminars in 2005 alone — on safe driving, identity theft protection and other topics, in the communities where they live and work. These efforts don't go unappreciated. "Nothing is more important than the safety and security of my family," Dennis Goebel said.

COMMERCIAL MARKETS

AT-A-GLANCE

Liberty Mutual's Commercial Markets distributes sophisticated risk management and risk transfer products and services to buyers and buyers' representatives through five business units: *National Market*, which serves the complex needs of large companies with customized financial and service programs; *Business Market*, which serves mid-sized businesses that prefer a direct relationship; *Liberty Mutual Property*, which provides property insurance programs, consultative loss prevention and claims services for both large and mid-sized companies; *Group Market*, which provides disability products, integrated disability management, group life insurance, AD&D, and FMLA administration for large and mid-sized businesses; and, *Liberty Mutual Alternative Markets*, which offers a comprehensive array of captive and rent-a-captive services.

Distribution Channels

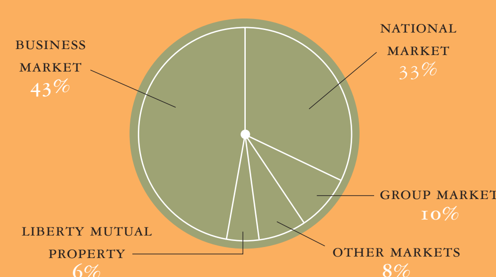
- DIRECT SALES FORCE
- NATIONAL AND REGIONAL BROKERS
- BENEFIT AND RISK MANAGEMENT CONSULTING FIRMS

By The Numbers

- 8,980 EMPLOYEES
- 676,000 CLAIMS CALL CENTER CALLS*
- 1,100 NATIONAL CUSTOMERS
- 7,000 MIDDLE-MARKET CUSTOMERS
- 450 LOSS PREVENTION CONSULTANTS*
- $1.3 BILLION IN MEDICAL BILL REVIEW SAVINGS*

*INCLUDES WAUSAU INSURANCE, PART OF LIBERTY MUTUAL AGENCY MARKETS

Business Lines | PERCENTAGE 2005 NET WRITTEN PREMIUM

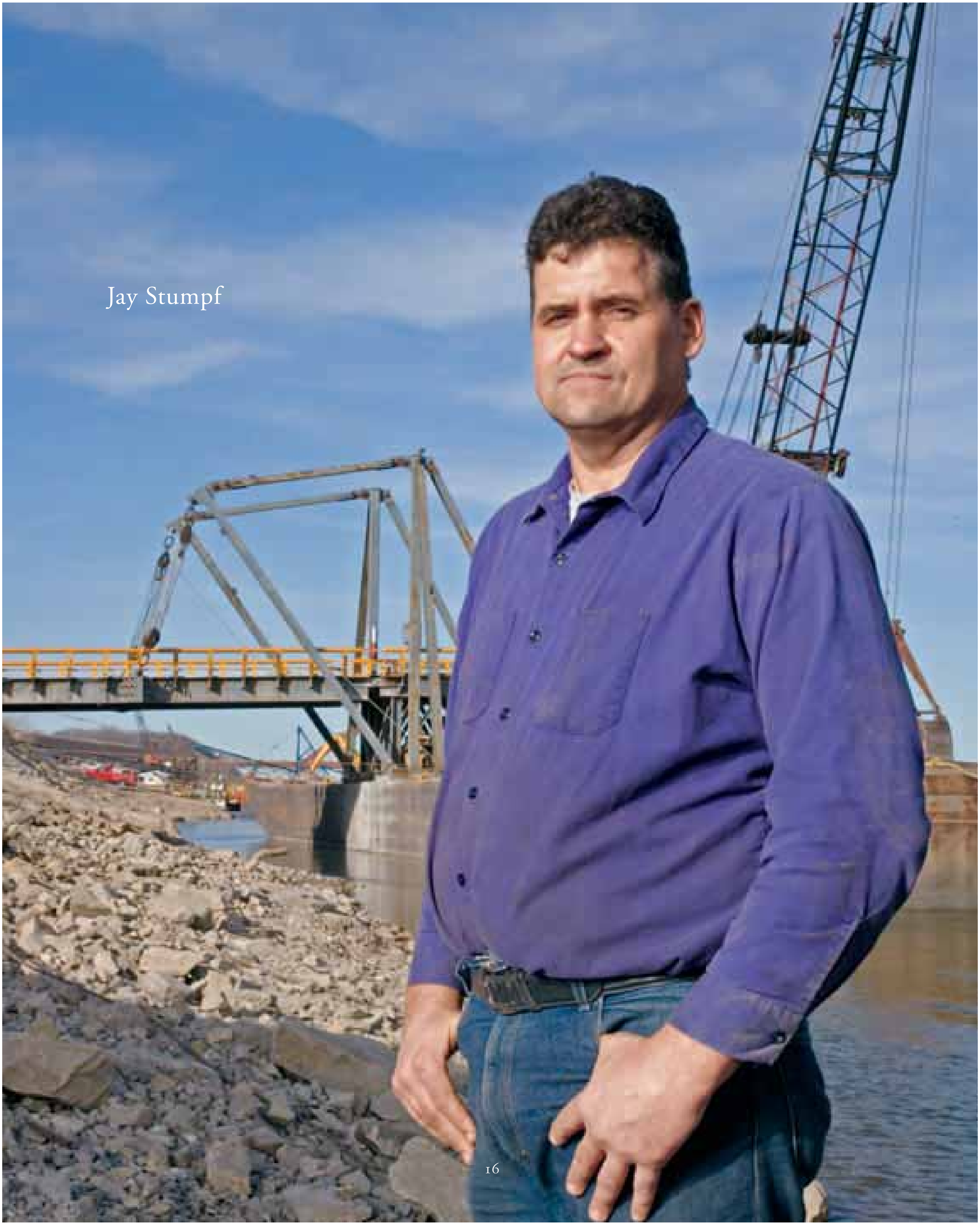


Financial Results

	2005	2004	2003
REVENUES	$4.4 BILLION	$4.4 BILLION	$4.2 BILLION
PRE-TAX OPERATING INCOME	$191 MILLION	$308 MILLION	$364 MILLION
CASH FLOW FROM OPERATIONS	$790 MILLION	$960 MILLION	$750 MILLION
GAAP COMBINED RATIO	108.7%	105.3%	104.6%

"Jay, listen to me, you're going to be OK."

Jay Stumpf



Return to work.

Jay Stumpf didn't know what hit him. Literally.

In fact, only after 11 days in the hospital and multiple surgeries did he learn what happened on April 17, 2004.

On that day, he was inspecting his crane's floating dock on the Mississippi River for his employer, Bussen Quarries in St. Louis, Mo. While relieving tension on a mooring cable, the handle on the ratchet binder slipped, striking him in the forehead and knocking him unconscious.

"They airlifted Jay to St. John's Mercy Hospital," said Dave Merz, a supervisor with Bussen Quarries, a Liberty Mutual customer. "He was in bad shape with severe skull fractures and some brain damage."

That same day at St. John's, Jennifer Gallagher, a Liberty Mutual medical case manager, met with Mr. Stumpf's family to describe her role. "My goal is to coordinate the best medical care and help injured workers like Mr. Stumpf recover and, if at all possible, eventually return to work," she said. "I also guide the family through what can be a very confusing workers compensation process."

During Mr. Stumpf's hospital stay, Jennifer, working closely with Liberty's Catastrophic Case Management Unit, handled every aspect of Mr. Stumpf's care, starting with intensive occupational and physical therapy at the Head Injury Resource Center (HIRC), an accredited facility in St. Louis. After four weeks at HIRC, he was discharged home, and soon began participating in therapy ("work hardening") arranged by Jennifer and her team, which simulated his activities at work.

With the work-hardening program in progress, Jennifer and Bussen Quarries identified ways for Mr. Stumpf to safely return to work, which he did 80 days after the accident.

Looking back, Jennifer said Mr. Stumpf's recovery from such a serious injury was nothing short of remarkable, thanks in great part to a supportive employer and a determined patient. "From the first moment of consciousness, I wanted to get back to work," he said.

Liberty Mutual Agency Markets consists of property and casualty, and specialty insurance carriers that distribute their products and services primarily through independent agents and brokers.

Core property and casualty products, including a comprehensive set of personal and commercial coverages, are available in most states from the following:

Regional Companies

AMERICA FIRST INSURANCE (GULF REGION)
COLORADO CASUALTY (MOUNTAIN REGION)
GOLDEN EAGLE INSURANCE (PACIFIC REGION)
HAWKEYE-SECURITY INSURANCE (NORTH CENTRAL REGION)
INDIANA INSURANCE, INCLUDING GOAMERICA AUTO INSURANCE (MIDWEST REGION)
LIBERTY NORTHWEST (PACIFIC NORTHWEST REGION)
MONTGOMERY INSURANCE (SOUTHEAST REGION)
PEERLESS INSURANCE (NORTHEAST REGION)

National and Specialty Companies

WAUSAU INSURANCE COMPANIES (NATIONAL)

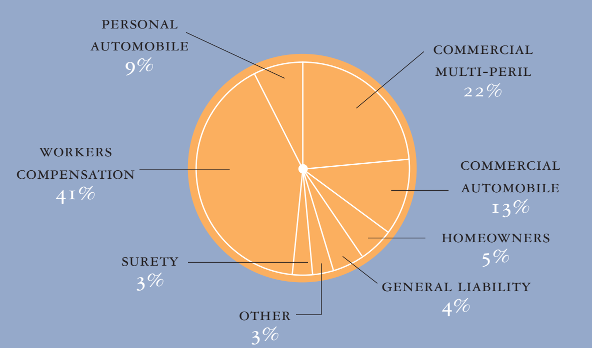
SUMMIT HOLDING SOUTHEAST, INC. (OFFERING WORKERS COMPENSATION PRODUCTS AND SERVICES PRIMARILY IN FLORIDA AND NINE SOUTHEASTERN STATES)

LIBERTY MUTUAL SURETY (OFFERING CONTRACT SURETY BONDS FOR CONSTRUCTION FIRMS, MANUFACTURERS AND SUPPLIERS, AND COMMERCIAL SURETY BONDS FOR CORPORATIONS AND INDIVIDUALS)

By The Numbers

- MORE THAN 6,800 EMPLOYEES
- TOP THREE CARRIER WITH 70 PERCENT OF ITS APPOINTED AGENCIES (REGIONAL COMPANIES)
- MORE THAN 6,500 APPOINTED AGENCIES AND BROKERAGES
- 793,649 REGIONAL COMPANY PERSONAL LINES POLICIES AND 462,630 COMMERCIAL LINES POLICIES IN FORCE, WITH AVERAGE PREMIUM OF $875 AND $8,307, RESPECTIVELY
- 5,378 WAUSAU INSURANCE ACCOUNTS IN FORCE AVERAGING $194,000 IN SIZE

Product Mix | PERCENTAGE 2005 NET WRITTEN PREMIUM



Financial Results

	2005	2004	2003
REVENUES	$5.8 BILLION	$5.2 BILLION	$4.5 BILLION
PRE-TAX OPERATING INCOME	$564 MILLION	$417 MILLION	$350 MILLION
CASH FLOW FROM OPERATIONS	$1.4 BILLION	$1.2 BILLION	$884 MILLION
GAAP COMBINED RATIO	98.3%	100.6%	102.7%

"The hurricanes spared no home or property."

Penny Goldman and Larry Mashburn, Louisiana Companies

Hurricane Rita

It's stressful enough when hurricane-force winds damage your home. But when those same winds damage your town and business, and that business is an insurance agency that handles policyholder claims, it's a challenge knowing what to do first.

Such was the nerve-wracking predicament facing Larry Mashburn when Hurricane Rita slammed ashore with 120 mph winds the morning of Saturday, Sept. 24, near Lake Charles, La. Mashburn is a risk advisor and certified insurance counselor with Louisiana Companies, a century-old insurance agency with offices in Baton Rouge, Lafayette and Lake Charles. Among the top insurance companies his firm represents is America First Insurance, a Liberty Mutual Agency Markets company, whose operating territory is the Gulf Region of the United States.

Despite a fallen tree crashing into his home, Mashburn and his coworkers got to work immediately in a 10'-by-10' tent near the street on Louisiana Companies' property. "We had no power, and we wanted to be visible to anyone driving by who might need our help," he said.

With communication in disarray, they sought out policyholders as best they could, taking claims, both commercial and personal. But, with more than 10,000 claims resulting from the storm, the task threatened to overwhelm. That's when Agency Markets Catastrophe Response Team members Monte Collins and Rob Nixon entered the picture.

"I got the impression they were pretty glad to have us take some of the claims burden off their shoulders," said Rob, a claims specialist with another Agency Markets company, Indiana Insurance. He and Monte, an Indiana Insurance claims unit manager, volunteered their services along with 30 other Agency Markets claims professionals in the aftermath of Katrina and Rita. "The hurricanes spared no home or property. Everybody for hundreds of miles was affected," he said. "Yet, the folks at Louisiana Companies were resilient, and tended to clients' needs, even while their own homes had no electricity or water."

With power out for the foreseeable future, Rob and Monte set up shop on Louisiana Companies' property using laptop computers powered from their vehicles. Little did they know that, for the next three weeks, they'd commute two hours each day to help process more than 2,000 America First claims in the Lake Charles area, among them Mashburn's homeowner claim.

"These guys hit the ground running a few days after the storm and did not stop," Mashburn said. "I've been in the insurance business for more than 35 years, and I had never experienced anything like the aftermath of Rita. America First was the first carrier to step up to the plate, and these guys made things happen."

LIBERTY INTERNATIONAL

AT-A-GLANCE

Liberty International provides personal and small commercial lines insurance through operations in 11 countries: Argentina, Brazil, Chile, China, Colombia, Hong Kong, Portugal, Singapore, Spain, Thailand and Venezuela. Additionally, Liberty International Underwriters, a global specialty lines insurance and reinsurance business, writes casualty, specialty casualty, marine, energy, engineering and aviation through offices in Asia, Australia, Europe and North America. Liberty Syndicate 4472 at Lloyd's of London writes on a worldwide basis.

Country Operations

(60 PERCENT OF INTERNATIONAL NET WRITTEN PREMIUM)

ASIA

LIBERTY MUTUAL INSURANCE COMPANY (CHINA)
LIBERTY INTERNATIONAL INSURANCE LTD. (HONG KONG)
LIBERTY INSURANCE PTE. LTD. (SINGAPORE)
LMG INSURANCE (THAILAND)
LIBERTY MUTUAL GROUP INC. (VIETNAM)

EUROPE

LIBERTY SEGUROS (PORTUGAL)
LIBERTY SEGUROS AND GENESIS (SPAIN)

LATIN AMERICA

LIBERTY ART S.A. (ARGENTINA)
LIBERTY SEGUROS ARGENTINA S.A.
LIBERTY PAULISTA SEGUROS (BRAZIL)
LIBERTY SEGUROS (CHILE)
LIBERTY SEGUROS (COLOMBIA)
SEGUROS CARACAS DE LIBERTY MUTUAL C.A. (VENEZUELA)

Liberty International Underwriters (LIU)

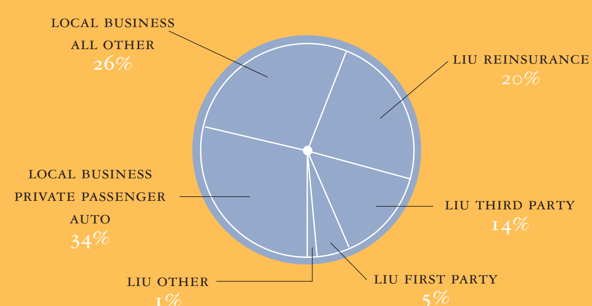
(40 PERCENT OF INTERNATIONAL NET WRITTEN PREMIUM)

LIBERTY SYNDICATE MANAGEMENT
LIBERTY MUTUAL INSURANCE EUROPE
LIU AUSTRALIA
LIU CANADA
LIU HONG KONG
LIU SINGAPORE
LIU U.S.

By The Numbers

- 7,000 EMPLOYEES
- 2ND-LARGEST U.S.-BASED INTERNATIONAL P&C COMPANY
- 3RD-LARGEST MANAGING AGENT IN LLOYDS
- NUMBER ONE RANKING IN COLOMBIA AND VENEZUELA
- FIRST APPROVED FOREIGN INSURER IN WESTERN CHINA
- AVERAGE FIVE-YEAR GROWTH RATE OF 20.2 PERCENT FOR LIU
- OVER $1 BILLION IN NET WRITTEN PREMIUM IN BOTH LATIN AMERICA AND EUROPE.

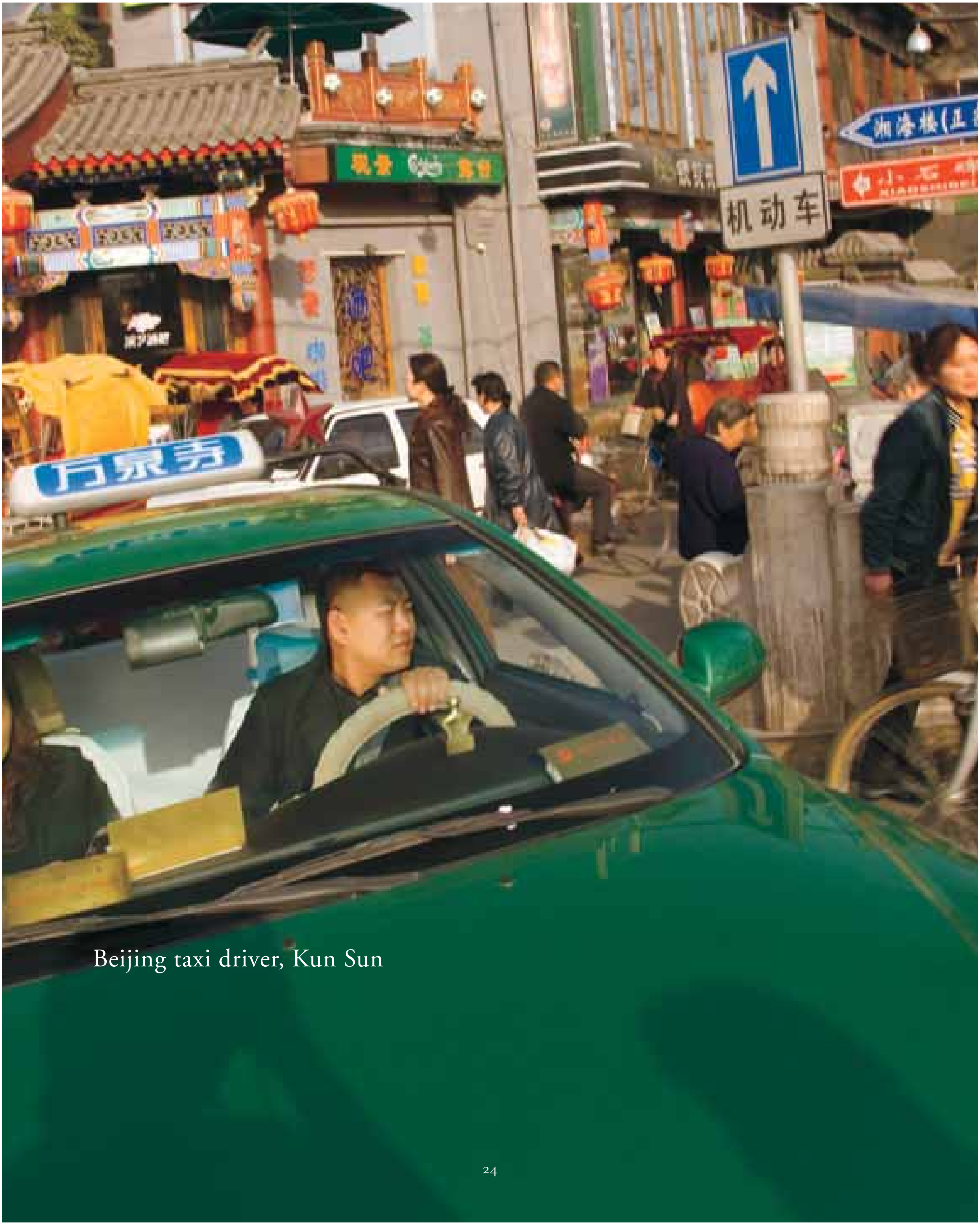
Product Mix | PERCENTAGE 2005 TOTAL NET WRITTEN PREMIUM



Financial Results

	2005	2004	2003
REVENUES	$3.9 BILLION	$3.6 BILLION	$2.9 BILLION
PRE-TAX OPERATING INCOME	($244 MILLION)	$273 MILLION	$130 MILLION
CASH FLOW FROM OPERATIONS	$967 MILLION	$768 MILLION	$750 MILLION
GAAP COMBINED RATIO	117.0%	97.9%	101.8%

“I’m much more alert to my driving habits.”



Beijing taxi driver, Kun Sun

Driver Training in China

On average, China, with its 1.3 billion people, experiences at least 100,000 traffic fatalities each year, compared to 42,000 in the U.S. And, despite having fewer than two percent of the world's vehicles, the country experiences 15 percent of the world's fatal highway crashes.

Sharing those roadways is 25-year-old Kun Sun, a taxi driver with Beijing Wanquansi Taxi Company Ltd. Along with 80 other taxi drivers, fleet owners and traffic officials, Kun Sun participated in Liberty Mutual's Decision Driving® program, a classroom and in-vehicle training seminar that improves how a driver perceives and processes information while driving, makes decisions, and avoids hazards and potential accident-producing situations. A proven tool in the U.S., Liberty Mutual Loss Prevention delivers more than 250 Decision Driving programs to domestic trucking and commercial auto clients each year.

Coming just weeks before Liberty issued its first auto insurance policy in China in June 2005, the introduction of Decision Driving in China was a learning experience for both the trainees and trainers, with the latter encountering some unexpected hurdles.

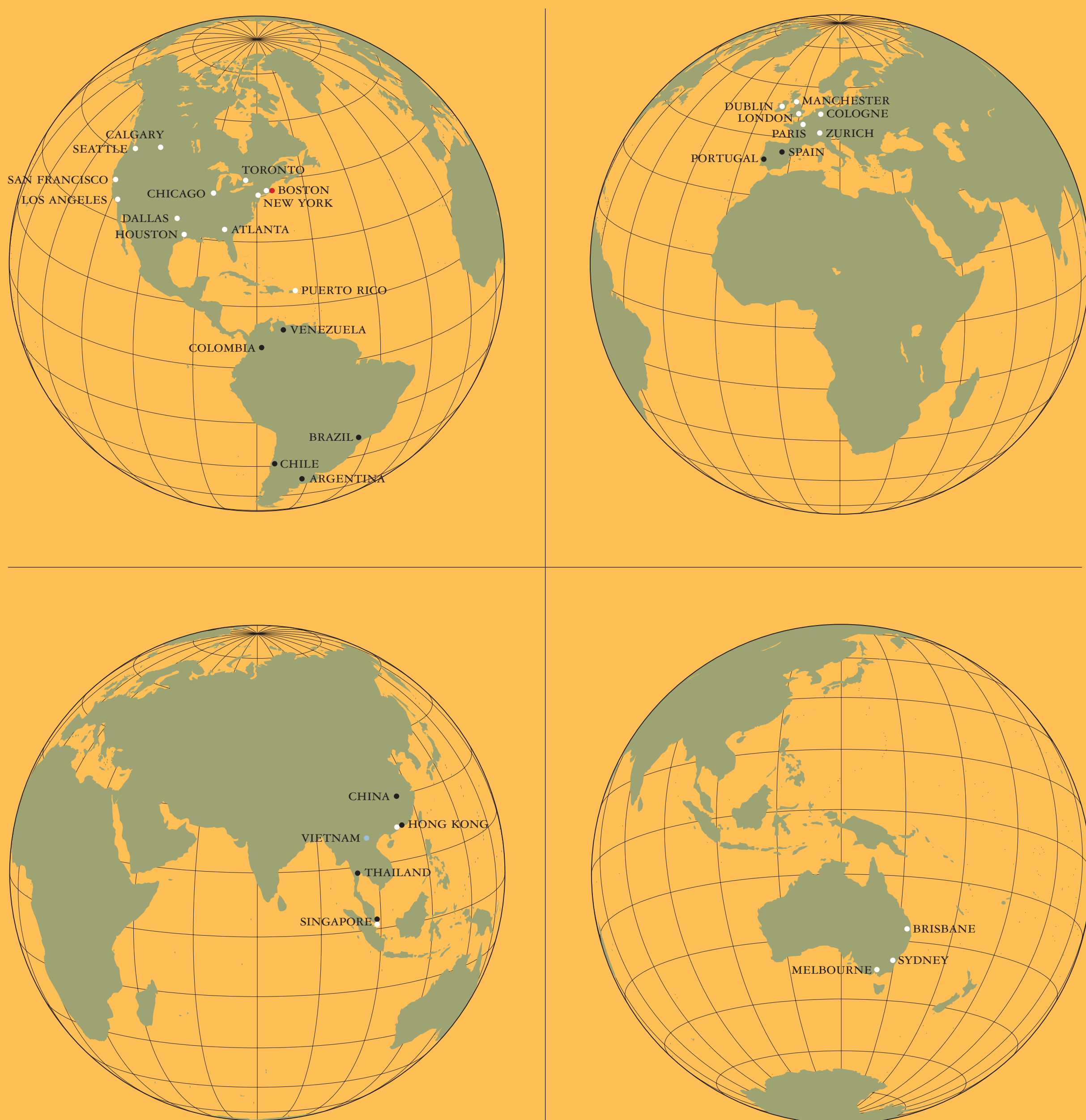
"We checked out a half-dozen remote sites near Beijing before settling for what we thought was an abandoned road, but actually was a former runway on a military fighter base," said Dave Melton, who along with Dave Money, is a driving safety expert for Liberty Mutual.

Language was a second hurdle, as the Liberty Mutual training staff spoke no Chinese and the trainees spoke no English. "We overcame this obstacle by training our own trainers first," Dave Money said.

Over two weeks, Liberty staff participated in three press conferences, with reporters expressing particular interest in perceived differences in driving conditions and behaviors between the U.S. and China. "You can attribute most crashes in China to inadequate driver skills training, congested roadways shared by pedestrians, bicycles and motor vehicles, or inadequate attention to and enforcement of traffic safety regulations," Dave Melton said. "Then again, you don't encounter the road rage issue you find in the U.S."

Said Kun Sun, "I face challenging driving conditions every day, and today I'm much more alert to my driving habits as well as others'. In the end, everyone will benefit."

HEADQUARTERS LOCAL COMPANIES LIBERTY INTERNATIONAL UNDERWRITERS OFFICES
OTHER LIBERTY INTERNATIONAL OFFICES



FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF INCOME

(DOLLARS IN MILLIONS)

Years Ended December 31,	2005	2004	2003
Revenues			
Premiums earned	$17,631	$16,563	$13,956
Net investment income	2,247	2,102	1,762
Net realized investment gains	523	312	373
Fee and other revenues	760	664	527
Total revenues	21,161	19,641	16,618
Claims, Benefits and Expenses			
Benefits, claims and claim adjustment expenses	14,252	13,055	11,103
Insurance operating costs and expenses	2,932	2,695	2,560
Amortization of deferred policy acquisition costs	2,480	2,349	1,915
Other expenses	367	323	263
Total claims, benefits and expenses	20,031	18,422	15,841
Income from continuing operations before income tax expense	1,130	1,219	777
Federal and foreign income tax expense	91	–	–
Income from continuing operations before extraordinary (loss) gain and discontinued operations	1,039	1,219	777
Extraordinary (loss) gain, net of tax	–	(3)	77
Discontinued operations, net of tax	(12)	29	(3)
Net income	$ 1,027	$ 1,245	$ 851

See accompanying notes to the audited consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN MILLIONS)

December 31,	2005	2004
Assets:		
Investments:		
Fixed maturities, available for sale, at fair value (amortized cost of $36,962 and $34,279)	$37,391	$35,601
Equity securities, available for sale, at fair value (cost of $1,154 and $1,126)	1,908	1,802
Trading securities, at fair value (cost of $13 and $447)	20	457
Other investments	1,124	990
Short-term investments	1,430	687
Total investments	41,873	39,537
Cash and cash equivalents	3,155	2,590
Premium and other receivables (net of allowance of $131 and $137)	5,976	5,642
Reinsurance recoverables (net of allowance of $324 and $349)	16,302	14,209
Deferred income taxes (net of valuation allowance of $99 and $340)	1,627	938
Deferred policy acquisition costs	1,476	1,354
Goodwill and intangible assets	810	824
Prepaid reinsurance premiums	1,224	1,330
Other assets	3,811	3,670
Separate account assets	2,570	2,363
Total assets	$78,824	$72,457
Liabilities:		
Unpaid claims and claim adjustment expense and future policy benefits:		
Property and casualty	$38,045	$33,884
Life	4,751	4,802
Other policyholder funds and benefits payable	2,491	2,290
Unearned premiums	8,454	8,240
Funds held under reinsurance treaties	1,826	1,767
Short-term debt	145	253
Long-term debt	2,555	2,074
Other liabilities	9,129	8,087
Separate account liabilities	2,570	2,363
Total liabilities	69,966	63,760
Policyholders' equity:		
Unassigned equity	8,466	7,439
Accumulated other comprehensive income	392	1,258
Total policyholders' equity	8,858	8,697
Total liabilities and policyholders' equity	$78,824	$72,457

See accompanying notes to the audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOW

(DOLLARS IN MILLIONS)

Years Ended Ended December 31,	2005	2004	2003
Cash flows from operating activities:			
Net income from continuing operations	$ 1,039	$ 1,219	$ 777
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	217	191	130
Realized investment gains	(523)	(312)	(373)
Undistributed private equity investment gains	(208)	(141)	-
Premium, other receivables, and reinsurance recoverables	(2,348)	(2,589)	(779)
Deferred policy acquisition costs and distribution costs	(122)	(246)	(182)
Liabilities for insurance reserves	4,623	5,512	2,998
Taxes payable, net of deferred	(186)	(229)	(68)
Other, net	1,214	(198)	176
Total adjustments	2,667	1,988	1,902
Net cash provided by operating activities	3,706	3,207	2,679
Cash flows from investing activities:			
Purchases of investments	(20,273)	(21,467)	(26,384)
Sales and maturities of investments	16,955	18,858	23,432
Property and equipment purchased, net	(306)	(208)	(258)
Other investing activities	(156)	(253)	(225)
Net cash from acquisitions and dispositions	(15)	(79)	(346)
Net cash used in investing activities	(3,795)	(3,149)	(3,781)
Cash flows from financing activities:			
Net activity in policyholder accounts	20	109	127
Debt financing, net	373	534	381
Net security lending activity and other financing activities	297	(146)	(23)
Net cash provided by financing activities	690	497	485
Net cash provided by discontinued operations	(36)	36	1
Net increase (decrease) in cash and cash equivalents	565	591	(616)
Cash and cash equivalents, beginning of year	2,590	1,999	2,615
Cash and cash equivalents, end of year	$ 3,155	$ 2,590	$ 1,999
Supplemental disclosure of cash flow information:			
Income taxes paid	$ 264	$ 185	$ 27

See accompanying notes to the audited consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN POLICYHOLDERS' EQUITY

(DOLLARS IN MILLIONS)

	Unassigned Equity	Accumulated Other Comprehensive Income	Policyholders' Equity
Balance, January 1, 2003	$5,343	$1,104	$6,447
Comprehensive income			
Net income	851	–	851
Other comprehensive income (loss), net of taxes:			
Unrealized gains on securities	–	144	144
Less: reclassification adjustment for gains and losses included in net income	–	(242)	(242)
Minimum pension liability	–	(13)	(13)
Foreign currency translation adjustments	–	194	194
Other comprehensive income, net of taxes	–	83	83
Total comprehensive income			934
Balance, December 31, 2003	$6,194	$1,187	$7,381
Comprehensive income			
Net income	1,245	–	1,245
Other comprehensive income (loss), net of taxes:			
Unrealized gains on securities	–	189	189
Less: reclassification adjustment for gains and losses included in net income	–	(203)	(203)
Minimum pension liability	–	(1)	(1)
Foreign currency translation adjustments	–	86	86
Other comprehensive income, net of taxes	–	71	71
Total comprehensive income			1,316
Balance, December 31, 2004	$7,439	$1,258	$8,697
Comprehensive income			
Net income	1,027	–	1,027
Other comprehensive income (loss), net of taxes:			
Unrealized losses on securities	–	(171)	(171)
Less: reclassification adjustment for gains and losses included in net income	–	(340)	(340)
Minimum pension liability	–	(306)	(306)
Foreign currency translation adjustments	–	(49)	(49)
Other comprehensive income, net of taxes	–	(866)	(866)
Total comprehensive income			161
Balance, December 31, 2005	$8,466	$ 392	$8,858

See accompanying notes to the audited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN MILLIONS)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2004 and 2003 consolidated financial statements to conform with the 2005 presentation. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company's principal estimates include (1) unpaid losses and loss expense reserves, including asbestos and environmental reserves, (2) allowance for uncollectible reinsurance and policyholder receivables, (3) other than temporary impairments to the fair value of the investment portfolio, (4) deferred acquisition costs, (5) the valuation of goodwill and intangible assets, and (6) valuation allowance on deferred taxes. While management believes that the amounts included in the consolidated financial statements reflect their best estimates and assumptions, these amounts could ultimately be materially different from the amounts currently provided for in the consolidated financial statements.

Nature of Operations

The Company conducts substantially all of its business through four strategic business units: Personal Market, Commercial Markets, Agency Markets and International.

The Company's Personal Market business unit writes virtually all types of property and casualty insurance covering personal risks, primarily personal automobile and homeowners.

The Commercial Markets business unit is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base, product grouping, or distribution channel to provide tailored products and services that specifically address customers' needs. The Commercial Markets business unit includes National Market, Business Market, Liberty Mutual Property and Group Market. The Commercial Markets coverages include workers compensation, commercial automobile, general liability, including product liability, multiple peril, group disability and life insurance, property, and a variety of other coverages. Commercial Markets is also a servicing carrier for workers compensation and commercial automobile involuntary market pools.

Agency Markets consist of regional property and casualty insurance companies distributing their products and services primarily through independent agents and brokers throughout the United States. The addition of Wausau and Liberty Mutual Surety in 2005 enhanced Agency Markets' capabilities and offerings through the independent distribution channels by providing a full range of commercial insurance products and services for mid-market accounts. Agency Markets provides workers compensation, property, commercial automobile and general liability coverages to small and mid-market businesses, surety coverages to national and multi-national companies and individuals, as well as personal lines coverages (primarily personal automobile and homeowners). Agency Markets also includes two specialty operations: Summit Holding Southeast Inc., that provides workers compensation products and services (primarily in Florida) and GoAmerica Auto Insurance, that offers non-standard automobile insurance (primarily in the Midwest).

The Company's International business unit consists of the global specialty business, known as Liberty International Underwriters ("LIU"), and local personal and commercial businesses, primarily property and casualty. LIU is composed of global specialty commercial insurance and reinsurance with operations principally based in the U.S., Canada, Australia, Singapore, London and European markets. London and European operations consist of Liberty Mutual Insurance Europe Ltd. with branches in Dublin, Paris and Cologne and Lloyd's of London, Syndicate 4472, (formerly known as Syndicates 190 and 282) with branches in Paris and Cologne. International distributes its LIU global specialty commercial insurance and reinsurance products exclusively through broker distribution channels. LIU provides a variety of specialty products including casualty, marine, engineering, energy, directors and officers, errors and omissions, aviation, property and professional liability insurance together with multi-line insurance and reinsurance including property catastrophe reinsurance, written through Lloyd's of London. International also operates local insurance operations consisting of local companies selling traditional property, casualty and life insurance products to individuals and businesses in several nations with a large and growing middle class, primarily in South America, Asia and Southern Europe.

In addition to the strategic business units, Corporate consists of Individual Life, discontinued operations, interest expense on the Company's debt, internal reinsurance programs, long-term compensation plans, income (loss) related to energy and non-energy limited partnership investments, substantially all realized gains (losses) from the domestic property-casualty investment portfolio and Liberty Energy. Individual Life provides life insurance and annuities for individuals and also issues structured settlement contracts and administers separate account contracts. Discontinued operations are 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"). Liberty Energy is a wholly owned subsidiary of the Company and generates revenue from the production and sale of oil and gas.

Adoption of New Accounting Standards

In November 2003, the Emerging Issues Task Force ("EITF") reached a consensus on the disclosures required for other-than-temporary impairments and continued their discussions on an other-than-temporary impairment model outlined in EITF Issue 03-1, *"The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"* ("EITF 03-1"). EITF 03-1 requires investors to disclose quantitative information about the (1) aggregate amount of unrealized losses, (2) the aggregate related fair values of investments with unrealized losses, segregated into less than and greater than 12 months categories and (3) qualitative information that supports their conclusion that the impairments noted in the quantitative disclosures are not other-than-temporary. The Company disclosed the required information in Note 4.

In November 2005, the FASB issued FSP FAS 115-1 and FAS 124-1, *"Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"* ("FSP FAS 115-1 and FAS 124-1") nullifying paragraphs 10-18 of EITF 03-1 dealing with certain aspects of the impairment model. Companies are required to determine whether investment impairment is other-than-temporary based on existing impairment guidance, recognize other-than-temporary impairment regardless of intent to sell and provide disclosures as required under EITF 03-1. The Company is required to implement FSP FAS 115-1 and FAS 124-1 effective January 1, 2006. The Company is assessing the guidance and whether changes to the Company's current other-than-temporary policy is necessary to comply.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act provides a prescription drug benefit under Medicare Part D and a 28% non-taxable subsidy to sponsors of defined benefit postretirement health plans that are actuarially equivalent to Medicare Part D. In May 2004, the FASB issued Staff Position 106-2, *"Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act")"* ("FSP 106-2"). FSP 106-2 supersedes FSP 106-1 and provides guidance on accounting for the effects of the Act. The Company adopted FSP 106-2 in the third quarter of 2004 and, as permitted, elected retroactive application to December 31, 2003 (the measurement date following enactment of the Act). The Company and its actuarial advisors determined that the postretirement medical plans for certain existing retirees and their dependents provide a benefit that is at least actuarially equivalent to Medicare Part D under the Act, and, accordingly, the Company is entitled to the subsidy. Accounting for the effect of the Federal subsidy reduced the Company's accumulated postretirement benefit obligation by $32 at January 1, 2004. As a result of adopting FSP 106-2, the net periodic postretirement benefit costs include a reduction in benefit costs of $2 in 2004.

In July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position 03-1, *"Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts"* ("SOP 03-1"). SOP 03-1 provides a conceptual framework that facilitates the determination of the proper accounting for various life and annuity products. SOP 03-1 requires (1) the reporting and measurement of separate account assets and liabilities as general account assets and liabilities when specified criteria are not met, (2) the capitalization of sales inducements that meet specified criteria and amortizing such amounts over the life of the contracts using the same methodology as used for amortizing deferred acquisition costs, but immediately expensing sales inducements accrued or credited if such criteria are not met, and (3) the classification and valuation of certain nontraditional long-duration contract liabilities. The Company adopted SOP 03-1 on January 1, 2004. The Statement did not have a material impact on the Company's results of operations, financial condition or liquidity.

In December 2004, the FASB issued Staff Position 109-2, *"Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004"* ("FSP 109-2") to address requirements of The American Jobs Creation Act of 2004 ("the AJC Act") that was signed into law on October 22, 2004. The AJC Act had a significant impact on taxpayers, including corporations that have foreign

U.S. operations. Among the changes to the U.S. tax rules, was the one-time U.S. tax rate reduction on the repatriation of offshore earnings, executive compensation and other employee benefits provisions. The AJC Act provided U.S. taxpayers with operations abroad, the ability to claim a one-time 85% deduction for repatriation of earnings previously reinvested in foreign subsidiaries. In order to qualify for the deduction, taxpayers were required to reinvest the dividends under a properly approved domestic reinvestment plan.

FSP 109-2 permitted additional time beyond the financial reporting period of enactment to evaluate the effect of the AJC Act on its plans for repatriation of unremitted earnings for purposes of applying FAS 109, *"Accounting for Income Taxes"* ("FAS 109"). The Statement required the recognition of the income tax effect when the decision to reinvest or repatriate the foreign earnings is made. The Company adopted FSP 109-2 on December 21, 2004, the date of issuance. In 2005, the Company repatriated a total of $161 from its foreign subsidiaries and recorded a related tax expense of $18.

In January 2003, the FASB issued Interpretation No. 46, *"Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51"* ("FIN 46"). FIN 46 requires certain variable interest entities ("VIEs") to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or the entity does not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 was revised in late 2003 (FIN 46(R)) and was effective January 1, 2004 for the Company for all new VIEs created or acquired after December 31, 2003. The provisions of FIN 46 were applied in 2005 for VIEs created or acquired by the Company prior to December 31, 2003 and they did not materially impact the Company's financial position or results of operations.

The Company's exposure to investment structures subject to analysis under FIN 46(R), relate primarily to investments in energy and private equity limited partnerships that are accounted for under the equity method. The Company has determined that it is the primary beneficiary for 2 VIEs in the energy investment sector at December 31, 2005. In addition, the Company has investments in 3 VIEs for which it is not the primary beneficiary at December 31, 2005. The Company's investments in VIEs are not material to the Company's consolidated financial position, results of operations or cash flows at December 31, 2005. The Company's maximum exposure to losses from all VIEs is $31 at December 31, 2005, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Future Adoption of New Accounting Standards

In September 2005, the AcSec issued Statement of Position No. 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts" ("SOP 05-1"). This SOP provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB Statement No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized gains and Losses from the Sale of Investments" ("FAS 97"). As defined by the SOP, an internal replacement is a modification in product benefits, features, rights, or coverage that occurs by exchange of a contract for a new contract, or by amendment, endorsement, rider, or by election of a feature or coverage within an existing contract. The guidance in this SOP is effective for internal replacements occurring in fiscal years beginning after December 15, 2006, with earlier adoption encouraged. This statement is effective for the Company on January 1, 2007 and its adoption is not expected to materially impact the Company's financial position or results of operations.

Investments

Available for sale: Fixed maturity securities classified as available for sale, are debt securities, that have fixed or variable principal payment schedules, held for indefinite periods of time, and are used as a part of the Company's asset/liability strategy or sold in response to risk/reward characteristics, liquidity needs or similar economic factors. These securities are carried at market value with the corresponding unrealized investment gains or losses, net of deferred income taxes, reported in accumulated other comprehensive income.

Equity securities classified as available for sale include common equities and non-redeemable preferred stocks and are reported at quoted market values. Changes in the market values of these securities, net of deferred income taxes, are reflected as unrealized investment gains or losses in accumulated other comprehensive income.

Trading securities: Trading securities are securities bought principally for the purpose of sale in the near term and are reported at market value. Changes in market value are recognized in income as realized gains or losses in the current period.

Realized gains and losses on sales of investments are recognized in income using the specific identification method. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company reviews fixed income and public equity securities for impairment on a quarterly basis and private equity and co-investment securities on a semi-annual basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to, (1) the extent of the decline in fair value below book value, (2) the duration of the decline, (3) significant adverse changes in the financial condition or near term prospects for the investment or issuer, (4) significant changes in the business climate or credit ratings of the issuer, (5) the intent and ability of the company to hold its investment for a period sufficient to allow for any anticipated recovery, (6) general market conditions and volatility, (7) industry factors, and (8) the past impairment history of the security holding or the issuer. All mortgage backed securities and asset backed securities are reviewed for other-than-temporary impairment treatment in accordance with the guidance of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets". 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.

For mortgage-backed fixed maturity securities, the Company recognizes income using a constant effective yield based on anticipated prepayments over the economic life of the security. The mortgage-backed portfolio is accounted for under the retrospective method and prepayment assumptions are based on market expectations. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments and any resulting adjustment is included in net investment income.

Cash equivalents are short-term, highly liquid investments that are both readily convertible into known amounts of cash and so near to maturity that they present insignificant risk of changes in value due to changing interest rates. The Company's cash and cash equivalents include debt securities purchased with maturities of three months or less at acquisition and are carried at amortized cost that approximates fair market value.

Short-term investments are debt securities with maturities at acquisition between three months and one year, are considered available for sale and are carried at amortized cost, that approximates fair market value.

Other investments, principally investments in limited partnerships, are accounted for using the equity method. Other investments, principally equity investments in privately held businesses, are accounted for under the cost method where market value data is unavailable for the underlying investment.

Derivatives

All derivatives are recognized on the balance sheet at fair value. On the date a contract is entered into, the Company designates the derivative as either (1) a hedge of a fair value of a recognized asset ("fair value hedge") or (2) an economic hedge ("non-designated derivative"). Changes in the fair value of a derivative that is highly effective and is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset attributable to the hedged risk, are recorded in current period operations as a component of net investment income. Changes in the fair value of non-designated derivatives are reported in current period operations, as a component of net realized gains and losses and the derivative is included in other assets or liabilities. The Company owns fixed securities which have an option to convert to equity. The derivative features embedded are ancillary to the overall investment. This type of activity is unrelated to hedging.

The Company uses various derivative instruments to hedge exposure against interest rates and equity market returns guaranteed by certain life products. In addition, there may be call, put or conversion options embedded in certain bonds it has purchased. The fair value of these derivative instruments is based on broker quotations. These derivatives are not material to the Company's financial statements.

Securities Lending

The Company participates in a securities lending program to generate additional income, whereby certain domestic fixed income securities are loaned for a short period of time from the Company's portfolio to qualifying third parties, via a lending agent. Terms of the agreement are for borrowers of these securities to provide collateral of at least 102% of the market value of the loaned securities. Acceptable collateral may be in the form of cash or U.S. Government securities. The market value of the loaned securities is monitored and additional collateral is obtained if the market value of the collateral falls below 100% of the market value of the loaned securities. Under the terms of the securities lending program, the lending agent indemnifies the Company against borrower defaults. The loaned securities remain a recorded asset of the Company, however, the Company records a liability for the amount of collateral held, representing its obligation to return the collateral related to the loaned securities.

Goodwill and Intangible Assets

Goodwill is tested for impairment at least annually using a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount of the intangible asset exceeds its fair value. Intangible assets are amortized over their useful lives. Impairment is recognized only if the carrying amount of the intangible asset is not recoverable from its undiscounted cash flows and is measured as the difference between the carrying amount and the fair value of the asset. Other changes in the carrying amount of goodwill are primarily caused as a result of foreign currency translation adjustments and adjustments to valuation allowances for acquired tax losses.

Deferred Policy Acquisition Costs

Costs that vary with and are primarily related to the acquisition of new and renewal insurance and investment contracts are deferred and amortized over the respective policy terms. Deferred policy acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration contracts, acquisition costs include commissions, underwriting expenses and premium taxes. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses.

For short-duration contracts, acquisition costs are amortized in proportion to earned premiums. For traditional long-duration contracts, acquisition costs are amortized over the premium paying period of the related policies using assumptions consistent with those used in computing policy benefit reserves. For universal life insurance, annuity and investment products, acquisition costs are amortized in relation to expected gross profits.

For long-duration contracts, to the extent unrealized gains or losses on fixed income securities carried at fair value would result in an adjustment of estimated gross profits had those gains or losses actually been realized, the related unamortized deferred policy acquisition costs are recorded net of tax as a reduction of the unrealized capital gains or losses and included in accumulated other comprehensive income.

Real Estate and Other Fixed Assets

The costs of buildings and furniture and equipment are depreciated, principally on a straight-line basis, over their estimated useful lives (a maximum of 40 years for buildings and 10 years for furniture and equipment). Expenditures for maintenance and repairs are charged to income as incurred while expenditures for improvements are capitalized and depreciated.

Separate Account Assets and Liabilities

Separate and variable accounts represent funds for which investment income and investment gains and losses accrue directly to the policyholders who predominantly bear the investment risk. Each account has specific investment objectives, and the assets are carried at fair value. The assets of each account are legally segregated and are not subject to claims that arise out of any other business of the Company. The assets of these accounts are equal to the account liabilities. Investment income, realized investment gains (losses), and policyholder account deposits and withdrawals related to separate accounts are excluded from the consolidated statements of income. The fees earned for administrative and contract holder maintenance services performed for these separate accounts are included in fee and other revenue.

Insurance Liabilities and Reserves

For short-duration contracts, the Company establishes reserves for unpaid insurance claims and claim adjustment expenses covering events that occurred in 2005 and prior years. These reserves reflect estimates of the total cost of claims reported but not yet paid and the cost of claims not yet reported, as well as the estimated expenses necessary to settle the claims. Reserve estimates are based on past loss experience modified for current claim trends, as well as prevailing social, economic and legal conditions. Final claim payments, however, may ultimately differ from the established reserves, since these payments might not occur for several years. Reserve estimates are continually reviewed and updated, and any resulting adjustments are reflected in current operating results. The Company does not discount reserves other than tabular discounting on the long-term indemnity portion of workers compensation claims, the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states and specific asbestos structured settlements. Reserves are reduced for estimated amounts of salvage and subrogation and deductibles recoverable from policyholders.

For long-duration contracts, measurement of liabilities is based on generally accepted actuarial techniques but requires assumptions about mortality, lapse rates and assumptions about future returns on related investments. Annuity and structured settlement contracts without significant mortality or morbidity risk are accounted for as investment contracts, whereby the premium received plus interest credited less policyholder withdrawals represents the investment contract liability. Credited interest rates for domestic structured settlement contracts in force were between 1.0% and 12.0% in 2005 and between 1.0% and 9.0% in 2004 and 2003. Credited interest rates for foreign structured settlement contracts in force were between 2.5% and 6.0% in 2005, 2004 and 2003. Credited rates for domestic universal life contracts in force were between 3.5% and 7.0% in 2005, between 4.0% and 8.0% in 2004 and between 4.0% and 8.5% in 2003. Credited rates for foreign universal life contracts in force were between 1.0% and 6.0% in 2005, 2004 and 2003. Liabilities for future policy benefits for traditional life policies have been computed using the net level premium method based upon estimated future investment yields (between 4.5% and 10.3% in 2005 and between 4.1% and 10.3% in 2004 and 2003), mortality assumptions (based on the Company's experience relative to standard industry mortality tables) and withdrawal assumptions (based on the Company's experience).

Policyholder Dividends

Policyholder dividends are accrued using an estimate of the ultimate amount to be paid in relation to premiums earned based on the underlying contractual obligations.

For domestic property-casualty insurance certain insurance contracts, primarily workers compensation policies are issued with dividend plans to be paid subject to approval by the insurer's board of directors. Such policies approximate 2% of domestic property-casualty insurance premiums written at December 31, 2005, 2004 and 2003.

For life insurance, dividends to participating policyholders are calculated as the sum of the difference between the assumed mortality, interest and loading, and the actual experience of the Company relating to participating policyholders. As a result of statutory regulations, the major portion of earnings from participating policies inures to the benefit of the participating policyholders and is excluded from the consolidated net income and policyholders' equity. Participating policies approximate 12% and 10% of ordinary life insurance in force at December 31, 2005 and 2004, respectively, and 23% and 20% of premiums for the years ended December 31, 2005 and 2004.

Long-Term Incentive and Performance Based Incentive Plans

The Company maintains short and long-term incentive compensation plans. Long-term plans that vest over the requisite service period and are based upon notional restricted and appreciated units are accounted for using guidance within Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, an Interpretation of APB Opinions No. 15 and 25 ("FIN 28"), and FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB No. 25 ("FIN 44"). Additionally, the Company provides various performance based incentive compensation to the majority of employees meeting the participation requirements of the respective plans. Compensation cost related to these plans is determined in accordance with plan formulas and recorded ratably over the years the employee service is provided.

Effective January 1, 2006, the Company is required to adopt FASB Statement No. 123(R), Share-based Payment "FAS 123(R)", for the plans discussed above. The Company is evaluating the effects of the elections available to it under the new standard.

Revenue Recognition

For short-duration insurance contracts, premiums are reported as earned income generally on a pro-rata basis over the terms of the related policies. For retrospectively rated policies and contracts, premium estimates are continually reviewed and updated and any resulting adjustments are reflected in current operating results. For traditional long-duration insurance contracts (including term and whole life contracts and annuities), premiums are earned when due. For annuities and structured settlements without significant mortality or morbidity risk (investment contracts) and universal life contracts (long-duration contracts with terms that are not fixed or guaranteed), revenues represent investment income earned on the related assets. Universal life and annuity contract revenues also include mortality, surrender and administrative fees charged to policyholders.

Reinsurance

All assets and liabilities related to reinsurance ceded contracts are reported on a gross basis in the consolidated balance sheets. Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. The consolidated statements of income reflect premiums, benefits and settlement expenses net of reinsurance ceded.

Transactions that do not transfer risk are included in other assets or other liabilities. Ceded transactions that transfer risk but are retroactive are included in reinsurance recoverables. The excess of estimated liabilities for claims and claim costs over the consideration paid net of experience adjustments is established as a deferred credit at inception. The deferred amounts are subsequently amortized using the effective interest method over the expected settlement period. The periodic amortization is reflected in the accompanying consolidated statements of income through operating costs and expenses.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liabilities associated with the reinsured business. The Company evaluates reinsurance collectibility and a provision for uncollectible reinsurance is recorded.

Translation of Foreign Currencies

The Company translates the financial statements of its foreign operations into U.S. dollars from the functional currency designated for each foreign unit, generally the currency of the primary economic environment in which it does its business. Assets and liabilities are translated into U.S. dollars at period-end exchange rates, while income and expenses are translated using average rates for the period. The resulting translation adjustments are recorded, net of tax, as a separate component of policyholders' equity.

For subsidiaries operating in highly inflationary economies, monetary assets and liabilities are translated at the rate of exchange as of the balance sheet date and non-monetary items are translated at historical rates. Gains and losses from balance sheet translation adjustments and foreign currency transactions are included in net income.

The aggregate exchange gains included in income from continuing operations for the years ended December 31, 2005, 2004, and 2003 were $23, $24, and $28, respectively. These amounts have been included in insurance operating costs and expenses in the accompanying consolidated statements of income.

Income Taxes

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 investments, insurance reserves, unearned premiums, deferred policy acquisition costs, certain employee benefits expenses and net operating losses.

Service Revenues and Expenses

Service revenues consist primarily of fees generated from processing business for involuntary assigned risk pools and are earned on a pro-rata basis over the term of the related policies and are included in fee and other revenues in the consolidated statements of income. Qualifying acquisition expenses are deferred and amortized over the period in which the related revenues are earned.

Accumulated Other Comprehensive Income

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

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

	2005	2004	2003
Unrealized gains on securities	$ 656	$1,167	$1,181
Foreign currency translation adjustments	68	117	31
Minimum pension liability	(332)	(26)	(25)
Accumulated other comprehensive income	$ 392	$1,258	$1,187

Catastrophe Exposure

The Company writes insurance policies that cover catastrophic events. The Company's policies cover unpredictable natural and other disasters, such as hurricanes, windstorms, earthquakes, floods, fires, terrorist attacks and explosions. Although the Company carries reinsurance to mitigate its exposure to certain catastrophic events, claims from catastrophic events could reduce the Company's earnings and cause substantial volatility in its financial results for any year and adversely affect its financial condition or results of operations. The Terrorism Risk Insurance Act (the "Terrorism Act"), effective November 26, 2002, requires all commercial property and casualty insurers writing business in the U.S. to make terrorism coverage available to commercial policyholders and provides a Federal backstop for certain terrorist acts which result in losses above individual insurance company deductible amounts. The Terrorism Act directly applies to the Company's U.S. property and casualty insurance business. Participating insurers will receive reimbursement from the Federal government for 90% in 2006 and 85% in 2007 of paid losses in excess of the deductible. The Company estimates its deductible for commercial policies subject to the Terrorism Act (the amount the Company will have to pay before the Federal backstop becomes available) to be $1,310 in 2006. This amounts to 17.5% of the Company's direct earned premium from commercial lines of business subject to the Terrorism

Act and approximately 15% of policyholders' equity of the Company at December 31, 2005, prior to consideration of terrorism reinsurance that the Company has purchased for 2006. The Terrorism Act is in effect until December 31, 2007. The Terrorism Act does not protect the Company from losses insured by the Company, which are not certified pursuant to the Terrorism Act, such as acts of domestic terrorism, like the Oklahoma City disaster. Damage outside the U.S. is not covered except in limited circumstances, such as damage to a U.S. airplane. Therefore, future losses from terrorist attacks could prove to be material to the Company's business, financial condition and results of operations.

(2) DIVESTITURES AND DISCONTINUED OPERATIONS

Divestitures

Effective June 30, 2003, the Company sold its Liberty Health business in Canada, a business line of the International business unit, and received proceeds approximating $98 and realized a gain of $82. This transaction did not meet the requirements for presentation as discontinued operations.

On April 1, 2004, the Company completed the sale of its Canadian personal lines business, consisting of private passenger automobile, homeowners and personal property insurance, to Meloche Monnex, Inc., a member of TD Bank Financial Group ("Meloche Monnex"). The transaction resulted in the transfer of approximately 350,000 automobile and homeowners insurance policies and approximately $300 (C$390) in direct written premiums to Meloche Monnex. Neither party has disclosed the financial terms of the transaction, which the Company believes is not material to its business, financial condition or results of operations.

Canadian Personal Lines Property and Casualty Operations

	2004	2003
Revenues	$82	$296
Income (loss) before income taxes and minority interest	12	(1)
Federal and foreign income tax benefit	(6)	–
Net income (loss)	$18	$ (1)

Discontinued Operations

During 2003, the Company's Board of Directors approved a plan to dispose of the operations of a non-insurance subsidiary that had a net loss of $2 for the year ended December 31, 2003.

In December 2004, the Company's management approved a plan to sell the pension externalization business of Seguros Genesis S.A. operations. The Company completed the disposition in December 2005.

	2005	2004
Revenues	$ –	$31
Operating expenses	(1)	14
Income before realized loss and income tax expense	1	17
Realized loss	(19)	–
Income tax (benefit) expense	(6)	6
Net income	$(12)	$11

(3) ACQUISITIONS AND GOODWILL

Effective May 2003, the Company acquired 100% of the outstanding shares of Winterthur's Portuguese business units and branch offices, including its subsidiary companies Companhia Europeia de Segueros and Winterthur Pensoes. The transaction resulted in goodwill of $23. The results of operation for the acquired business are included subsequent to May 2003.

On October 31, 2003, LMGI acquired all the outstanding stock of Prudential Property and Casualty Insurance Company, Prudential General Insurance Company and Prudential Commercial Insurance Company (collectively referred to as "PruPac") from Prudential Financial Inc. ("Prudential"). The acquisition included PruPac's U.S. personal lines property and casualty business and operations in 47 states, excluding the New Jersey business and also excluding the specialty automobile and affinity business. The cost of PruPac was $520 and consideration was a combination of cash and two series of promissory notes to Prudential. The Series A promissory note had an aggregate principal balance of $130, due on October 31, 2008 and accrues interest annually at an interest rate of 7%. On April 16, 2004, LMGI repaid this note. The Series B promissory note has an aggregate principal balance of $260, matures on October 31, 2013 and accrues interest annually at an interest rate of 8%.

LMGI recorded the acquisition in accordance with Financial Accounting Standards No. 141, Business Combinations ("FAS 141") and assigned fair values to the identifiable assets and liabilities of PruPac on October 31, 2003. The excess of the assigned fair value of net assets over the purchase price, or negative goodwill, of $77 was recorded by LMGI as an extraordinary gain in the accompanying consolidated statements of income in 2003. Management completed its allocation of the purchase price in October 2004, which resulted in a decrease of $3 to the previously recognized negative goodwill. Additionally, as part of the transaction and integration of PruPac's operations, $36 of restructuring charges were recorded relating to the acquisition costs of PruPac. The restructuring liability primarily includes severance and retention bonuses for employees that were involuntarily terminated or relocated.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(CONTINUED)

In connection with the acquisition, the Company acquired the discontinued channels business of Prudential agency business. Prudential, through its wholly owned subsidiary, Vantage Casualty Insurance Company ("Vantage"), reinsured and guaranteed 100% of the first $50 and 75% of the next $60 of the net losses of the operation. To support the surplus of the Company in writing the discontinued channels business, Prudential provided the Company with a $30 cash payment in exchange for a note that matures on December 31, 2008 and accrues interest at a rate of 5% annually. The note is repaid annually in amounts corresponding to the reduction in the Company's gross written premium in the discontinued channels business. Vantage's obligations are guaranteed by Prudential. Additionally, the discontinued channel runoff business includes performance incentives for the Company. The remaining note payable was $14 and $30 at December 31, 2005 and 2004, respectively.

In addition to the above-mentioned agreement, certain risks, including, without limitation, asbestos and other environmental risks, assumed reinsurance arrangements, unlimited medical benefits and certain mold claims, and various litigation arising out of or relating to conduct prior to closing have been ceded and transferred by virtue of reinsurance, indemnification and guaranty arrangements with Prudential and certain of its subsidiaries.

Effective January 9, 2004, the Company acquired MetLife's Spanish operations, including its non-life subsidiary, Genesis Seguros Generales, S.A., and its life subsidiary, Seguros Genesis, S.A. (collectively referred to as "Genesis"). The transaction resulted in goodwill of $74.

The following is a condensed balance sheet of Genesis at January 9, 2004:

Assets:	
Investments, cash and cash equivalents	$ 946
Premium and other receivables	38
Reinsurance recoverables	9
Deferred policy acquisition costs	9
Deferred income taxes	10
Goodwill and intangible assets	109
Other assets	52
Total assets	$1,173
Liabilities:	
Unpaid claims and claim adjustment expenses	$ 798
Unearned premiums	96
Other liabilities	116
Total liabilities	$1,010

Included in the 2004 consolidated statement of income is $21 generated from this acquisition.

Effective August 19, 2004, the Company acquired 100% of the outstanding shares of AGF Allianz Chile S.A., a unit of France's AGF, which is in turn a division of Germany's Allianz AG. The transaction resulted in goodwill of $13. The results of operation for the acquired business are included subsequent to August 2004.

Effective April 12, 2005, the Company acquired the insurance operations of ING Seguros Generales in Chile. The transaction resulted in goodwill of $14.

(4) INVESTMENTS

Components of Net Investment Income

Years Ended December 31,	2005	2004	2003
Interest income	$2,103	$1,944	$1,761
Dividends	82	95	60
Limited partnerships and limited liability companies	208	141	–
Other investment income	6	5	14
Gross investment income	2,399	2,185	1,835
Investment expenses	(152)	(83)	(73)
Net investment income	$2,247	$2,102	$1,762

Components of Net Realized Investment Gains

Years Ended December 31,	2005	2004	2003
Fixed maturities			
Gross realized gains	$263	$ 404	$ 396
Gross realized losses	(92)	(100)	(195)
Equities			
Gross realized gains	237	108	132
Gross realized losses	(46)	(84)	(73)
Other			
Gross realized gains	165	55	124
Gross realized losses	(4)	(71)	(11)
Net realized investment gains	$523	$ 312	$ 373

During the years ended December 31, 2005, 2004, and 2003, other-than-temporary impairments recognized were $18, $35, and $74, respectively.

During the years ended December 31, 2005, 2004, and 2003, proceeds from sales of fixed maturities available for sale were $8,385, $9,219, and $8,930, respectively. The gross realized gains and (losses) on such sales totaled $220 and $(68) in 2005, $344 and $(38) in 2004, and $378 and $(87) in 2003, respectively. The net realized gains (losses) related to trading securities held as of the end of the year amounted to $7, $10, and $5 for the years ended December 31, 2005, 2004, and 2003.

Components of Change in Net Unrealized Investment Gains

	2005	2004	2003
Fixed maturities	$(893)	$(92)	$(267)
Equities	78	143	213
Other	2	8	–
Adjustments to deferred policy acquisition costs	26	(80)	(97)
Net change in unrealized investment losses	(787)	(21)	(151)
Deferred income taxes	276	7	53
Net change in unrealized investment losses, net of tax	$(511)	$(14)	$ (98)

Available for Sale Investments

The gross unrealized gains and losses and fair values of available for sale investments at December 31, 2005 and 2004 are as follows:

December 31, 2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 3,216	$ 41	$ (49)	$ 3,208
U.S. Mortgage and asset-backed securities of government and corporate agencies	12,563	126	(181)	12,508
State and municipal	3,971	61	(27)	4,005
Corporate and other	13,596	504	(215)	13,885
Foreign	3,616	186	(17)	3,785
Total fixed maturities	36,962	918	(489)	37,391
Total equity securities	1,154	774	(20)	1,908
Total securities available for sale	$38,116	$1,692	$(509)	$39,299

December 31, 2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 2,644	$ 72	$ (13)	$ 2,703
U.S. Mortgage and asset-backed securities of government and corporate agencies	12,676	307	(50)	12,933
State and municipal	1,096	49	(4)	1,141
Corporate and other	14,235	864	(66)	15,033
Foreign	3,628	177	(14)	3,791
Total fixed maturities	34,279	1,469	(147)	35,601
Total equity securities	1,126	698	(22)	1,802
Total securities available for sale	$35,405	$2,167	$(169)	$37,403

At December 31, 2005 and 2004, securities carried at $3,982 and $4,477, respectively, were on deposit with regulatory authorities as required by law.

At December 31, 2005 and 2004, the fair values of fixed maturities loaned were approximately $890 and $572, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately $486 and $192 as of December 31, 2005 and 2004, respectively. Non-cash and short-term investments collateral received in connection with the loaned securities was approximately $424 and $390 as of December 31, 2005 and 2004, respectively.

The amortized cost and fair value of fixed maturities at December 31, 2005 by contractual maturity are set forth as follows:

	Amortized Cost	Fair Value
Due to mature:		
One year or less	$ 1,080	$ 1,080
Over one year through five years	6,891	6,898
Over five years through ten years	7,571	7,615
Over ten years	8,825	9,256
U.S. and foreign mortgage and asset-backed securities	12,595	12,542
	$36,962	$37,391

Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration that individual securities have been in a continuous unrealized loss position at December 31, 2005 that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		Greater than 12 Months	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. Treasury securities	$ (31)	$ 2,130	$ (18)	$ 527
U.S. Mortgage and asset-backed securities of government and corporate agencies	(121)	7,406	(60)	1,207
State and municipal	(24)	1,587	(3)	77
Corporate and other	(155)	5,897	(60)	1,330
Foreign	(15)	960	(2)	57
Equities	(12)	145	(8)	59
Total	$(358)	$18,125	$(151)	$3,257

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration that individual securities have been in a continuous unrealized loss position at December 31, 2004 that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		Greater than 12 Months	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. Treasury securities	$ (9)	$1,062	$ (4)	$ 105
U.S. Mortgage and asset-backed securities of government and corporate agencies	(23)	2,619	(27)	664
State and municipal	(2)	196	(2)	42
Corporate and other	(30)	2,901	(36)	814
Foreign	(13)	291	(1)	68
Equities	(17)	136	(5)	25
Total	$(94)	$7,205	$(75)	$1,718

The above table for 2005 includes $236 of unrealized losses related to securities issued and guaranteed by the United States government, its agencies, government sponsored enterprises and state and municipal governments. There were $468, or approximately 92%, of the unrealized losses as of December 31, 2005 on securities where the market value of the security is 10% or less below the book value for the security. The increase in unrealized losses is indicative of the increase in long-term interest rates in that period. The unrealized losses as of December 31, 2005 involve approximately 11,000 lots across more than approximately 3,500 different securities within the holdings of the Company.

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.

The Company has cost method investments consisting primarily of private equities with a carrying value of $104 and $153 at December 31, 2005 and 2004, respectively. All of the Company's cost method investments are evaluated systematically for identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment.

(5) DEFERRED POLICY ACQUISITION COSTS

The following reflects the policy acquisition costs deferred for amortization against future income and related amortization charged to income:

Years Ended December 31,	2005	2004	2003
Balance at beginning of year	$ 1,354	$ 1,104	$ 913
Acquisition costs deferred	2,602	2,601	2,113
Amortization charged to continuing income	(2,480)	(2,349)	(1,915)
Amortization included in discontinued operations	–	(2)	(7)
Balance at end of year	$ 1,476	$ 1,354	$ 1,104

(6) ASBESTOS AND ENVIRONMENTAL RESERVES

The Company has exposure to asbestos and environmental claims that emanate principally from general liability policies written prior to the mid-1980's. In establishing the Company's asbestos and environmental reserves, the Company estimates case basis reserves for anticipated losses and bulk reserves for loss adjustment expenses and IBNR losses. The Company maintained casualty excess of loss reinsurance during the relevant periods. The reserves are reported net of cessions to reinsurers and include any reserves reported by ceding reinsurers on assumed reinsurance contracts.

Upon their de-affiliation from the Nationwide Group and affiliation with the Company, Employers Insurance Company of Wausau ("EICOW"), Wausau Business Insurance Company ("WBIC"), Wausau General Insurance Company ("WGIC"), and Wausau Underwriters Insurance Company ("WUIC") entered into ceded reinsurance contracts whereby Nationwide Indemnity Company assumed full responsibility for obligations on certain policies with effective dates prior to January 1, 1986, including all asbestos and environmental exposures.

The process of establishing reserves for asbestos and environmental claims is subject to greater uncertainty than the establishment of reserves for liabilities relating to other types of insurance claims. A number of factors contribute to this greater uncertainty surrounding the establishment of asbestos and environmental reserves, including, without limitation: (i) the lack of available and reliable historical claims data as an indicator of future loss development, (ii) the long waiting periods between exposure and manifestation of any bodily injury or property damage, (iii) the difficulty in identifying the source of asbestos or environmental contamination, (iv) the difficulty in properly allocating liability for asbestos or environmental damage, (v) the uncertainty as to the number and identity of insureds with potential exposure, (vi) the cost to resolve claims, and (vii) the collectibility of reinsurance.

The uncertainties associated with establishing reserves for asbestos and environmental losses and loss adjustment expenses are compounded by the differing, and at times inconsistent, court rulings on environmental and asbestos coverage issues involving: (i) the differing interpretations of various insurance policy provisions and whether asbestos and environmental losses are or were ever intended to be covered, (ii) when the loss occurred and what policies provide coverage, (iii) whether there is an insured obligation to defend, (iv) whether a compensable loss or injury has occurred, (v) how policy limits are determined, (vi) how policy exclusions are applied and interpreted, (vii) the impact of entities seeking bankruptcy protection as a result of asbestos-related liabilities, (viii) whether clean-up costs are covered as insured property damage, and (ix) applicable coverage defenses or determinations, if any, including the determination as to whether or not an asbestos claim is a products/completed operation claim subject to an aggregate limit and the available coverage, if any, for that claim. The uncertainties cannot be reasonably estimated, but could have a material impact on the Company's future operating results and financial condition.

In recent years, the Company, as well as the industry generally, has witnessed a significant increase in the number of asbestos claims being filed, due to a number of variables, including more intensive advertising by lawyers seeking asbestos claimants, and the increasing focus by plaintiffs on new and previously peripheral defendants, attempts to broaden the interpretation of compensable loss, and courts expanding the scope of the coverage.

In the third quarter of 2005, a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel completed their comprehensive review of the Company's asbestos exposure on a direct, assumed, and ceded basis. As part of the internal review, potential exposures of large policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with the latest published actuarial paper on asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. Small policyholders were evaluated using aggregate methods that utilized information developed from the large policyholders.

Additionally, a provision of pure incurred but not reported losses was established for the potential emergence of first-time filers of future asbestos claims. As a result of the comprehensive study, the Company increased net loss and allocated loss adjustment expense reserves by $203.

During 2004, the Company completed a comprehensive study of its environmental reserves. The study was performed with the assistance of an independent actuarial firm, and focused on the implications of claim and litigation trends and other significant developments. The study encompassed the Company's liabilities with respect to both National Priority List (NPL) claims and direct site claims involving the presence of hazardous waste at sites owned or operated by the insured. As a result of the comprehensive study, the Company increased net loss and allocated loss adjustment expense reserves by $316.

As a result of the significant uncertainty inherent in determining a company's asbestos and environmental liabilities and establishing related reserves, the amount of reserves required to adequately fund the Company's asbestos and environmental claims cannot be accurately estimated using conventional reserving methodologies based on historical data and trends. As a result, the use of conventional reserving methodologies frequently has to be supplemented by subjective considerations including managerial judgment. In that regard, 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 an aggregate liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

The following tables summarize the activity for the Company's asbestos and environmental claims and claim adjustment expenses, a component of the Company's unpaid claims and claim adjustment expenses, for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
Gross Asbestos:			
January 1 reserves:	$2,399	$2,039	$1,686
Acquisitions	–	–	175
Incurred activity	614	683	548
Paid activity	293	323	370
Ending reserves	$2,720	$2,399	$2,039
Net Asbestos:			
January 1 reserves:	$ 961	$1,120	$ 974
Acquisitions	–	–	118
Incurred activity	238	20	178
Paid activity	133	179	150
Ending reserves	$1,066	$ 961	$1,120
Allowance for reinsurance on unpaid losses	110	127	140
Total unpaid losses including allowance for unpaid reinsurance	$1,176	$1,088	$1,260

Included in gross asbestos incurred for 2005 and 2004 are significant amounts attributable to claims against 1985 and prior policies issued by EICOW and its affiliates, which are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. The Company's acquisition of PruPac included $175 and $118 of gross and net asbestos reserves, respectively. Any increase in Prudential related asbestos reserves is reinsured by Vantage and guaranteed by Prudential.

	2005	2004	2003
Gross Environmental:			
January 1 reserves:	$816	$410	$577
Acquisitions	–	–	15
Incurred activity	155	484	(106)
Paid activity	196	78	76
Ending reserves	$775	$816	$410
Net Environmental:			
January 1 reserves:	$553	$287	$317
Acquisitions	–	–	12
Incurred activity	5	316	–
Paid activity	106	50	42
Ending reserves	$452	$553	$287

(7) UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

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

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

As information develops that varies from past experience, provides additional data, or 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.

Catastrophes are an inherent risk of the property-casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and financial position. The level of catastrophe losses experienced in any period cannot be predicted and can be material to the results of operations and financial position of the Company. Catastrophe losses incurred during the years ended December 31, 2005, 2004, and 2003 were $1,578, $856, and $193, respectively, and related primarily to the hurricanes in 2005 and 2004 and other natural disasters and weather related events (California wildfires in 2003).

Please see Note 6 for a discussion of incurred attributable to prior years for asbestos and environmental reserves.

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

	2005	2004	2003
Balance as of January 1	$33,884	$29,952	$26,751
Less: unpaid reinsurance recoverables[1]	11,548	9,671	8,651
Net balance as of January 1	22,336	20,281	18,100
Balance attributable to dispositions, acquisitions, and affiliations	7	(236)	905
Incurred attributable to:			
Current year	13,062	11,702	9,684
Prior years:			
Asbestos and environmental	232	324	178
All other	105	262	497
Discount accretion	96	98	66
Total incurred	13,495	12,386	10,425
Paid attributable to:			
Current year	6,018	5,138	4,355
Prior years	5,260	5,109	5,059
Total paid	11,278	10,247	9,414
Amortization of deferred retroactive reinsurance gain	97	47	48
Net adjustment due to foreign exchange	(128)	105	217
Add: unpaid reinsurance recoverables[1]	13,516	11,548	9,671
Balance as of December 31	$38,045	$33,884	$29,952

[1]In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements discussed in Note 8, the Company has recorded retroactive reinsurance recoverable balances of $2,247, $2,225, and $2,200 at December 31, 2005, 2004 and 2003, respectively.

In 2005, 2004 and 2003, incurred attributable to prior years, excluding asbestos and environmental, is primarily related to the workers compensation line of business, partially offset by the auto and homeowners lines of business.

The Company has not discounted unpaid property and casualty insurance claims and claim adjustment expenses other than tabular discounting on the long-term indemnity portion of workers compensation claims, the Company's disability claims as permitted by insurance regulations in certain states and specific asbestos structured settlements.

The tabular discounting on these workers compensation claims is based on Unit Statistical Plan tables as approved by the respective states and ranges from 3.50% to 4.00% for the years ended December 31, 2005 and 2004. Unpaid claims and claim adjustment expenses at December 31, 2005 and 2004 include liabilities of $4,698 and $4,668 at discounted values of $3,217 and $3,234, respectively. The discounting of the disability claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 4.5% to 7.0% in 2005 and 2004. Unpaid claims and claim adjustment expenses at December 31, 2005 and 2004 include liabilities of $954 and $912 carried at discounted values of $712 and $670, respectively.

For certain commercial lines of insurance, the Company offers experience-rated insurance contracts whereby the ultimate premium is dependent upon the claims incurred. At December 31, 2005 and 2004, the Company held $4,228 and $3,934, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of $823 and $867 at December 31, 2005 and 2004, respectively. For the years ended December 31, 2005, 2004, and 2003, the Company recognized additional premium income of $86, $93, and $173, respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of $493 and $579 as of December 31, 2005 and 2004, respectively.

At December 31, 2005 and 2004, the reserve for unpaid claim reserves was reduced by $4,183 and $3,800, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were $258 and $236 at December 31, 2005 and 2004, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(CONTINUED)

(8) REINSURANCE

In the ordinary course of business, the Company assumes reinsurance and also cedes reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Company is also a member of various involuntary pools and associations and serves as a servicing carrier for residual market organizations.

A summary of reinsurance financial data reflected within the consolidated statements of income is presented below:

	2005		2004		2003	
	Written	Earned	Written	Earned	Written	Earned
Direct	$20,569	$20,242	$19,812	$19,059	$16,949	$16,187
Assumed	1,411	1,364	1,314	1,333	1,370	1,539
Ceded	3,904	3,975	3,805	3,829	3,837	3,770
Net premiums	$18,076	$17,631	$17,321	$16,563	$14,482	$13,956

The following table summarizes the Company's ceded reserves by reinsurers' Standard & Poor's ("S&P") rating (or the rating of any guarantor) as of December 31, 2005.

S&P Rating	Reinsurance Recoverables
AAA	$ 1,372
AA+, AA, AA-	4,313
A+, A, A-	4,956
BBB+, BBB, BBB-	142
BB+ or below	42
Involuntary Pools	3,306
Voluntary Pools	378
Other	2,117
Gross Recoverables	16,626
less: Allowance	324
Net Recoverables	$16,302

The Company remains contingently liable in the event reinsurers are unable to meet their obligations for paid and unpaid reinsurance recoverables and unearned premiums ceded under reinsurance agreements. As of December 31, 2005, the Company holds $4,106 of collateral as security under related reinsurance agreements in the form of funds, securities and/or letters of credit.

The Company has an aggregate reinsurance recoverable from Nationwide Indemnity Company in the amount of $2,120 and $1,838 as of December 31, 2005 and 2004, respectively. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company. Additionally, the Company has significant reinsurance recoverable concentrations with Swiss Reinsurance Group, Berkshire Hathaway Group, GE Global Insurance Group, Everest Re Group and Munich Re totaling $1,410, $760, $534, $491 and $463 respectively, as of December 31, 2005, net of offsetting collateral under the contracts.

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 this servicing carrier business is the composite of the cumulative creditworthiness of all participants in their respective pools.

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 as of December 31, 2005 and 2004) that are amortized into income using the effective interest method over the estimated settlement periods. During the second quarter of 2005, the Company re-estimated the amount of deferred gains and amortization related to these reinsurance agreements. At December 31, 2005 and 2004, deferred gains related to these reinsurance arrangements were $878 and $973, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the years ended December 31, 2005, 2004, and 2003 was $113, $103, and $88, respectively. Deferred gain amortization was $89, $47, and $48 for the years ended December 31, 2005, 2004, and 2003, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2,211 and $2,219 as of December 31, 2005 and 2004, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002 renewal, premium and loss activity subsequent to December 31, 2001 is now accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods. Approximately $38 and $31 of additional losses were ceded to these retroactive and prospective contracts during the twelve months ended December 31, 2005, with additional premium of $24 and $22, respectively. Approximately $68 and $78 of additional losses were ceded to these retroactive and prospective contracts during the twelve months ended December 31, 2004, with additional premium of $38 and $45, respectively. The income statement impact of ceding the additional losses and premium on the fourth quarter 2000 through fourth quarter 2001 covered accident period was deferred for GAAP purposes and is amortized into income using the effective interest method over the estimated settlement period.

(9) DEBT OUTSTANDING

Debt outstanding at December 31, 2005 and 2004 includes the following:

Short-term debt:

	2005	2004
Commercial paper	$ 100	$ 147
Revolving credit facilities	35	29
Current maturities of long-term debt	10	77
Total short-term debt	$ 145	$ 253

Long-term debt:

	2005	2004
8.20%, Surplus Notes, due 2007	$ 121	$ 121
6.75%, Notes, due 2008	15	15
5.00% Notes, due 2008	4	14
8.00% Notes, due 2013	260	260
5.75% 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%, Notes due 2034	250	250
6.50%, Notes due 2035	500	–
7.697%, Surplus Notes, due 2097	500	500
7.10% - 7.86%, Medium Term Notes, with various maturities	27	27
	2,580	2,090
Unamortized discount	(25)	(16)
Total long-term debt excluding current maturities	$2,555	$2,074

Short-term Debt

The Company issues commercial paper to meet short-term operating needs. The total facility was $600 at December 31, 2005 and 2004 and is supported by a $750 line of credit facility which LMGI entered into on July 25, 2005 to replace its previous 364-day $450 revolving credit facility. Commercial paper issued and outstanding at December 31, 2005 and 2004 was $100 and $147, respectively. Interest rates ranged from 2.31% to 4.45% in 2005 and 1.08% to 2.50% in 2004.

Long-term Debt

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

At December 31, 2005, the principal maturity schedule of long-term borrowings is as follows:

2006	$ –
2007	121
2008	21
2009	–
Thereafter	2,438
Less: discount	(25)
Total long-term debt	$2,555

On March 22, 2005, the Company issued $500 of 6.50% unsecured senior notes due 2035. The proceeds were contributed to its wholly owned subsidiaries, LMIC and Employers Insurance Company of Wausau ("EICOW").

On April 12, 2004, LMIC retired approximately $129 of its $250 of 8.20% Surplus Notes due 2007 and realized a loss of approximately $19. As discussed in Note 3, the Company entered into two promissory note agreements with Prudential in conjunction with the acquisition of all the outstanding stock of PruPac. On April 16, 2004, LMGI repaid approximately $130 of these notes.

On March 23, 2004, the Company issued $500 of 5.75% unsecured senior notes due 2014 and $250 of 7.00% unsecured senior notes due 2034. Approximately $277 of the net proceeds were used to retire existing obligations.

Capital lease obligations as of December 31, 2005 and 2004 were $106 and $109, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

In 2005, 2004 and 2003, the Company entered into an arrangement to sell and leaseback certain furniture and equipment. The Master Leasing Agreement was amended on December 15, 2005 to change the interest rate on 60-month basic term for new equipment. The weighted average interest rate on the lease is LIBOR plus 132 basis points. The transactions are accounted for as capital leases. As of December 31, 2005, the Company's future minimum lease payments under the sale-leaseback agreement through maturity are approximately $35 for 2006, $17 for 2007, $16 for 2008, $11 for 2009, and $5 for 2010.

Interest

The Company paid $173, $146, and $106 of interest in 2005, 2004, and 2003, respectively, and incurred $184, $157, and $113 of interest expense in 2005, 2004, and 2003, respectively, for all indebtedness.

(10) FEDERAL AND FOREIGN INCOME TAXES

The Company files a consolidated U.S. federal income tax return for substantially all of its operations. Pursuant to intercompany Federal income tax allocation agreements among each of these companies and their respective subsidiaries, the consolidated tax liabilities are allocated to each company based on its separate return tax liability. Tax benefits are allocated to each company for its portion of net operating losses and tax credit carry forwards in the year they are used by the consolidated group. Intercompany tax balances are settled quarterly. A provision is made, where applicable, for taxes on foreign operations.

The components of Federal and foreign income tax expense (benefit) related to continuing operations are:

Years ended December 31,	2005	2004	2003
Current tax expense (benefit):			
United States Federal	$ 348	$ 111	$ 198
United States Federal benefit of net operating losses	(96)	(140)	(118)
Foreign	74	31	47
Total current tax expense (benefit)	326	2	127
Deferred tax expense (benefit):			
United States Federal	(85)	(30)	(137)
Foreign	(150)	28	10
Total deferred tax (benefit) expense	(235)	(2)	(127)
Total Federal and foreign income tax expense	$ 91	$ –	$ –

A reconciliation of the income tax expense (benefit) attributable to continuing operations computed at U.S. federal statutory tax rates to the income tax expense (benefit) as included in the consolidated statements of income follows:

Years ended December 31,	2005	2004	2003
Expected Federal income tax expense (benefit)	$396	$427	$272
Tax effect of:			
Nontaxable investment income	(35)	(25)	(23)
Change in valuation allowance	(256)	(389)	(226)
Goodwill	(16)	(20)	(10)
IRS Settlement	–	(18)	–
Foreign	45	4	5
Other	(43)	21	(18)
Actual Federal and foreign income tax expense	$ 91	$ –	$ –

The significant components of the deferred income tax assets and liabilities at December 31, are summarized as follows:

	2005	2004
Deferred tax assets:		
Unpaid claims discount	$ 577	$ 492
Unearned premium reserves	470	452
Net operating losses	350	221
Employee benefits	463	267
Retroactive reinsurance deferred gain	321	340
Credits	76	267
Other	247	243
	2,504	2,282
Less: valuation allowance	(99)	(340)
Total deferred tax assets	2,405	1,942
Deferred tax liabilities:		
Deferred acquisition costs	380	352
Net unrealized gains and other-than-temporary declines in investments	383	604
Other	15	48
Total deferred tax liabilities	778	1,004
Net deferred tax assets	$1,627	$ 938

The total decrease in valuation allowance differs from the $256 change reflected in income from continuing operations primarily due to purchase price adjustments. Based on the assumption that future levels of income will be achieved, management believes it is more likely than not that the net deferred tax assets will be realized.

The Company's subsidiaries had net operating loss carry forwards of $1,050, alternative minimum tax credit carry forwards of $47 and foreign tax credit carry forwards of $28 as of December 31, 2005. The net operating losses available in the U.S. and various non-U.S. tax jurisdictions will begin to expire, if not utilized, as follows:

2006	$ 6
2007	4
2008	9
2009	2
2010	3
Thereafter	1,026
Total	$1,050

The foreign tax credits will begin to expire, if not utilized, in 2010 and the alternative minimum tax credits do not expire.

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the United States where such earnings are permanently reinvested. At December 31, 2005, unremitted earnings of foreign subsidiaries were $423. If these earnings were distributed in the form of dividends or otherwise, the Company would be subject to U.S. income taxes less an adjustment for applicable foreign tax credits.

As discussed in Note 1, the American Jobs Creation Act of 2004 (“the AJC Act”) introduced a special 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 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. In 2005, the Company repatriated a total of $161 from its foreign subsidiaries and recorded a related tax expense of $18.

The IRS has completed its review of the Company’s federal income tax returns through the 1998 tax year and is currently reviewing income tax returns for the 1999 through 2003 tax years. Any adjustments that may result from the IRS examinations of these income tax returns are not expected to have a material impact on the financial position, liquidity or results of operations of the Company.

(11) BENEFIT PLANS

The Company sponsors non-contributory defined benefit pension plans (“the Plans”) covering substantially all U.S. and Canadian employees. The benefits and eligibility are based on age, years of service and the employee’s compensation, as more fully described in the Plans.

The Company sponsors supplemental retirement plans to provide pension benefits above the levels provided by the pension plans without regard to the statutory earnings limitations of qualified defined benefit pension plans. The supplemental plans are unfunded.

The Company also provides certain healthcare and life insurance benefits (“Postretirement”) covering substantially all U.S. and Canadian employees. Life insurance benefits are based on a participant’s final compensation subject to the plan maximum.

Assets of the defined benefit pension and postretirement plans consist primarily of investments in life insurance company separate accounts that invest primarily in fixed income and Standard and Poor’s 500 Index of equity securities. At December 31, 2005 and 2004, assets of the Plans totaling $2,443 and $2,170, respectively, were held in separate accounts of the Company.

The Company sponsors defined contribution savings plans for substantially all U.S. (a 401(k) plan) and Canadian (a Deferred Profit Sharing Plan) employees who meet certain eligibility requirements. During 2005, 2004, and 2003, employees could contribute a percentage of their annual compensation on a before and after-tax basis, subject to Federal limitations. The benefits are based on the employee’s contribution amount and Company profitability. In 2005, 2004, and 2003, the Company made matching contributions of $76, $68, and $60, respectively, including the supplemental defined contribution plans.

Some foreign subsidiaries sponsor pension plans (principally non-contributory) to employees which provide benefits based on final pay. The assets of the plans are held separately from the assets of the foreign subsidiaries. The pension reporting for these plans has been restated on a FAS 87 basis. Therefore, the assets, obligations, and benefit costs are included within the following U.S. and Canada pension plan tables.

Compensation expense related to the Company’s long-term and short-term incentive compensations plans was $355, $389, and $388, for the years ended December 31, 2005, 2004 and 2003, respectively.

The following table sets forth the assets, obligations and assumptions associated with the various U.S., Canadian, and certain foreign subsidiary pension and post-retirement benefits. The amounts are recognized in the accompanying consolidated balance sheets as of December 31, 2005 and 2004, and consolidated statements of income for the years ended December 31, 2005, 2004 and 2003.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(CONTINUED)

	Pension		Supplemental Pension		Postretirement	
	2005	2004	2005	2004	2005	2004
Change in benefit obligations:						
Benefit obligation at beginning of year	$2,829	$2,537	$ 219	$ 207	$ 608	$ 498
Service costs	127	125	9	7	14	18
Interest cost	173	161	13	12	27	30
Amendments	(23)	(17)	–	1	(9)	–
Actuarial (gains)/losses	362	125	10	26	(105)	90
Currency exchange rate change	(4)	3	–	–	–	–
Divestitures	–	(5)	–	–	–	(4)
Benefits paid	(108)	(102)	(18)	(35)	(27)	(25)
Other	12	2	–	1	–	1
Benefit obligations at end of year	$3,368	$2,829	$ 233	$ 219	$ 508	$ 608
Accumulated benefit obligations	$2,827	$2,334	$ 168	$ 162	$ 508	$ 608
Change in plan assets:						
Fair value of plan assets at beginning of year	$2,339	$2,097	–	–	$ 20	$ 20
Actual return on plan assets	139	217	–	–	1	2
Currency exchange rate change	(2)	2	–	–	–	–
Employer contribution	153	128	–	–	25	23
Benefits paid	(108)	(102)	–	–	(27)	(25)
Other	5	(3)	–	–	–	–
Fair value of plan assets at end of year	$2,526	$2,339	$ –	$ –	$ 19	$ 20
Reconciliation of funded status:						
Funded status of the plan	$ (842)	$ (490)	$(233)	$(219)	$(489)	$(588)
Unrecognized net (gain)/loss	1,051	641	98	94	(1)	103
Unrecognized prior service cost	(2)	23	13	15	(38)	(41)
Unrecognized net transition (asset)/obligation	(29)	(31)	–	–	95	114
Net amount recognized	$ 178	$ 143	$(122)	$(110)	$(433)	$(412)
Amounts recognized in the consolidated balance sheets consist of:						
Prepaid benefit cost	$ 181	$ 143	$ –	$ –	$ –	$ –
Accrued benefit liability	(486)	(6)	(168)	(162)	(433)	(412)
Intangible asset	7	6	13	14	–	–
Accumulated other comprehensive income	476	-	33	38	–	–
Net amounts recognized at year end	$ 178	$ 143	$(122)	$(110)	$(433)	$(412)
Additional Information:						
Change in additional minimum liability included in other comprehensive income	$ 476	$ –	$ (5)	$ (1)	$ –	$ –

The expected long-term rate of return assumption is primarily driven by two factors: (1) the asset allocation targets and (2) the expected long-run returns associated with each asset class. The starting point for generating long-run expected asset class returns for large-cap equities, small-cap equities, private equities and high yield bonds is an analysis of historical asset class returns and risk premiums relative to the 5-year U.S. Treasury. Investment grade bonds and cash are expected to earn returns that are generally consistent with prevailing market yields.

This approach is not entirely formulaic as professional judgment is used to make modest adjustments to these numbers in cases where the Company believes that certain data are at abnormal levels relative to long-run averages. For example, the spread between Treasury yields and inflation appeared low relative to long-run averages at the end of 2004. The 5-year U.S. Treasury was approximately 3.6% and inflation (as measured by the CPI-U) was 3.3%, resulting in a difference of 0.3%. Over the past ten and twenty years, this difference has averaged approximately 2.5% and 3.2%, respectively. Based on this information, the Company assumed a modest increase in future 5-year Treasury yields in generating its expected long-run return estimates.

The net benefit costs for the years ended December 31, 2005, 2004, and 2003 included the following components:

December 31, 2005	Pension	Supple-mental Pension	Post retire-ment
Components of net periodic benefit costs			
Service costs	$ 127	$ 9	$14
Interest cost	173	13	27
Expected return on plan assets	(201)	–	(1)
Amortization of unrecognized:			
Net (gain)/loss	18	6	(1)
Prior service cost	3	2	(3)
Net transition (assets)/obligation	(5)	–	10
Net periodic benefit costs	$ 115	$30	$46

December 31, 2004	Pension	Supple-mental Pension	Post retire-ment
Components of net periodic benefit costs			
Service costs	$ 125	$ 7	$18
Interest cost	161	12	30
Expected return on plan assets	(208)	–	(1)
Curtailment (gain)/loss	–	15	(1)
Amortization of unrecognized:			
Net (gain)/loss	–	6	(1)
Prior service cost	5	2	(3)
Net transition (assets)/obligation	(5)	–	9
Net periodic benefit costs	$ 78	$42	$51

December 31, 2003	Pension	Supple-mental Pension	Post retire-ment
Components of net periodic benefit costs			
Service costs	$ 99	$ 5	$15
Interest cost	144	11	30
Expected return on plan assets	(203)	–	(1)
Amortization of unrecognized:			
Net (gain)/loss	–	3	–
Prior service cost	5	2	(3)
Net transition (assets)/obligation	(5)	–	9
Net periodic benefit costs	$ 40	$21	$50

The measurement date used to determine pension and other postretirement measurements is December 31, 2005.

Weighted-average actuarial assumptions for benefit obligations are set forth in the following table.

December 31,	2005	2004
Pension		
Discount rate	5.50%	6.25%
Rate of compensation increase	4.70%	5.20%
Supplemental Pension		
Discount rate	5.50%	6.25%
Rate of compensation increase	4.90%	4.90%
Postretirement		
Discount rate	5.50%	6.25%

Weighted-average actuarial assumptions for net periodic benefit costs are set forth in the following table.

December 31,	2005	2004	2003
Pension			
Discount rate	6.25%	6.50%	7.00%
Expected return on plan assets	8.00%	8.50%	8.50%
Rate of compensation increase	5.20%	5.20%	5.20%
Supplemental Pension			
Discount rate	6.25%	6.50%	7.00%
Rate of compensation increase	4.90%	4.90%	4.90%
Postretirement			
Discount rate	6.25%	6.50%	7.00%
Expected return on plan assets	7.15%	7.15%	7.15%

The weighted-average healthcare cost trend rates are expected to be 10.4% in 2006 graded down to 5.2% in 2012. Healthcare cost trend rate assumptions have a material impact on the postretirement benefit obligation. A one-percentage change in assumed healthcare cost trend rates would have the following effects:

	1% point increase	1% point decrease
Effect on Postretirement Benefit Obligation	$44	$(40)
Effect on total service and interest costs	$ 4	$ (3)

Plan Assets

The pension plan's weighted-average asset allocation by asset category is as follows:

Asset Category	2005	2004
Equity Investments	57%	58%
Debt Investments	27%	33%
Other	16%	9%
Total	100%	100%

The fundamental investment policies of the Plans have been formulated so they balance the primary objectives of (1) achieving long-term growth sufficient to fund, as fully practicable, future obligations and (2) supporting the short-term requirement of meeting current benefit payments, all after giving due consideration to the underlying characteristics of the Company's employment base. Overall, the Plans' policies have traditionally emphasized the maximization of long-term returns in a manner that is consistent with an asset base that: consists of high quality investments as a means of enhancing capital preservation; is broadly diversified; generates a relatively high level of investment income in accordance with the level of risk incurred; and is generally, highly marketable.

Asset allocation and selection guidelines for the Plans have been developed around the aforementioned fundamental policies. Equities have been considered the most appropriate asset class for the Plan given their record of superior, long-term, real rates of return and the Plan's ability to accommodate the shorter-term volatility typically associated with equity investments. The guidelines for equity investing have historically focused on high quality stocks and the diversification of risk. The Plans' target allocation for equity investments is 65%, with a range of from 45% to 80%.

The other major component of the Plans' assets consists of fixed income securities. The primary investment objective for this class of assets is to balance the pursuit of total return and the generation of a relatively high level of investment income. Once again, from a policy perspective, emphasis is placed on high quality investments and the diversification of risk. The Plans' target allocation for debt investments is 29%, with a range of from 17% to 42%.

The remaining assets of the Plans are maintained in cash or invested in limited partnerships, which are principally engaged in venture capital investing and other so-called "non-traditional" forms of investment. The Plans' target allocation for other investments is 6%, with a range of from 3% to 12%. The increase in Other in 2005 is primarily attributable to an increase in cash and short-term securities with redeployment expected to commence during the first quarter of 2006.

The Postretirement Plan weighted-average asset allocations by asset category are as follows:

Asset Category	2005	2004
Equity Investments	29%	25%
Debt Investments	13%	14%
Other	58%	61%
Total	100%	100%

The Postretirement Plan maintains assets in an insurance contract used to pay current life insurance premiums for certain retirees. These amounts are classified as other assets. The investment strategy for this portion of the assets places a greater emphasis on funding current benefits and a lesser emphasis on long-term growth.

Cash Flows

Contributions

The Company contributed $153 to the qualified plans, and directly funded $18 to retirees in the supplemental pension plans in 2005. In addition, the Company directly funded $25 to the postretirement benefit plans in 2005.

The Company expects to contribute $150 to the qualified plan, and directly fund $15 to retirees in the supplemental pension plan in 2006. In addition, the Company expects to directly fund $28 to the postretirement benefit plan gross of the Medicare Subsidy in 2006.

Expected Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate are expected to be paid:

	Pension	Supplemental Pension	Postretirement Welfare Plans	Postretirement Medicare Subsidy
2006	$106	$15	$28	$(5)
2007	109	11	29	(5)
2008	113	11	30	(6)
2009	119	11	32	(7)
2010	126	11	33	(8)
2011-2015	811	58	199	(52)

(12) FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, *"Disclosures about Fair Value of Financial Instruments"* ("FAS 107") requires disclosure of fair value information about financial instruments, as defined therein, for which it is practicable to estimate such fair value. FAS 107 excludes certain financial instruments, including those related to certain insurance contracts. In the measurement of the fair value of certain financial instruments, quoted market prices were not available and other valuation techniques were utilized. These derived fair value estimates are significantly affected by the assumptions used. The following methods and assumptions were used to estimate the fair value of the financial instruments presented:

Cash, cash equivalents and short-term investments: The carrying amounts reported in the consolidated balance sheets for these instruments approximate fair values.

Fixed maturities: Fair values for fixed maturities were generally based on quoted market prices. For certain fixed maturities securities for which quoted market prices were not available, fair values were estimated using values obtained from independent pricing services, or in the case of private placements, were determined by discounting expected future cash flows using a current market rate applicable to the yield, credit quality, and maturity of the securities.

Equity and trading securities: Fair values for equity and trading securities were based upon quoted market prices.

Other investments: Fair values represent the Company's equity in the partnerships' net assets as determined by the respective general partners.

Individual and group annuities: Fair values for deferred annuity contracts are equal to current net surrender value. Fair values of liabilities under investment-type insurance contracts, including individual and group annuities, are estimated using discounted cash flow calculations at pricing rates at December 31, 2005 and 2004.

Debt outstanding: Fair values of commercial paper and short-term borrowings approximate carrying value. Fair values of long-term debt were based on either quoted market prices or estimated using discounted cash flow analyses based on the Company's incremental borrowing rate at December 31, 2005 and 2004.

The fair values and carrying values of the Company's financial instruments at December 31, 2005 and 2004 are as follows:

	2005		2004	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturity securities	$37,391	$37,391	$35,601	$35,601
Equity securities	1,908	1,908	1,802	1,802
Trading securities	20	20	457	457
Other investments	1,124	1,124	990	990
Short-term investments	1,430	1,430	687	687
Cash and cash equivalents	3,155	3,155	2,590	2,590
Individual and group annuities	927	1,049	911	1,040
Debt	2,700	2,863	2,327	2,485

(13) COMMITMENTS AND CONTINGENT LIABILITIES

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

The Company has been in various insurance coverage disputes with Armstrong World Industries ("Armstrong") for over twenty years relating to asbestos liabilities and insurance covering the period 1973 to 1981. The Company prevailed in a favorable arbitration ruling before an appellate panel regarding Armstrong's insurance coverage in July 2003. Armstrong filed a Chapter 11 Bankruptcy petition in the United States Bankruptcy Court for the District of Delaware in December 2000 and is still operating under the protection of Chapter 11. A declaratory judgment action, filed by Armstrong in 2002, is pending in the United States District Court for the Eastern District of Pennsylvania seeking coverage for asbestos claims under insurance policies issued to Armstrong during the period of 1973 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania action is currently in the initial pleading stages and is inactive by agreement of the parties. In February 2004, Armstrong filed, in the same Pennsylvania District Court, a Motion to Vacate the appellate arbitration award that was favorable to the Company. In turn, the Company filed a Motion to Confirm the Appellate Panel's Award. The Company intends to vigorously defend its position. Management believes that the ultimate liability, if any, to Armstrong will not be resolved for at least one year and very likely may not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and in the event of an adverse outcome, could have a material adverse effect on the Company's results of operations, financial condition and liquidity.

The Company leases certain land, office facilities and equipment under operating leases expiring in various years through 2101. Rental expense amounted to $187, $179, and $151 and for the years ended December 31, 2005, 2004 and 2003, respectively. Future minimum rental payments under non-cancelable leases with terms in excess of one year are estimated as follows:

2006	$154
2007	130
2008	107
2009	87
2010	68
Thereafter	207
Total	$753

In 2003, the Company entered into an arrangement to sell and leaseback certain equipment. The transaction is accounted for as an operating lease. Rental expense amounted to $12, $12, and $9 for the years ended December 31, 2005, 2004 and 2003, respectively. Future minimum rental payments under these leases are estimated as follows:

2006	$13
2007	13
2008	13
2009	13
2010	10
Total	$62

It is expected that as leases expire they will be replaced.

At December 31, 2005, the Company had unfunded capital commitments to private equity, commercial mortgages and energy investments of $1,072.

At December 31, 2005, the Company had commitments to purchase various mortgage-backed securities settling in 2006, at a cost of $120 with a fair value of $121 and are included as fixed maturities in the consolidated balance sheets.

At December 31, 2005 and 2004, the Company had $595 and $658 respectively, in assigned structured settlement annuities in connection with the Prudential transaction. The asset and annuity liability of the same amount are correspondingly classified as other assets and other liabilities in the consolidated balance sheets.

On January 9, 2006, the Company acquired a commercial office building adjacent to the Company's headquarters for $482. The Company currently occupies approximately 16% of the office space.

At December 31, 2005, the Company had $933 of undrawn letters of credit outstanding.

Liabilities for guaranty fund and other insurance-related assessments are accrued when an assessment is probable, when it can be reasonably estimated, and when the event obligating the entity to pay an imposed or probable assessment has occurred (based on past premiums for life lines and future premiums for property and casualty lines). Liabilities for guaranty funds and other insurance-related assessments are not discounted and are included as part of other liabilities in the consolidated balance sheets. As of December 31, 2005 and 2004, the liability balance was $175 and $137, respectively. As of December 31, 2005 and 2004, included in other assets were $15 and $14, respectively, of related assets for premium tax offsets or policy surcharges. The related asset is limited to the amount that is determined based on future premium collections or policy surcharges from policies in force. Current assessments are expected to be paid out over the next five years; while premium tax offsets are expected to be realized within one year.

The Company has reinsurance funds held balances of approximately $1,605, which are subject to ratings triggers whereby if any of the Company's insurance financial strength ratings (with the three major rating agencies) fall below the A- (or equivalent) categories, the funds may be required to be placed in trust and invested in assets acceptable to the Company. The Company has no additional material ratings triggers.

(14) POLICYHOLDERS' EQUITY

Statutory Surplus

The Statutory surplus of the Company's domestic insurance companies was $9,869 and $8,739 at December 31, 2005 and 2004, respectively. The Company's domestic insurance subsidiaries prepare the statutory basis financial statements in accordance with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual ("NAIC APP"), subject to any deviations prescribed or permitted by the insurance commissioners of the various insurance companies' states of domicile. The Company does not have any material permitted practices that deviate from NAIC APP.

Dividends

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, 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 LMFIC and 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 and certain other affiliates which effectively limit LMIC 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), 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. The maximum dividend payout in 2006 that may be made prior to regulatory approval is $783.

REPORT OF MANAGEMENT

The Board of Directors
Liberty Mutual Holding Company Inc.

The accompanying consolidated financial statements and related information contained in this annual report are the responsibility of management and have been prepared in conformity with general accepted accounting principles. These consolidated financial statements include amounts that are based on management's estimates and judgments, particularly our reserves for losses and loss adjustment expenses. We believe that these consolidated financial statements present fairly the Company's financial position and results of operations and that other information contained in the annual report is consistent with the consolidated financial statements.

We maintain and rely on a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized and recorded. We continually monitor these internal accounting controls, modifying and improving them as business conditions and operations change. Additionally, our internal audit department independently reviews and evaluates these controls. We believe our systems of internal accounting controls provide reasonable assurance that error or irregularities that would be material to the consolidated financial statements are prevented or detected in the normal course of business.

Our independent auditors, Ernst & Young LLP, have audited the consolidated financial statements and expressed their opinion on the fairness of these consolidated financial statements. Their audit provides an independent, objective review of our consolidated financial statements. They review our internal controls and procedures, perform test of accounting records, and conduct other auditing procedures as they consider necessary to comply with auditing standards generally accepted in the United States.

The Audit Committee of the Board of Directors, comprised solely of outside directors, oversees management's discharge of its financial reporting responsibilities. The Audit Committee meets periodically with management, our internal auditors and representatives from Ernst & Young LLP to discuss auditing, financial reporting and internal control matters. Both our internal audit department and Ernst & Young LLP have access to the Audit Committee without management's presence.

Edmund F. Kelly

EDMUND F. KELLY *Chairman, President and Chief Executive Officer*

DENNIS J. LANGWELL *Senior Vice President and Chief Financial Officer*

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Liberty Mutual Holding Company Inc.

We have audited the accompanying consolidated balance sheets of Liberty Mutual Holding Company Inc. and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in policyholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liberty Mutual Holding Company Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States. As discussed in Note 1 to the consolidated financial statements, in 2005, the Company adopted FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51.

Ernst & Young LLP

Boston, Massachusetts
March 7, 2006

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General Manager, Field
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Trenton, Michigan

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Springfield, Illinois

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Officer and President
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