

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Statutory Financial Statements and Schedules

December 31, 2004 and 2003

(With Independent Auditors' Report Thereon)



KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Directors
American Manufacturers Mutual Insurance Company:

We have audited the accompanying statutory statements of admitted assets, liabilities, and surplus of American Manufacturers Mutual Insurance Company (the Company) as of December 31, 2004 and 2003, and the related statutory statements of operations, surplus, and cash flow for the years then ended. 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in note 1 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the State of Illinois Department of Financial and Professional Regulation – Division of Insurance (the Division of Insurance), which differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between statutory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of American Manufacturers Mutual Insurance Company as of December 31, 2004 and 2003, or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of American Manufacturers Mutual Insurance Company as of December 31, 2004 and 2003, and the results of its operations and its cash flow for the years then ended, on the basis of accounting described in note 1.



Our audits were made for the purposes of forming an opinion on the basic financial statements as a whole. The supplementary information included on the Summary Investment Schedule and Supplemental Investment Risks Interrogatories is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying financial statements and supplementary information have been prepared assuming that the Company will continue as a going concern. The Company is exposed to credit risk related to reinsurance recoverables as discussed in notes 5 and 9 and operating risk related to administrative sharing agreements, including a shared management group, as discussed in note 7 with Lumbermens Mutual Casualty Company (LMC), an affiliated company. As discussed in note 8 to the financial statements, the Division of Insurance imposes risk-based capital (RBC) requirements on insurance enterprises, including the Company. As of December 31, 2004, the Company's total adjusted capital, as reported in the 2004 Annual Statement filed with the Division of Insurance, was above any action levels based on the RBC calculation required by the Division of Insurance; however, LMC's RBC was at the "mandatory control level." At this level, the Division of Insurance has substantial authority to exercise control over LMC, its subsidiaries and affiliates, including the Company. The Division of Insurance is mandated to place a company at this level under its control, except where, as is the case with LMC, such company is a property and casualty insurance company that is no longer writing new business and is running off its existing business, in which case the Director of the Division of Insurance has discretion to allow the continued run-off. As required, LMC in early 2003 proposed an RBC plan to address its RBC level. The Division of Insurance did not accept that plan. In the first half of 2003, as a result of a combination of various business factors including certain ratings downgrades and LMC's deteriorating statutory surplus, LMC, its subsidiaries and affiliates, including the Company, substantially ceased underwriting activities. Since July 2003, LMC and most of its subsidiaries and affiliates, including the Company, have been subject to a Corrective Order by the Division of Insurance not to write any new or renewal business except as necessary to comply with contractual commitments or as expressly permitted by the Division of Insurance. On March 19, 2004, LMC, along with the Company, submitted to the Division of Insurance its commercial run-off plan which was approved on June 9, 2004.

The Division of Insurance could seek to place LMC, its subsidiaries and affiliates, in a formal proceeding (receivership, rehabilitation, or other) at any time based on LMC's financial condition or operating performance. This risk of a proceeding would be further increased if LMC fails to execute successfully on its commercial run-off plan, if LMC fails to have sufficient liquid assets to meet its current obligations, or if LMC's reported statutory liabilities at any time would exceed its reported statutory assets as discussed in note 9 to the financial statements.



There are a number of factors that could adversely affect the Company's surplus and liquidity position and its adequacy through future years. There can be no assurance that LMC will be successful to the extent necessary to avoid a negative surplus in future years.

The matters discussed in the previous three paragraphs raise substantial doubt about the ability of the Company to continue as a going concern. The ability of the Company to continue as a going concern is dependent on many factors, the most important of which is regulatory action, including the continued acceptance of LMC's comprehensive run-off plan and the continued collection of reinsurance recoverables from LMC. Management's plans in regard to these matters are described throughout the notes to the financial statements. The accompanying financial statements and the supplementary information do not include any adjustments that might result from the outcome of this uncertainty.

KPMG LLP

Chicago, Illinois
August 19, 2005

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Admitted Assets		
Bonds	\$ 6,122,574	4,331,528
Cash and short-term investments	19,793,166	5,585,585
Investment income due and accrued	72,002	137,367
Total admitted assets	<u>\$ 25,987,742</u>	<u>10,054,480</u>
Liabilities and Surplus		
Liabilities:		
Payable to affiliates	\$ 15,577,425	—
Other expenses payable	1,300	54,480
Total liabilities	<u>15,578,725</u>	<u>54,480</u>
Surplus:		
Guaranty fund	1,500,000	1,500,000
Unassigned surplus	8,909,017	8,500,000
Total surplus	<u>10,409,017</u>	<u>10,000,000</u>
Total liabilities and surplus	<u>\$ 25,987,742</u>	<u>10,054,480</u>

See accompanying notes to statutory financial statements.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Statutory Statements of Operations

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Underwriting:		
Premiums earned	\$ —	34,399,165
Losses and expenses incurred:		
Losses and loss adjustment expenses	—	4,378,762
Underwriting expenses	—	(27,706,563)
Change in premium deficiency reserve	—	(678,841)
Total underwriting deductions	—	(24,006,642)
Net underwriting gain	—	10,392,523
Investment income:		
Net investment income	409,017	17,991,949
Net realized capital gains on investments	—	7,642,079
Net investment gain	409,017	25,634,028
Other income:		
Retroactive loss on reinsurance	—	(40,922,235)
Loss related to reinsurance transaction	—	(229,183,168)
Other income	—	(474,530)
Other losses, net	—	(270,579,933)
Income (loss) before dividends to policyholders and federal income taxes	409,017	(234,553,382)
Dividends to policyholders	—	(1,488,287)
Income (loss) before Federal income taxes	409,017	(236,041,669)
Federal income tax benefit	—	9,534,383
Net income (loss)	\$ <u>409,017</u>	<u>(226,507,286)</u>

See accompanying notes to statutory financial statements.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Statutory Statements of Surplus

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Surplus at the beginning of the year	\$ 10,000,000	230,739,341
Net income (loss)	409,017	(226,507,286)
Other increases (decreases) in surplus		
Changes in:		
Unrealized losses	—	(910,745)
Net deferred income taxes	(3,922,998)	80,102,524
Nonadmitted assets	3,922,998	(73,423,834)
Net increase (decrease) in surplus	<u>409,017</u>	<u>(220,739,341)</u>
Total surplus	<u>\$ 10,409,017</u>	<u>10,000,000</u>

See accompanying notes to statutory financial statements.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Statutory Statements of Cash Flow

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash from operations:		
Premiums collected, net of reinsurance	\$ —	106,416,678
Net investment income	414,383	22,666,005
Loss related to reinsurance transaction	—	(229,183,168)
Retroactive reinsurance loss	—	(40,922,235)
Other miscellaneous items	—	(474,530)
	<hr/>	<hr/>
Cash provided by (used in) underwriting	414,383	(141,497,250)
Benefits and loss related payments	—	(280,229,932)
Commissions, expenses paid and aggregate write-ins for deductions	—	(129,844,380)
Dividends paid to policyholders	—	9,196,359
Federal income taxes recovered	—	11,612,880
	<hr/>	<hr/>
Net cash provided by (used in) operations	414,383	(530,762,323)
Proceeds from investments sold, matured, or repaid:		
Bonds	3,148,000	499,210,776
Stocks	—	1,348,123
Mortgage loans	—	3,767,104
Other invested assets	—	13,345,068
	<hr/>	<hr/>
Total investment proceeds	3,148,000	517,671,071
Cost of investments acquired:		
Bonds	(4,932,227)	(68,781,875)
Stocks	—	(175,313)
Other invested assets	—	(499,786)
Miscellaneous applications	—	(7,370,261)
	<hr/>	<hr/>
Total investments acquired	(4,932,227)	(76,827,235)
Net cash (used in) provided by investing	<hr/>	<hr/>
	(1,784,227)	440,843,836
Cash from financing and miscellaneous sources:		
Net transfers to affiliates	15,577,425	75,919,983
	<hr/>	<hr/>
Net increase (decrease) in cash and short-term investments	14,207,581	(13,998,504)
Cash and short-term investments:		
Beginning of year	5,585,585	19,584,089
	<hr/>	<hr/>
End of year	\$ <u>19,793,166</u>	<u>5,585,585</u>

See accompanying notes to statutory financial statements.

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Notes to Statutory Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

Basis of Presentation

American Manufacturers Mutual Insurance Company (the Company) is domiciled in the State of Illinois. The Company is affiliated with and shares common management with Lumbermens Mutual Casualty Company (LMC). LMC is the lead company in a group of insurers, now in run-off status, which have operated under the trade name of Kemper Insurance Companies (Kemper). LMC is incorporated under the insurance laws of the State of Illinois and is headquartered in Long Grove, Illinois. The Company, LMC, and all Kemper affiliates substantially ceased underwriting activities in early 2003. Prior to that, the Company offered most types of personal and commercial property and casualty insurance in all fifty states, and the District of Columbia. These insurance products were marketed primarily through independent agents and brokers.

The Company's risk-based capital ratio exceeds any regulatory action levels; however, LMC's risk-based capital ratio is at the "mandatory control level" as of December 31, 2004 and 2003 (see note 8). Because of the Company's heavy reliance on reinsurance recoveries and operations support from LMC, the regulatory and financial status of LMC has had and will continue to have a significant impact on the Company's liquidity and operations.

The accompanying statutory financial statements have been prepared in accordance with the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual* (the Manual), and in conformity with permitted accounting practices or prescribed accounting practices (including accounting allowances under Corrective Orders (accounting allowances)) from or by the Illinois Department of Financial and Professional Regulation – Division of Insurance (the Division of Insurance), which vary in some respects from accounting principles generally accepted (GAAP) in the United States of America. The most significant of these differences are as follows:

- the costs related to acquiring business are charged to income when incurred rather than deferred and amortized over the life of the related insurance policy;
- investments in bonds are generally carried at amortized cost, regardless of the planned level of portfolio activity;
- assets are included in the statutory statements of admitted assets, liabilities, and surplus (the statutory balance sheet) at admitted asset value and nonadmitted assets are excluded through a charge against surplus;
- deferred Federal income taxes do not completely provide for the temporary differences between the carrying value of assets and liabilities and their tax bases and are recorded directly to surplus;
- ceded reinsurance balances are netted against direct and assumed balances on the statutory balance sheet rather than shown gross;
- the costs of providing pension benefits and postretirement benefits other than pensions are calculated without regard to active nonvested employees;
- loss reserves on certain lines of business are discounted using discount rates prescribed by the Division of Insurance rather than rates based on current market conditions;

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December 31, 2004 and 2003

- dividends to policyholders are expensed at the earlier of payment or declaration by the Company's board of directors (the Board), rather than based on estimated ultimate payments to policyholders on the earned portions of policies;
- the correction of errors related to previously issued financial statements are charged directly to surplus rather than restating prior period results;
- the statutory statements of cash flow are presented in a specified format which differs from the formats prescribed by Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*; and
- comprehensive income is not determined for statutory reporting purposes.

The effects of such differences on the statutory financial statements have not been determined but are presumed to be material.

Invested Assets and Related Income

Bonds and short-term investments are valued at amortized cost. The amortized cost of bonds is adjusted for amortization of premiums and accretion of discounts using a level effective yield method to maturity.

Realized gains or losses on the sale of investments, the recognition of other-than-temporary declines in value, or situations where the Company has made a decision to sell a security at an amount below the security's carrying value are determined on the basis of specific identification of the acquisition lots of the respective investment sold or written down and are reflected as a component of operations. Unrealized gains or losses on revaluation of investments are credited or charged to surplus.

The Company does not accrue interest income on fixed maturities deemed to be impaired on an other-than-temporary basis when it judges that the likelihood of collection of interest is doubtful.

Premiums and Policy Acquisition Costs

Premiums are earned on a daily pro-rata basis over the term of the policies and are net of reinsurance placed with reinsurers. Unearned premiums are also stated after deduction for premiums ceded to reinsurers. Premiums received in advance are recorded as a liability and are not considered income until due. Agents' balances and uncollected premiums receivable are recorded at the effective date of the underlying contract or in the case of audit premiums in accordance with the terms of the underlying contracts. Such receivables are recorded net of balances over 90-days past due and such other balances as required by the Manual. The Company evaluates the collectibility of all receivables for possible impairment. When the Company determines it is probable a receivable balance will not be collected, such amounts are written off and charged to other income. Policy acquisition costs such as commissions, premium taxes, and other underwriting and agency expenses are charged to income as incurred. The Company anticipates investment income as a factor in determining premium deficiency reserves; however, as of December 31, 2004 and 2003, the Company did not require an ending premium deficiency reserve.

Liabilities for Losses and Loss Adjustment Expenses

The Company records liabilities for unpaid claims, losses, and related loss adjustment expenses (LAE) based upon management's best estimate of aggregate case-basis estimates for losses reported, estimates

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Notes to Statutory Financial Statements

December 31, 2004 and 2003

received from ceding reinsurers, and estimates of incurred but not reported (IBNR) losses related to direct and assumed business, less amounts ceded to reinsurers. Reserves for unreported losses are established using various statistical and actuarial techniques reflecting historical patterns of development of paid and reported losses adjusted for current trends. Certain liabilities for unpaid losses related to workers' compensation pension cases and long-term disability losses are discounted to present value.

Because the ultimate settlement of claims is subject to future events, no single loss or LAE reserve can be considered accurate with certainty. The Company's analysis of the reasonableness of loss or LAE reserve estimates includes an analysis of the amount of variability in the estimate. The Company develops its estimate considering a range of reserve estimates bounded by a high and a low estimate. The high and low ends of the range do not correspond to an absolute best-and-worst case scenario of ultimate settlements because such estimates may be the result of unlikely assumptions. Management's best estimate therefore does not include the set of all possible outcomes but only those outcomes that are considered reasonable.

The Company reflects its liability for losses net of anticipated salvage and subrogation recoveries, which were zero as of December 31, 2004 and 2003. Salvage and subrogation received and changes in estimates of future recoveries are reflected in current year underwriting results.

Management believes the liabilities for losses and LAE are adequate to cover the ultimate liability; however, due to the underlying risks and high degree of uncertainty associated with the determination of the liability for losses, such estimates may be more or less than the amounts ultimately paid when the claims are settled. In the event reinsurance companies are unable to pay their portion of any claim under reinsured policies, the Company would remain liable for such payments.

Federal Income Taxes

The Company's Federal income tax return is not consolidated with any other entities. Federal income taxes are charged to operations based on income that is currently taxable. The Company provides as a component of surplus, an estimate of deferred income tax assets and liabilities which reflect the expected future tax consequences of unrealized capital gains or losses and the temporary differences generated between statutory accounting and the tax bases of assets and liabilities that are anticipated to reverse within one year or can be recovered through loss carrybacks.

Nonadmitted Assets

Assets included in the statutory balance sheet are at admitted asset value. Nonadmitted assets, principally deferred tax assets, agents' balances over 90-days past due, computer software, other equipment, and 10% of unsecured policyholder dividends recoverable, are excluded through a charge against surplus.

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Notes to Statutory Financial Statements

December 31, 2004 and 2003

Cash Flow Information

The Company defines cash and cash equivalents as cash in banks or short term, highly liquid investments that are both readily convertible to cash and have original maturities of three months or less. The Company considers all other highly liquid investments with an original maturity of one year or less to be short-term investments.

Use of Estimates

The preparation of the statutory financial statements requires management to make estimates and assumptions that affect the reported financial statement balances as well as the disclosure of contingent assets and liabilities. Accordingly, actual results reported in the accompanying statutory financial statements could differ from those estimates.

As further discussed in the accompanying notes to the statutory financial statements, significant estimates and assumptions affect various provisions including losses and policyholder dividends. The liabilities for losses and LAE, although supported by actuarial analysis and other data, are ultimately based on management's reasoned expectations of future events. As further described in note 4, estimates of losses and LAE related to environmental and asbestos claims are also subject to a greater degree of uncertainty and variability. Policyholder dividend recalls (accrued retrospective premiums) and dividends payable to policyholders are estimated based on similar assumptions used to estimate the ultimate liabilities for losses and LAE.

(2) **Significant Transactions**

Renewal Rights Transactions

In 2002, LMC and its affiliates, including the Company, entered into a renewal rights and asset sale transaction transferring, over time, substantially all its personal lines business to Unitrin.

In 2003, LMC and its affiliates, including the Company and its affiliates, entered into several renewal rights transactions allowing the Company and its affiliates to receive future commissions from other insurance companies that renew any of the in-force business when such business expires or cancels from the Company or its affiliates. In some cases, employees and leases were also transferred related to certain of the Company's business lines, resulting in future expense savings related to severance and lease costs.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

Presented below is the revenue from these transactions for LMC in 2003:

<u>Kemper business line</u>	<u>Purchaser of renewal rights</u>	<u>Total renewal rights revenue earned in 2003</u>
Small and middle market accounts	St. Paul Companies	\$ 24,963,270
Excess casualty	St. Paul Companies	2,000,000
Personal lines	Unitrin, Inc.	7,830,032
Directors and officers liability	AXIS Capital Holdings	5,699,999
Bundled large risk accounts	Argonaut Insurance Company	5,125,803
Alternative risk programs	Hartford Fire Insurance Company	1,391,901
Environmental casualty	Zurich Insurance	837,352
Unbundled large risk accounts	Old Republic	353,664
		<u>\$ 48,202,021</u>

The Company's share of the above renewal rights revenue earned in 2004 and 2003 was \$0 and \$3.9 million, respectively.

Reinsurance Transaction between the Company and LMC

Effective December 31, 2003, the Company and LMC entered into a reinsurance transaction, the results of which included (1) an amendment to the intercompany pooling agreement (the Pool or the Pooling Agreement) that removed the Company from the Pool and ceded all net liabilities of the Company at December 31, 2003 to LMC and (2) the issuance by LMC of a new insurance policy to each and every policyholder of the Company other than those policyholders already fully reinsured by Trinity Universal Insurance Company, a subsidiary of Unitrin, Inc. (Unitrin). In exchange for the issuance of these new insurance policies, the Company incurred an approximate charge of \$229.2 million, and LMC recorded income of the same amount as of December 31, 2003. Absent this reinsurance transaction as well as certain accounting allowances prescribed by the Division of Insurance, the statutory surplus of LMC at December 31, 2004 and 2003 would have been negative. In turn, the Company's solvency would also be at risk given the Company's significant reliance on its substantial reinsurance recoverables from LMC.

Historically, the Company and other Kemper Insurance Companies ceded their directly written insurance business to LMC as their reinsurer, and LMC in turn ceded to the Company 8% of that pooled business. As part of the reinsurance transaction described herein, the 8% cession from LMC to the Company was eliminated, with LMC receiving as payment from the Company assets equal to the Company's loss and loss expense reserves/liabilities (approximately \$370.0 million) assumed by LMC. The Company then also paid to LMC an amount equal to the remainder of the Company's December 31, 2003 statutory surplus less \$10.0 million. The payments were in cash, securities, and the assignment of assets or beneficial rights to assets where the legal title to such assets could not be directly accomplished by December 31, 2003. Legal title to certain assets of the Company which are restricted from transfer, because they are statutory deposits or collateral for other purposes or subject to other restrictions, is to be transferred to LMC at the earliest practicable date.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

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LMC assumed most of the Company's liabilities, agreed to perform for the Company all insurance policy-related obligations including handling and paying claims, and issued to each holder of a policy ever issued by the Company, including any policy no longer in force but excluding any policy reinsured by Unitrin, an additional policy which is substantively identical to the policy previously issued by the Company. The additional LMC policy assures the affected Company policyholders that their claims will be treated equally with the claims of other LMC policyholders not only in the managed run-off of LMC and the Company, but also in the event of any insolvency proceedings with respect to the two companies.

Because the reinsurance transaction was not assumption reinsurance and the Company policies were not novated, the affected policyholders now hold separate policies issued by both the Company and LMC. The Company remains liable for policy liabilities in the event LMC does not comply with all the terms of the affected policies. The Company has \$600.0 million in reinsurance recoverables due from LMC as of December 31, 2004 which are netted against loss and LAE reserves on the statutory balance sheet.

The reinsurance transaction was approved by the Division of Insurance, as well as by independent committees of the boards of directors of each of the Company and LMC following receipt of fairness opinions by their respective independently engaged financial advisors.

(3) Invested Assets

Bonds

The Company is generally carrying its bond portfolio at amortized cost. The carrying value of bonds is adjusted for other-than-temporary declines in value or situations where the Company has made a decision to sell a security at an amount below the security's carrying value. The fair values of the Company's bonds have been determined using market quotations provided by the NAIC's Securities Valuation Office (SVO), or independent pricing services that use prices provided by market makers or estimates of fair values obtained from yield data relating to instruments or securities with similar characteristics, or fair value as determined in good faith by the Company's portfolio managers, when such values are not available from the SVO. Such values are referred to in the accompanying tables as "NAIC fair value."

The statement value and NAIC fair value of bonds at December 31, 2004 and 2003 were as follows:

		2004			
		Statement value	Gross unrealized gains	Gross unrealized losses	NAIC fair value
		(In thousands)			
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$	5,633	18	(33)	5,618
State, political subdivision, and special revenue obligations		412	51	—	463
Debt securities issued by foreign governments		78	6	—	84
Total bonds	\$	6,123	75	(33)	6,165

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	2003			NAIC fair value
	Statement value	Gross unrealized gains	Gross unrealized losses	
		(In thousands)		
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 3,841	134	—	3,975
State, political subdivision, and special revenue obligations	412	45	—	457
Debt securities issued by foreign governments	79	6	—	85
Total bonds	\$ <u>4,332</u>	<u>185</u>	<u>—</u>	<u>4,517</u>

The following table sets forth the maturity aging schedule of bonds at December 31, 2004. The actual maturities may differ from the contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties.

	Statement value	NAIC fair value
	(In thousands)	
One year or less	\$ 686	703
Over one year through five years	4,948	4,915
Over five years through ten years	78	84
Over ten years	411	463
Total bonds	\$ <u>6,123</u>	<u>6,165</u>

Bonds carried at \$4.3 million at December 31, 2004 and cash and bonds carried at \$4.5 million at December 31, 2003 were on deposit with government authorities as required by law.

There were no sales of investments in bonds prior to maturity during 2004. Proceeds from sales of investments in bonds prior to maturity during 2003 were \$390.2 million. Gross gains of \$18.3 million and gross losses of \$790 thousand were realized on those sales during 2003.

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Net Realized Capital Gains (Losses)

Net realized capital gains (losses) by category for the years ended December 31, 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Bonds	\$ —	15,499
Loss on sale of assets	—	(7,370)
Short-term investments and other	—	(1,655)
Equity securities	—	1,168
	<hr/>	<hr/>
Net realized capital gains	\$ —	7,642
	<hr/> <hr/>	<hr/> <hr/>

The Company had no realized capital gains in 2004. During 2003, the Company recorded realized losses related to other-than-temporary declines in fair value of \$2.0 million related to bonds and \$1.7 million related to venture capital partnerships. The determination of fair value for such write-downs is based upon estimated fair value.

Net Investment Income

The sources of the Company's net investment income as of December 31, 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Bonds	\$ 259	18,578
Cash and short-term investments	152	851
Mortgage loans	—	156
Equity securities	—	3
Other invested assets	33	948
	<hr/>	<hr/>
Total investment income	444	20,536
Investment expenses	<hr/> (35)	<hr/> (2,544)
Net investment income	\$ <hr/> 409	<hr/> 17,992
	<hr/> <hr/>	<hr/> <hr/>

(4) Losses and Loss Adjustment Expenses

The Company establishes loss reserves to cover its estimated ultimate liability for property and casualty losses and LAE with respect to reported claims and claims incurred but not yet reported as of the end of each accounting period, except for certain liabilities for unpaid losses related to workers' compensation pension cases and long-term disability losses, which are discounted to present value. As required by applicable accounting rules, no reserves are established until a loss, including a loss from a catastrophe occurs. Reserves are estimates of what the Company expects the ultimate settlement and administration of claims will cost based on facts and circumstances then known, predictions of future events and estimates of future trends in claims severity and frequency, judicial theories of liability, and other factors. The inherent

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uncertainties of estimating insurance reserves are generally greater for liability coverages or where judicial and political climates involving certain types of claims are changing, than for property coverages due to the longer periods of time (the tail) that elapse before a definitive determination of ultimate loss may be made. Activity in the liabilities for losses and LAE is summarized as follows (in thousands):

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Balance as of January 1, net of reinsurance recoverables of \$1,167,554 in 2004 and \$1,060,981 in 2003	\$ —	360,670
Incurred related to:		
Current accident year	—	(3,773)
Prior accident years	—	(606)
Total incurred	—	(4,379)
Paid related to:		
Current accident year	—	3,773
Prior accident years	—	(360,064)
Total paid	—	(356,291)
Balance as of December 31, net of reinsurance recoverables of \$596,819 in 2004 and \$1,167,554 in 2003	\$ —	—

100% of the Company's liabilities for losses and LAE are ceded to LMC at December 31, 2004 and 2003.

The Company's gross exposure to asbestos and environmental claims arise principally from general liability insurance contracts. Establishing reserves for asbestos and environmental claims is subject to greater uncertainties than those presented by other types of claims. Among the complications are lack of historical data, long reporting delays, uncertainty as to the number and identity of insurers with potential exposure, and unresolved legal issues regarding policy coverage and the extent and timing of any such contractual liability. The legal issues concerning the interpretation of various insurance policy provisions and whether asbestos and environmental losses are or were ever intended to be covered are complex. Courts have reached different and sometimes inconsistent conclusions as to when the loss occurred and what policies provided coverage; what claims are covered; whether there is an insured obligation to defend; how policy limits are determined; how policy exclusions are applied and interpreted; and whether clean-up costs are covered as insured property damage. Based on the foregoing, reserves for asbestos and environmental claims cannot be estimated with traditional loss reserving techniques. Loss reserves including IBNR have been established when sufficient information has been developed to indicate the involvement of a specific insurance policy. The Company estimates the impact of these exposures by establishing case basis reserves on all known losses and LAE and by computing IBNR losses based on previous experience.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

Asbestos-related Losses

The asbestos-related losses (including coverage dispute costs) as of December 31, 2004 and 2003, gross of reinsurance, were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Beginning reserves	\$ 59,330	84,102
Incurred losses and LAE	5,033	(18,993)
Calendar year payments for losses and LAE	<u>(36,914)</u>	<u>(5,779)</u>
Ending reserves	<u>\$ 27,449</u>	<u>59,330</u>

The asbestos-related losses (including coverage dispute costs) as of December 31, 2004 and 2003, net of reinsurance, were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Beginning reserves	\$ —	40,524
Incurred losses and LAE	—	(36,046)
Calendar year payments for losses and LAE	<u>—</u>	<u>(4,478)</u>
Ending reserves	<u>\$ —</u>	<u>—</u>

The total asbestos-related loss reserves at December 31, 2004 included IBNR reserves in the amount of \$4.7 million gross of reinsurance and \$0 net of reinsurance. These IBNR reserves and the comparable amounts for prior years covered both losses and defense and cost containment expenses. The Company also included adjusting and other expenses in the amounts shown above.

Environmental-related Losses

The environmental-related losses (including coverage dispute costs) as of December 31, 2004 and 2003, gross of reinsurance, were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Beginning reserves	\$ 12,639	14,207
Incurred losses and LAE	(824)	(1,337)
Calendar year payments for losses and LAE	<u>(10,319)</u>	<u>(231)</u>
Ending reserves	<u>\$ 1,496</u>	<u>12,639</u>

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

The environmental-related losses (including coverage dispute costs) as of December 31, 2004 and 2003, net of reinsurance, were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Beginning reserves	\$ —	10,903
Incurred losses and LAE	—	(11,211)
Calendar year payments for losses and LAE	—	308
Ending reserves	\$ —	—

The total environmental loss reserves at December 31, 2004 included IBNR reserves in the amount of \$580 thousand gross of reinsurance and \$0 net of reinsurance. These IBNR reserves and the comparable amounts for prior years covered both losses and defense and cost containment expenses. The Company also included adjusting and other expenses in the amounts shown above.

(5) Reinsurance

The Company reinsures 100% of its premiums, losses, and underwriting expenses with LMC. All reinsurance recoverables from LMC are unsecured, and the Company remains primarily liable as the direct insurer on all risks reinsured if LMC is unable to pay such claims. As noted elsewhere in these notes, the Company's liquidity, surplus, and ability to operate in a commercial run-off outside a formal insolvency proceeding are dependent on LMC's financial and regulatory status.

The Company's assumptions from and cessions to unaffiliated reinsurers were as follows:

	<u>Assumed</u>	<u>Ceded</u>
	(In thousands)	
2004:		
Written premiums	\$ —	—
Unearned premiums	—	—
Outstanding losses and LAE (including IBNR)	—	—
Paid losses	—	(1)
2003:		
Written premiums	\$ 3,414	—
Unearned premiums	8,833	—
Outstanding losses and LAE (including IBNR)	228,399	—
Paid losses	—	—

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

The Company's assumptions from and cessions to affiliated reinsurers were as follows:

	<u>Assumed</u>	<u>Ceded</u>
	(In thousands)	
2004:		
Written premiums	\$ (8,833)	(2,934)
Unearned premiums	—	3,740
Outstanding losses and LAE (including IBNR)	—	596,819
Paid losses	303,880	638,415
2003:		
Written premiums	\$ 3,414	258,047
Unearned premiums	8,833	83,862
Outstanding losses and LAE (including IBNR)	228,399	1,167,554
Paid losses	—	516,949

The Company's liquidity is largely dependent on LMC's ability to maintain its liquidity. A significant portion of LMC's liquidity needs is its ability to collect on unaffiliated reinsurance balances. LMC reinsures a portion of the risks it underwrites in an effort to control its exposure to losses and protect surplus. LMC cedes to reinsurers a portion of these risks and pays premiums based upon the risk and exposure of the policies subject to such reinsurance. Reinsurance is subject to collectibility in all cases and to aggregate loss limits in certain cases. Although the reinsurer is liable to the extent of the reinsurance limits purchased, LMC remains primarily liable as the direct insurer on all risks reinsured. Reinsurance recoverables are reported after allowances for uncollectible amounts. LMC also holds collateral, including escrow funds, letters of credit, and trust funds, under certain reinsurance agreements. LMC monitors the financial condition of reinsurers on an ongoing basis, and reviews its reinsurance arrangements periodically. Reinsurers are selected based on their financial condition and business practices. As of December 31, 2004, approximately 74.8% of LMC's \$2.4 billion of unsecured recoverables from reinsurers, excluding the Company's participation in third-party pools, were from reinsurers rated A or better by A.M. Best Company or Standard & Poor's, and approximately 79.6% of LMC's \$2.4 billion of unsecured recoverables were rated A- or better by A.M. Best Company or Standard & Poor's.

The estimated maximum amount of return commission due LMC if all of the Company's reinsurance was canceled as of December 31, 2004 was as follows:

	<u>Assumed reinsurance</u>		<u>Ceded reinsurance</u>		<u>Net</u>	
	<u>Premium reserve</u>	<u>Commission equity</u>	<u>Premium reserve</u>	<u>Commission equity</u>	<u>Premium reserve</u>	<u>Commission equity</u>
Affiliates	\$ —	—	3,740,332	581,553	(3,740,332)	(581,553)
All other	—	—	—	—	—	—
Total	\$ —	—	3,740,332	581,553	(3,740,332)	(581,553)

There were no additional or return commission resulting from existing contractual arrangements, predicated on loss experience or on any other form of profit sharing arrangements, as of December 31, 2004.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

Events of September 11, 2001

The terrorist attacks of September 11, 2001 resulted in a tremendous loss of life and property. In the past, insurance companies have incurred losses as a result of catastrophes such as earthquakes, hurricanes, and even other terrorist attacks. However, these events are unprecedented in the United States in terms of the magnitude of the losses incurred and the number of entities affected. Through December 31, 2004, the Company's inception-to-date gross incurred loss and LAE related to the September 11 events are estimated to be \$19.7 million. LMC reinsures 100% of the Company's gross liabilities under a quota share reinsurance agreement, and the net loss and loss adjustment expense incurred by the Company is zero.

(6) Federal Income Taxes

The components of the Company's net deferred tax asset as of December 31, 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Total of gross deferred tax assets	\$ 100,429	104,351
Total of deferred tax liabilities	(6)	(5)
Net deferred tax asset	<u>100,423</u>	<u>104,346</u>
Deferred tax asset nonadmitted	<u>(100,423)</u>	<u>(104,346)</u>
Net admitted deferred tax asset	\$ <u>—</u>	\$ <u>—</u>
Decrease in nonadmitted asset	\$ 3,923	—

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2004 and 2003 were as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Deferred tax assets:		
Section 197 intangible	\$ 74,421	80,214
Net operating loss carryforward	26,008	24,137
Total deferred tax assets	<u>100,429</u>	<u>104,351</u>
Nonadmitted deferred tax assets	<u>(100,423)</u>	<u>(104,346)</u>
Admitted deferred tax assets	<u>6</u>	<u>5</u>
Deferred tax liabilities:		
Other	<u>(6)</u>	<u>(5)</u>
Total deferred tax liabilities	<u>(6)</u>	<u>(5)</u>
Net admitted deferred tax asset	\$ <u>—</u>	\$ <u>—</u>

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

The change in net deferred income taxes as of December 31, 2004 and 2003 was comprised of the following:

	<u>2004</u>	<u>2003</u>	<u>Change</u>
		(In thousands)	
Total deferred tax assets	\$ 100,429	104,351	(3,922)
Total deferred tax liabilities	(6)	(5)	(1)
Net deferred tax asset	\$ <u>100,423</u>	<u>104,346</u>	(3,923)
Tax effect of unrealized gains or losses			—
Decrease in net deferred income tax in surplus			\$ <u>(3,923)</u>

The actual Federal income tax benefit (expense) as of December 31, 2004 and 2003 differed from “expected” tax benefit (expense) (“expected” tax is computed by applying the corporate tax rate of 35% to income before Federal income taxes) as follows:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Computed “expected” benefit (expense)	\$ (143)	82,615
Section 197 intangible	5,348	(80,214)
Net operating loss adjustment	(5,205)	(24,137)
Prior year tax adjustments	—	9,544
Unearned premium reserve adjustments	—	2,084
Loss reserve discounting	—	7,871
Accrued liabilities	—	10,533
Foreign income taxes	—	(10)
Other, net	—	1,248
Federal and foreign income tax benefit	\$ <u>—</u>	<u>9,534</u>

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Notes to Statutory Financial Statements

December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Provision computed at statutory rate	\$ (143)	82,615
Prior period adjustment	—	9,544
Accrued liabilities	—	(510)
Section 197 intangible	(446)	—
Loss carryforward	(3,333)	—
Receivables	—	(2,302)
Other	(1)	289
	<u> </u>	<u> </u>
Total statutory income taxes	\$ (3,923)	89,636
	<u> </u>	<u> </u>
Federal income tax benefit	\$ —	9,534
Change in net deferred income taxes	(3,923)	80,102
	<u> </u>	<u> </u>
Total statutory income taxes	\$ (3,923)	89,636
	<u> </u>	<u> </u>

At December 31, 2004, the Company had \$74.3 million of operating loss carryforward which originated and expires as follows:

<u>Origination year</u>	<u>Expiration year</u>	<u>Amount</u>
		(In thousands)
2003	2023	\$ 59,440
2004	2024	14,870
		<u> </u>
		\$ 74,310
		<u> </u>

There are no income taxes incurred in the current year and prior year that will be available for recoupment in the event of future net losses. Tax returns for the years through 2000 are closed for IRS examination. The Company is not currently under examination by the Internal Revenue Service for any open tax years.

(7) Transactions with Affiliates and Related Parties

The Company utilizes the employees and the office facilities of LMC. Charges for these services, which include benefit plan expenses for such employees, are allocated to the Company. Such charges are based on time spent and facilities used in order to provide for an appropriate matching of revenues and expenses.

As mentioned elsewhere in the notes, the Company is largely dependent on LMC's financial and regulatory status. If LMC does not or cannot meet its reinsurance obligations to the Company, the Company's liquidity and financial status would be significantly affected.

LMC and its affiliates, including the Company, jointly participate in a corporate insurance program, including D&O coverage. An LMC subsidiary, Specialty Surplus Insurance Company, entered into a reinsurance agreement, effective for a three-year period (2005, 2006, and 2007), facultatively reinsuring a corresponding three-year A-side management liability policy issued by an unaffiliated third party to LMC and the Company.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

In various other notes to the financial statements, transactions with affiliates and related parties are also discussed. At December 31, 2004, the Company had a payable to LMC in the amount of \$15.6 million for services and payments LMC made on behalf of the Company. These balances are settled quarterly.

(8) Risk-Based Capital

The NAIC utilizes a risk-based capital (RBC) formula intended for regulatory monitoring of property-casualty insurers. Under risk-based capital rules in Illinois, state regulators may mandate remedial action for inadequately capitalized companies. The focus of the capital rules is a risk-based formula that applies prescribed factors to various risk elements in an insurer's business and investments to develop a minimum capital requirement designed to be proportional to the amount of risk assumed by the insurer. At year-end 2004 and 2003, LMC's level of capital and surplus was determined to be at the "mandatory control level" under the risk-based capital rules. At this level, the Division of Insurance has substantial authority to exercise control over LMC and its affiliates, including the Company. The Division of Insurance is mandated to place a company at this level under its control, except where, as is the case with LMC, such company is a property and casualty insurance company that is no longer writing new business and is running off its existing business, in which case the Director of the Division of Insurance (the Director) has discretion to allow the continued run-off. Exercising its supervisory authority, the Division of Insurance has issued Corrective Orders to the Illinois-domiciled Kemper Insurance Companies. As required, LMC in early 2003 proposed an RBC plan to address its RBC level. The Division of Insurance did not accept that plan, but required that Kemper develop a commercial run-off plan based on Kemper's results and financial condition at December 31, 2003.

On March 19, 2004, Kemper and the other Illinois-domiciled Kemper Insurance Companies filed a commercial run-off plan with the Division of Insurance. On June 9, 2004, the Division of Insurance gave the Kemper Insurance Companies permission to proceed with the run-off plan as submitted. Details of the plan are confidential, pursuant to the state's risk-based capital statute. The plan is designed to help the Kemper Insurance Companies meet their goal of resolving, to the maximum extent possible, all valid policyholder claims.

Risks and uncertainties involved in implementing the plan include the needs to achieve significant policy buybacks and novations, to conclude other surplus and liquidity-enhancing transactions, to commute reinsurance agreements, to conclude other transactions, to hire and retain the staff and resources necessary to implement the plan, to further reduce expenses, and to consummate agreements with regulators and other third parties. Achieving the surplus and liquidity projections in the run-off plan requires the consummation of agreements with insureds for policy buybacks and novations, the timely performance of payment and other contractual obligations owed to Kemper and the Company by various third parties, including reinsurers as well as insureds and agents, and the absence of significant additional disputes not only with reinsurers but also with creditors, including insureds and certain states, which could involve judicial or other actions to seek either to force Kemper to collateralize its unsecured obligations or to not timely release collateral. Therefore, no assurance can be given that the plan will be successfully implemented.

The Division of Insurance continues to closely monitor Kemper's progress in achieving the objectives of the run-off plan. As has been the case for the last two years, the Division of Insurance retains the discretion at any time to seek to place Kemper and the Company in a formal proceeding (conservatorship or

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

receivership, rehabilitation, or liquidation). As previously disclosed, the risk of a proceeding would be exacerbated if Kemper fails to have sufficient liquid assets to meet current obligations, or if the reported liabilities of Kemper at any time exceeds reported assets, or if the Kemper fails to meet the surplus and liquidity projections set forth in the plan.

Having entered into voluntary run-off in the first half of 2003, Kemper has been operating under guidance provided within certain agreed to Corrective Orders with the Division of Insurance, pursuant to which Kemper and the Company have ceased to write virtually all insurance business and are settling liabilities under the administrative supervision of the Division of Insurance. The Company has also entered into consent agreements with certain states under which the Company agreed to cease writing business in those jurisdictions. In addition, in 2005, the Company entered into an Agreed Order with the Tennessee Division of Insurance for its licenses to be suspended with the Company permitted to maintain its licenses, but not permitted to write any new business. Florida has also sought to unilaterally suspend certificates of authority of the Company. The Company has resisted those unilateral actions by states as not being in the best interests of the policyholders or claimants of the Company.

The Company's risk-based capital ratio exceeds any regulatory action levels; however, LMC's risk-based capital ratio is at the "mandatory control level" as of December 31, 2004 and 2003. Because of the Company's heavy reliance on reinsurance recoveries and operations support from LMC, the regulatory and financial status of LMC has had and will continue to have a significant impact on the Company's liquidity and operations.

(9) **Commitments, Contingent Liabilities, Liquidity, and Other Contingencies**

Ratings

As of December 31, 2004, A.M. Best had assigned the Kemper Insurance Companies a D (poor) rating. In early 2005, Kemper requested that A.M. Best cease rating Kemper. In June and July 2003, respectively, Moody's Investor Services and Standard & Poors last downgraded Kemper's financial strength ratings to Caa3 (very poor) and CCC (very weak), respectively, when, at Kemper's request, they ceased rating Kemper. The downgrades to below A- effectively ended Kemper's ability to write most new commercial lines of business or retain existing policyholders.

Sources of Liquidity

Although the Company's positive operating cash flows (along with the portion of the investment portfolio that is held in cash and highly liquid short-term securities) have historically met the liquidity requirements of the Company's operations, the Company is heavily dependent on its reinsurance with LMC to meet its current obligations and maintain its surplus. Other than reinsurance recoverables from business ceded to LMC, the Company's cash inflows consist primarily of income from investments and sales and maturities of investments. Thus, it is critical that the Company is able to collect its reinsurance recoverables from LMC. However, the Corrective Order prohibits the transfer of assets from, or liabilities to, any affiliated parties without the prior written approval of the Director.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

Other Items

In the ordinary course of business, the Company is involved in various legal actions for which it establishes liabilities where appropriate. In the opinion of the Company's management, based upon the advice of legal counsel, contingent liabilities arising from litigation, tax, and compliance matters are not expected to have a material adverse effect on the Company's statutory financial statements due to established reserves and anticipated insurance and reinsurance recoverables.

(10) Surplus

Under risk-based capital rules in Illinois, state regulators may mandate remedial action for inadequately capitalized companies. The focus of the capital rules is a risk-based formula that applies prescribed factors to various risk elements in an insurer's business and investments to develop a minimum capital requirement designed to be proportional to the amount of risk assumed by the insurer.

(11) Fair Value of Financial Instruments

Fair value estimates are made at specific points in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Fair value estimates for financial instruments are generally determined using discounted cash flow models and assumptions that are based on judgments regarding current and future economic conditions and the risk characteristics of the investments. Although fair value estimates are calculated using assumptions that management believes are appropriate, changes in assumptions could significantly affect the estimates and such estimates should be used with care.

Fair value estimates are determined for existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and certain liabilities that are not considered financial instruments. Accordingly, the aggregate fair value estimates presented do not represent the underlying value of the Company. In addition, tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Bonds: Fair values for bonds have been determined using market quotations provided by the SVO, or independent pricing services that use prices provided by market makers or estimates of fair values obtained from yield data relating to instruments or securities with similar characteristics, or fair value as determined in good faith by the Company's portfolio managers, when such values are not available from the SVO.

Cash, cash equivalents and short-term investments: The statement values reported for these instruments approximate fair value.

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Notes to Statutory Financial Statements

December 31, 2004 and 2003

The statement values and estimated fair values of the Company's financial instruments at December 31, 2004 and 2003 are as follows:

	2004		2003	
	<u>Statement value</u>	<u>Estimated fair value</u>	<u>Statement value</u>	<u>Estimated fair value</u>
	(In thousands)			
Financial instruments recorded as assets:				
Bonds	\$ 6,123	6,165	4,332	4,517
Cash, cash equivalents and short-term investments	19,793	19,793	5,586	5,586

(12) Retirement Plans, Deferred Compensation, Postemployment Benefits and Compensated Absences, and Other Postretirement Benefit Plans

The Company utilizes the employees of LMC. LMC had a non-contributory defined benefit pension plan which covered substantially all full-time employees as well as certain deferred compensation plans for its officers and employees. Effective January 15, 2004, LMC adopted an amendment to freeze the pension plan. On October 19, 2004, the Pension Benefit Guaranty Corporation (the PBGC), the federal corporation responsible for guaranteeing payment of pension benefits, notified LMC that the PBGC would move to take control of LMC's defined benefit pension plans effective October 21, 2004. The benefits under the pension plans are insured through the PBGC. It is anticipated that the benefit levels for the majority of the approximately twelve thousand plan participants will not be significantly affected by this development, and payments to retirees will continue uninterrupted. Future retirees will receive their pension from the PBGC when they are eligible to retire.

LMC historically provided non-pension retirement benefits consisting of certain health care benefits and life insurance for retired employees. Through December 31, 2004, the cost of the health care benefit was borne jointly by LMC (which was self insured for its share) and its retirees (and spouses) at varying percentages depending on the age and service of the plan participant. Effective January 1, 2003, LMC placed a cap on the level of subsidy provided by LMC. For all current and future groups who received subsidized coverage in 2004 and 2003, LMC's costs were capped at 120% of the 2003 subsidy levels. In addition, effective January 1, 2004, LMC (i) changed its funding policy for post-retirement medical, shifting more of the annual costs to the retiree while reducing the amount LMC would then pay for post retirement medical, and (ii) changed its eligibility requirements for post retirement medical so only active employees age 55 or older as of January 1, 2004 with ten or more years of service with LMC would be eligible for medical benefits at retirement. Effective December 31, 2003, LMC received from the Division of Insurance an allowance under Corrective Orders to account for the changes implemented as of January 1, 2004 as a permanent curtailment of the benefit, allowing LMC to reduce its prior service liability at December 31, 2003 from \$64.1 million to \$32.3 million.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Notes to Statutory Financial Statements

December 31, 2004 and 2003

Effective December 31, 2004, LMC permanently eliminated all subsidies previously provided by LMC to its retirees for medical benefits. This resulted in a \$32.3 million reduction in LMC's carried liabilities at December 31, 2004.

The Company was allocated its share of the benefit costs for these benefit plans under the terms of the administrative services agreement described in note 7.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Summary Investment Schedule

December 31, 2004

The following is a summary of certain financial data as of December 31, 2004 and for the year then ended for purposes of complying with the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual*. Such data is included in the Company's 2004 Annual Statement as filed with the Division of Insurance.

<u>Investment categories</u>	<u>Gross investment holdings</u>		<u>Admitted assets as reported in the annual statement</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
Bonds:				
U.S. Treasury securities	\$ 5,633,275	21.737%	\$ 5,633,275	21.737%
Foreign government (including Canada, excluding mortgage-backed securities)	77,979	0.301	77,979	0.301
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
Revenue and assessment obligations	411,320	1.587	411,320	1.587
Cash, cash equivalents and short-term investments	19,793,166	76.375	19,793,166	76.375
Total invested assets	\$ <u>25,915,740</u>	<u>100.000%</u>	\$ <u>25,915,740</u>	<u>100.000%</u>

See accompanying independent auditors' report.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Supplemental Investment Risks Interrogatories

December 31, 2004

The following interrogatories as of December 31, 2004 and for the year then ended are for the purpose of complying with the National Association of Insurance Commissioners *Accounting Practices and Procedures Manual*.

Answer the following interrogatories by reporting the applicable U.S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments.

- Reporting entity's total admitted assets as reported on page 2 of the annual statement: \$25,987,742
- Ten largest exposures to a single issuer/borrower/investment.

Issuer	Description of exposure	Amount	Percentage of total admitted assets
1. Short Term Invts Tr Liq Assets Ptf	Class 1 MMF - Cat. 8	\$ 19,636,632	75.6%
2. Chicago Ill Pub Bldg Commn	Bond - Cat. 1.43	411,320	1.6%
3. BNY Midwest Trust Co	Cash - Cat. 8	156,534	0.6%
4. Hydro Quebec	Bond - Cat. 1.3	77,979	0.3%

- Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

Bonds	Amount	Percentage of total admitted assets	Preferred stocks	Amount	Percentage of total admitted assets
NAIC-1	\$ 25,759,206	99.1%	P/RP-1	\$ —	—%
NAIC-2	—	—	P/PSF-2	—	—
NAIC-3	—	—	P/PSF-3	—	—
NAIC-4	—	—	P/PSF-4	—	—
NAIC-5	—	—	P/PSF-5	—	—
NAIC-6	—	—	P/PSF-6	—	—

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Supplemental Investment Risks Interrogatories

December 31, 2004

4. Assets held in foreign investments:

- | | | | | |
|----|--|----|---|-----------------------------|
| 1. | Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? | | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> |
| 2. | Total admitted assets held in foreign investments | \$ | — | —% |
| 3. | Foreign-currency-denominated investments | | — | —% |
| 4. | Insurance liabilities denominated in that same foreign currency | | — | —% |

If response to 1. above is yes, responses are not required for interrogatories 5 – 10.

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:

Not applicable.

6. Two largest foreign investment exposures in a single country, categorized by NAIC sovereign rating:

Not applicable.

7. Aggregate unhedged foreign currency exposure:

Not applicable.

8. Aggregate unhedged foreign currency exposure categorized by the country's NAIC sovereign rating:

Not applicable.

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign rating:

Not applicable.

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

Not applicable.

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure.

Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets?
Yes No

If response is yes, detail is not required for the remainder of interrogatory 11.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Supplemental Investment Risks Interrogatories

December 31, 2004

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions.

Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 12.

13. Amounts and percentages of admitted assets held in the largest 10 equity interests.

Are assets held in equity interests less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 13.

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities.

Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 14.

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests.

Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 15.

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans.

Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 16 and interrogatory 17.

17. Not applicable.

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate.

Are assets held in real estate reported in Schedule A less than 2.5% of the reporting entity's total admitted assets? Yes No

If response is yes, responses are not required for the remainder of interrogatory 18.

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

Supplemental Investment Risks Interrogatories

December 31, 2004

19. State the amounts and percentages of the reporting entity's total admitted assets subject to securities lending, repurchase and reverse repurchase agreements, and dollar repurchase and dollar reverse repurchase agreement:

None.

20. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:

None.

21. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:

None.

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:

None.

See accompanying independent auditors' report.