

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined With

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY

and

AMERICAN MOTORISTS INSURANCE COMPANY

Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus and
Schedules

December 31, 2009 and 2008

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Directors
Lumbermens Mutual Casualty Company:

We have audited the accompanying combined statutory statements of admitted assets, liabilities, and surplus of Lumbermens Mutual Casualty Company (LMC) and its subsidiary American Motorists Insurance Company (AMICO) and its affiliate American Manufacturers Mutual Insurance Company (AMM) (collectively, the Company) as of December 31, 2009 and 2008. These combined statutory financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined statutory 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 audits to obtain reasonable assurance about whether the combined statutory 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the statutory financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statutory financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in note 2 to the combined statutory financial statements, the Company prepared these combined statutory financial statements using accounting practices prescribed or permitted by the Illinois Department of Insurance (the Department of Insurance) which practices differ from U.S. generally accepted accounting principles. The effects on the combined statutory financial statements of the variances between the statutory accounting practices and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the combined statutory financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company as of December 31, 2009 and 2008.

Also, in our opinion, the combined statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Company as of December 31, 2009 and 2008, on the basis of accounting described in note 2.

As discussed in note 2 to the combined statutory financial statements, the Department of Insurance has prescribed or permitted certain accounting practices under a Corrective Order which result in an increase to policyholder surplus of \$282 million and \$292 million as of December 31, 2009 and 2008, respectively. These accounting practices differ from the National Association of Insurance Commissioners *Accounting Practices and Procedures Manual*.



Our audits were made for the purpose of forming an opinion on the basic combined statutory financial statements taken as a whole. The combining information and supplementary information included on the Combined Supplemental Schedule of Investments, Combined Supplemental Schedule of Investment Risks Interrogatories, and Combined Supplemental Schedule of Reinsurance Risk Interrogatories is presented for purposes of additional analysis of the combined statutory financial statements rather than, as related to the combining information, to present the financial position of the individual companies, and is not a required part of the basic combined statutory financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic combined statutory financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined statutory financial statements taken as a whole.

The accompanying combined statutory financial statements and combined supplementary information have been prepared assuming that the Company will continue as a going concern. As discussed in note 9 to the combined statutory financial statements, the Department of Insurance imposes risk-based capital (RBC) requirements on insurance enterprises, including the Company. As of December 31, 2009 and 2008, LMC's total adjusted capital, as reported in the 2009 and 2008 Annual Statements filed with the Department of Insurance, is at the "mandatory control level" and "authorized control level," respectively, based on the RBC calculation required by the Department of Insurance. Excluding the benefit of prescribed or permitted accounting practices, LMC's total adjusted capital was at the "mandatory control level" as of December 31, 2008. AMM and AMICO's total adjusted capital is above any action levels based on the RBC calculation required by the Department of Insurance; however, at the "authorized control level" and "mandatory control level," the Department of Insurance has substantial authority to exercise control over LMC, its subsidiaries, and affiliates including AMM and AMICO. The Department of Insurance is mandated to place a company at the "mandatory control 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 Department of Insurance has discretion to allow the continued run-off. 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, the Company substantially ceased underwriting activities. Since July 2003, the Company has been subject to a Corrective Order by the Department of Insurance not to write any new or renewal business except as necessary to comply with contractual commitments or as expressly permitted by the Department of Insurance. On March 19, 2004, the Company submitted to the Department of Insurance its commercial run-off plan, which was approved on June 9, 2004.

The Department of Insurance could seek to place the Company in formal proceeding (conservatorship or receivership, rehabilitation, or liquidation) at any time based on the Company's financial condition or operating performance. This risk of a proceeding would be further increased if the Company fails to execute successfully on its commercial run-off plan, if the Company fails to have sufficient liquid assets to meet its current obligations, or if the Company's reported statutory liabilities at any time would exceed its reported statutory assets as discussed in note 9 to the combined statutory 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 the Company will be successful to the extent necessary to avoid a negative surplus in future years. In addition, as of December 31, 2009, the Company has approximately \$507 million of invested assets that are encumbered by being on deposit or held in trust or escrow arrangements and access to these amounts is subject to certain limitations.



The matters discussed in the preceding 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 the Company's commercial run-off plan and the continued permission to apply the aforementioned prescribed or permitted accounting practices. Management's plans in regards to these matters are described throughout the notes to the combined statutory financial statements. The accompanying combined statutory financial statements and the combined supplementary information do not include any adjustments that might result from the outcome of this uncertainty.

KPMG LLP

May 28, 2010

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Admitted Assets	2009	2008
Cash, cash equivalents, and short-term investments	\$ 60,835,707	87,972,544
Common stocks:		
Affiliated	37,421,153	48,455,061
Unaffiliated	1,895,670	806,589
Bonds	834,956,780	1,048,797,311
Investment in affiliate held for sale	2,190,887	1,714,942
Other invested assets	5,618,196	5,966,691
	<hr/>	<hr/>
Total cash and invested assets	942,918,393	1,193,713,138
Reinsurance recoverable on paid losses and loss adjustment expenses	70,193,501	85,675,362
Other admitted assets	58,424,262	56,361,412
Funds held by or deposited with reinsured companies	11,184,035	12,246,065
Accrued retrospective premiums	9,741,523	17,251,970
Funds held by claim service provider	8,292,510	8,334,447
Agents' balances and uncollected premiums	7,957,054	14,977,686
Investment income due and accrued	6,505,783	9,735,972
Amounts billed and receivable under high deductible policies	4,664,498	11,088,052
Equities and deposits in pools and associations	2,546,939	8,794,227
Federal and foreign income tax recoverable	319,039	318,027
Receivable from subsidiaries and affiliates	38,874	—
Reinsurance accounted for as a deposit	—	599,510
	<hr/>	<hr/>
Total admitted assets	\$ <u>1,122,786,411</u>	<u>1,419,095,868</u>

See accompanying notes to statutory statements of admitted assets, liabilities, and surplus.

Liabilities and Surplus	2009	2008
Liabilities:		
Losses and loss adjustment expenses	\$ 940,113,044	1,040,398,919
Amounts withheld for others	72,666,145	124,464,509
Accounts payable and other liabilities	45,158,743	44,422,490
Reinsurance payable on paid losses and loss adjustment expenses	22,869,036	16,041,492
Other expenses payable	11,421,103	14,273,356
Taxes, licenses, and fees payable	9,326,453	33,073,387
Unearned premium	2,569,021	3,663,958
Funds held under reinsurance treaties	2,133,617	2,741,570
Remittances and items not allocated	1,029,380	12,676,987
Net adjustments in assets and liabilities due to foreign exchange rates	434,296	1,485,005
Commissions payable	407,204	500,233
Ceded reinsurance premiums payable	331,486	960,829
Payable to subsidiaries and affiliates	—	109,644
Total liabilities	<u>1,108,459,528</u>	<u>1,294,812,379</u>
Guaranty fund	3,000,000	3,000,000
Surplus notes	698,355,598	698,355,598
Unassigned deficit	(687,028,715)	(577,072,109)
Total surplus	<u>14,326,883</u>	<u>124,283,489</u>
Total liabilities and surplus	<u>\$ 1,122,786,411</u>	<u>1,419,095,868</u>

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

(1) Business Operations

Lumbermens Mutual Casualty Company (LMC) is a mutual property and casualty insurance company domiciled in the State of Illinois. LMC is the lead company of a group of insurers and affiliates, now in run-off status, which have operated under the trade names of Kemper and the Kemper Insurance Companies. American Manufacturers Mutual Insurance Company (AMM) is a mutual property and casualty insurance company domiciled in the State of Illinois. Under common management with LMC, AMM cedes 100% of its premiums, losses, loss adjustment expenses (LAE), and underwriting expenses to LMC. American Motorists Insurance Company (AMICO) is a stock property and casualty insurance company domiciled in the State of Illinois. A wholly owned subsidiary of LMC, AMICO cedes 100% of its premiums, losses, LAE, and underwriting expenses to LMC.

LMC, AMM, and AMICO collectively referred to as the Company, received approval from the Illinois Department of Insurance (the Department of Insurance) to file the 2009 audited statutory financial statement on a combined basis, which includes the 2008 audited statutory financial statements presented on a combined basis for comparative purposes.

The AMM and AMICO risk-based capital (RBC) ratios exceed any regulatory action levels; however as further discussed in note 9, LMC's RBC ratio, as filed, fell below the "authorized control level" as of December 31, 2002, and has remained below that level to date. LMC's RBC ratio and the reduction of the Company's financial strength ratings (see note 10) have had and will continue to have a significant impact on the Company's operations. Because of AMM's and AMICO'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 AMM's and AMICO's operations.

(2) Basis of Presentation and Summary of Significant Accounting Policies

The accompanying combined statutory statements of admitted assets, liabilities, and surplus (the statutory balance sheets) have been prepared in accordance with the National Association of Insurance Commissioners' (the NAIC) *Accounting Practices and Procedures Manual* (the Manual), and in conformity with prescribed accounting practices (including accounting allowances under Corrective Orders) or permitted accounting practices by the Department of Insurance, which vary in some respects from U.S. generally accepted accounting principles (GAAP). 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, while under GAAP, such fixed maturity investments are designated at purchase as held-to-maturity, available-for-sale, or trading. Held-to-maturity investments are reported at amortized cost. Available-for-sale and trading investments are reported at fair value with unrealized gains and losses reported in operations for those designated as trading and as a separate component of stockholder's equity, net of applicable deferred income taxes, for those designated as available-for-sale;
- assets are included in the statutory balance sheets at admitted asset value, and nonadmitted assets are excluded through a direct charge against surplus, while under GAAP, such assets would be recognized at the lower of cost or net realizable value;

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

- majority owned subsidiaries are carried under the equity method and are not consolidated, and adjustments reflecting the equity in earnings of affiliated companies are credited or charged directly to surplus as net unrealized capital gains or losses rather than being recorded through income;
- surplus notes are reflected as a component of surplus rather than as a liability as would be reported under GAAP, and interest on such notes is not recorded as a liability or expense until payment has been approved by the Department of Insurance;
- the realizability of deferred tax assets under GAAP is evaluated utilizing a “more likely than not” standard. A valuation allowance is established for deferred tax assets deemed not realizable using this standard. Under statutory accounting principles, the realizability of deferred tax assets is determined utilizing a valuation allowance standard and an admissibility test. Any gross deferred tax assets (after application of a valuation allowance) determined not to be realizable are nonadmitted for statutory accounting purposes. Additionally, changes in the balances of deferred tax assets and liabilities result in increases or decreases in net income under GAAP, whereas under statutory accounting principles, these changes are charged or credited to surplus;
- ceded reinsurance balances are netted against direct and assumed balances on the statutory balance sheets rather than shown gross as under GAAP;
- liabilities for losses and LAE are discounted using discount rates prescribed by the Department of Insurance; and
- certain assets and liabilities originated in foreign currency are adjusted to U.S. dollars through a direct charge to surplus.

The effects of such differences between these statutory accounting practices and GAAP have not been determined but are presumed to be material.

Prescribed and Permitted Practices

The Company’s reported surplus at December 31, 2009 and 2008 reflects increases of approximately \$293.7 million and \$291.7 million, respectively, over what would have been reported without accounting practices prescribed or permitted by the Department of Insurance.

Pursuant to the prescribed practices in 2009 and 2008, the Company:

- Discounted all its loss and LAE liabilities at 4.2% (at December 31, 2009, the Company’s book yield on cash and invested assets, excluding affiliate investments, was approximately 3.7%);
- Reflected as admitted assets the amounts that the Company has prepaid for claim handling services to two third-party administrators related to unallocated LAE (ULAE); and further allows the Company to admit its December 31, 2009 prepaid expense assets primarily related to information technology services;
- Established a general provision for uncollectible reinsurance, net of discount (this provision has been established using the same 4.2% discount rate used for the Company’s discounted underlying loss and LAE liabilities);

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

- Recognized amounts due from Washington National Insurance Company (formerly National Fidelity Life Insurance Company) as an admitted receivable to reflect the “economic basis” of certain annuity reinsurance contracts;
- Discounted the liability for loss-based assessments (LBA) and premium deficiency at 4.2%; and further allows the Company to calculate its December 31, 2009 LBA liability based on an estimate of LBA payments to be made within two years of the date of the quarterly statutory financial statement; and

Pursuant to the permitted practices in 2009 and 2008, the Company:

- Accounted for certain reinsurance contracts that meet the definition of retroactive reinsurance agreements as prospective reinsurance agreements;
- Forewent the requirement to obtain audited financial statements for certain of the Company’s noninsurance company subsidiaries. The Company believes that the statutory carrying values of these subsidiaries approximate the carrying values that would be determined under the Manual if audited statements were obtained.

The accompanying table details the effects on surplus as of December 31, 2009 and 2008 of the prescribed and permitted practices as described above by reconciling the reported positive surplus of the Company to the negative surplus that would have been reported in the absence of prescribed and permitted practices:

	Surplus	
	2009	2008
	(In thousands)	
As reported herein	\$ 14,327	124,283
Decrease as a result of prescribed and permitted practices:		
Discount on liability for loss and LAE	(232,188)	(241,339)
Prepaid expenses	(18,748)	(19,431)
Provision for uncollectible reinsurance	(166)	(5,095)
Annuity reinsurance contracts	(10,082)	(9,509)
Discount on liability for LBA and premium deficiency	(28,443)	(12,705)
Retroactive reinsurance agreements	—	—
Subsidiary audited financials	(4,101)	(3,628)
Total prescribed and permitted practices	<u>(293,728)</u>	<u>(291,707)</u>
Manual basis	<u>\$ (279,401)</u>	<u>(167,424)</u>

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Recent Accounting Pronouncements

During 2009, the NAIC adopted SSAP No. 43 Revised, *Loan-Backed and Structured Securities* (SSAP No. 43R). SSAP No. 43R supersedes SSAP No. 98, *Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments*, and paragraph 13 of SSAP No. 99, *Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment* (SSAP No. 99). If the fair value of a structured debt security is less than its amortized cost basis at the reporting date, an entity shall assess whether the impairment is an other-than-temporary impairment. When an entity intends to sell an impaired loan-backed or structured security or more-likely than-not will be required to sell an impaired loan-backed or structured security before recovery of its amortized cost basis, an other-than-temporary impairment is recognized in earnings as the difference between the amortized cost basis and fair value. If the an entity does not expect to recover the entire amortized cost basis of an impaired debt security, even if it does not intend to sell the security and it is not more-likely than-not that it would be required to sell the security before recovery of its amortized cost basis and the security is deemed other-than-temporarily impaired, a credit loss is recorded in earnings based upon the discounted cash flows expected to be collected. There was no impact to the combined statutory financial statements upon adoption.

In 2009, the Company adopted SSAP No. 99. This statement adopts the guidance in paragraph 16 of Financial Accounting Standards Board Staff Position FAS 115-1/124-1 with modification to be consistent with statutory language in the respective statutory accounting statements. Paragraph 16 describes the accounting for debt securities subsequent to other-than-temporary impairment. There was no impact to the combined statutory financial statements upon adoption.

During 2009, the Company adopted SSAP No. 100 *Fair Value Measurements* (SSAP No. 100). SSAP No. 100 provides guidance on defining fair value, establishing a framework for measurement of fair value, and expanding fair value disclosures. This new SSAP applies fair value when required by other statutory accounting pronouncements that require or permit fair value measurements, but does not require any new items to be measured at fair value. SSAP No. 100 establishes a fair value hierarchy to increase consistency and comparability in fair value measurements and related disclosures. There was no impact to the combined statutory financial statements upon adoption.

In 2009, the NAIC adopted temporary changes to SSAP No. 10 *Income Taxes*, and issued SSAP No. 10 *Income Taxes – Revised, A Temporary Replacement of SSAP No. 10* (SSAP No. 10R). The changes are effective for year-end December 31, 2009 and for interim reporting periods in 2010. Under this new guidance, the Company considers a statutory valuation allowance against deferred tax assets that may or may not be realized. There are also new elective admissibility considerations, including the increase in the loss carryback allowance from one year to a limit not to exceed three years and a capital and surplus limitation increasing from 10% to 15%. There was no impact to the combined statutory financial statements upon adoption.

Invested Assets and Related Income

Bonds, cash equivalents, and short-term investments are generally carried at amortized cost; however, bonds rated NAIC 3 or below are carried at the lower of amortized cost or fair value. The amortized cost of bonds is adjusted for amortization of premiums and accretion of discounts using a level effective yield method to maturity, or in the case of loan-backed securities, over the estimated life of the security. Amortization of the discount or premium from loan-backed securities is generally recognized

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

retrospectively based on the estimated timing and amount of prepayments of the underlying assets and is adjusted to reflect differences which arise between the prepayments originally anticipated and the actual prepayments received and currently anticipated; however, the amortization change is recognized prospectively after an other-than-temporary impairment has been recorded for a loan-backed security. Prepayment assumptions used for loan-backed securities are derived using an external securities information service and are consistent with the current interest rate and economic environment.

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 and money market fund investments to be short-term investments.

At December 31, 2009, unaffiliated common stocks are carried at fair value with unrealized gains and losses recorded in surplus. At December 31, 2008, the Company's investment in an unaffiliated private placement common stock was carried at cost adjusted for impairment writedown.

Affiliated common stocks are generally carried at the underlying statutory equity of the respective entity's financial statements.

Other invested assets include notes receivable and joint venture interests. Notes receivable are carried at amortized cost, net of any impairments. Joint ventures in which the Company has a less than 10% ownership interest are carried at cost adjusted for impairment writedowns. The Company accounts for a real estate acquisition, development, and construction arrangement (ADC) as a joint venture carried at cost adjusted for impairment writedowns, which approximates its underlying statutory equity.

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

Premium Balances

Premiums are earned on a daily pro rata basis over the term of the policies. Unearned premiums are 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. The Company regularly evaluates the collectibility of all receivables. When the Company determines it is probable a receivable balance will not be collected, such amount is written off. The Company anticipates investment income as a factor in determining the premium deficiency liability. As of December 31, 2009 and 2008, the Company recorded an ending premium deficiency liability of \$0.7 million and \$2.0 million, respectively, net of discount.

The Company has recorded an admitted asset for accrued retrospective premiums which includes amounts due the Company for additional premiums for loss sensitive programs and dividend recalls. Such amounts have been estimated based on actuarial techniques and as such are subject to periodic re-evaluation. Changes in the valuation of this asset will result in a corresponding benefit or expense on dividends to policyholders, but do not reflect any agreement or expectation to pay any such dividends.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Liability for Losses and Loss Adjustment Expenses

The Company records liabilities for unpaid claims, losses, and related LAE based upon management's best estimate of aggregate case-basis estimates for losses reported, estimates received from ceding reinsurers, and estimates of incurred but not reported (IBNR) losses related to direct and assumed business, less amounts ceded to reinsurers. Liabilities 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.

The Department of Insurance has prescribed an accounting practice under a Corrective Order pursuant to which the Company discounts all its loss and LAE liabilities at 4.2% in the accompanying statutory balance sheets as of December 31, 2009 and 2008. At December 31, 2009 and 2008, the total amount of the discounts related to this prescribed practice included in the accompanying statutory balance sheets are \$232.2 million and \$241.3 million, respectively.

Because the ultimate settlement of claims is subject to future events, no single loss or LAE liability can be considered accurate with certainty. The Company's analysis of the reasonableness of loss or LAE liability estimates includes an analysis of the amount of variability in the estimate. The Company develops its estimate considering a range of liability 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. Those anticipated recoveries were \$13.1 million and \$20.2 million at December 31, 2009 and 2008, respectively.

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 and Foreign Income Taxes

In December of 2009, the NAIC adopted SSAP No. 10R. The provisions of SSAP No. 10R are similar to SSAP No. 10 except for the following significant changes; the introduction of the concept of a statutory valuation allowance, the increased admittance of deferred tax assets for insurers that meet certain risk-based capital requirements and the expanded reporting of deferred tax items by tax character (ordinary versus capital).

Due to the Company's run-off status, no net deferred tax assets are being recognized in the Company's combined statutory financial statements in 2009 and 2008. The only significant change resulting from the adoption of SSAP No. 10R is that the Company replaced its 2008 nonadmitted deferred tax asset with a 2009 statutory valuation allowance which had no net effect on surplus. No other significant change to the Company's combined financial statements resulted from the adoption of SSAP No. 10R.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the statutory financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Gross deferred tax assets are reduced by a statutory valuation allowance if it is more likely than not that some portion or all of the gross deferred tax assets will not be realized. The admissibility of the net deferred tax assets recorded is subject to the limitation set forth in statutory accounting principles and has changed upon adoption of SSAP No. 10R. Changes in deferred tax assets and liabilities, including changes attributable to changes in tax rates and changes in tax status, are recognized as a separate component of the change in accumulated surplus.

LMC files a consolidated federal income tax return with its subsidiaries, including AMICO. The federal income tax return of AMM is not consolidated with any other entities. Federal and foreign income taxes are charged to operations based on income that is currently taxable.

LMC has a tax allocation agreement that provides that current federal income taxes will generally be paid to or recovered from LMC on the basis of each subsidiary company's taxable income or taxable loss as if the subsidiary were filing a separate federal income tax return. The agreement provides that in the event of a federal income tax benefit on a separate return basis which is greater than the subsidiary company's actual amount recoverable on a consolidated return basis, the amount recoverable will be apportioned among all such companies entitled to a recovery on a pro rata basis. Settlement among the companies occurs within a reasonable time period following the filing of the consolidated federal tax return. Based upon LMC's and its affiliate's current financial position, all settlements of intercompany tax balances are subject to approval by the Department of Insurance.

Nonadmitted Assets

Assets included in the statutory balance sheets are at admitted asset value. Certain assets designated as "nonadmitted assets" are excluded from the statutory balance sheets and are charged to unassigned surplus at December 31, 2009 and 2008 as follows:

	<u>2009</u>	<u>2008</u>
	(In thousands)	
Net deferred tax assets	\$ —	866,510
Premiums receivable	4,994	10,369
Other assets nonadmitted	4,155	7,489
Total nonadmitted assets	<u>\$ 9,149</u>	<u>884,368</u>

Provision for Uncollectible Reinsurance

The Department of Insurance has prescribed an accounting practice under a Corrective Order pursuant to which the Company has established a general provision for uncollectible reinsurance. Changes in this provision are charged directly against surplus.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The general provision for uncollectible reinsurance, net of discount, was \$25.0 million and \$26.3 million at December 31, 2009 and 2008, respectively. The Schedule F penalty otherwise prescribed would have been \$25.2 million and \$31.4 million at December 31, 2009 and 2008, respectively.

Use of Estimates

The preparation of the statutory balance sheets requires management to make estimates and assumptions that affect the reported statutory balance sheet amounts as well as the disclosure of contingent assets and liabilities. Accordingly, actual results could differ from those estimates.

The Company's investments are primarily comprised of bonds. The evaluation of bonds for other-than-temporary impairments is subject to risks and uncertainties and is intended to determine whether declines in fair values of bonds should be recognized in current year earnings. The risk and uncertainties include changes in general economic conditions, the issuers' financial condition and future prospects, the effects of changes in interest rates or current spreads, and the expected recovery period. The Company's bonds include loan-backed securities and other securities subject to prepayment and call risk. Significant changes in interest rates, defaults, and recoveries affect the timing and amount of cash flows on such securities. In addition, the amortization of premium and accretion of discount for loan-backed securities is based on historical payment experience and estimates of the timing of future payments on the underlying loans. Actual payment experience will differ from original estimates and will result in adjustments to amortization or accretion recorded in future periods.

As further discussed in the accompanying notes to the statutory balance sheets, significant estimates and assumptions affect various provisions including losses and policyholder dividends. The liabilities for losses and LAE and related reinsurance recoverables, 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) are estimated based on similar assumptions used to estimate the ultimate liabilities for losses and LAE. Currently, under the Corrective Order, the Company is prohibited from paying policyholder dividends. Additionally, valuation of the Company's real estate-related investments is subjective and estimated by management based upon current and expected future real estate market conditions and other factors. Actual results could differ from those estimates.

(3) Invested Assets and Investments in Subsidiaries

Bonds

The fair values of the Company's bonds have been determined using quoted market prices from an orderly market at the reporting date for those or similar investments. If quoted market prices from an orderly market are not available, the fair value is determined using an income approach valuation technique (present value using the discount rate adjustment technique) that considers, among other things, interest rates, the issuer's credit spread, prepayments, performance of the underlying collateral for loan-backed securities and illiquidity by sector and maturity.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus
December 31, 2009 and 2008

The statement value and fair value of bonds at December 31, 2009 and 2008 were as follows:

2009				
Statement value	Gross unrealized gains	Gross unrealized losses	Fair value	
(In thousands)				
U.S. governments	\$ 126,961	6,509	(39)	133,431
All other governments	76	4	—	80
Special revenue and assessment obligations and all non-guaranteed obligations of agencies and authorities of U.S. governments	57,661	784	(246)	58,199
Industrial and miscellaneous	408,825	11,073	(28,159)	391,739
Asset-backed securities	26,794	26	(347)	26,473
Mortgage-backed securities	214,640	2,951	(1,985)	215,606
Total bonds	\$ 834,957	21,347	(30,776)	825,528
2008				
Statement value	Gross unrealized gains	Gross unrealized losses	Fair value	
(In thousands)				
U.S. governments	\$ 168,389	9,794	—	178,183
All other governments	2,138	26	—	2,164
Special revenue and assessment obligations and all non-guaranteed obligations of agencies and authorities of U.S. governments	18,494	68	(182)	18,380
Industrial and miscellaneous	555,383	1,055	(45,589)	510,849
Asset-backed securities	66,820	1	(1,642)	65,179
Mortgage-backed securities	237,573	611	(8,396)	229,788
Total bonds	\$ 1,048,797	11,555	(55,809)	1,004,543

Bonds in an unrealized loss position are regularly reviewed for other-than-temporary declines in value. Factors considered in determining whether a decline is other-than-temporary include the length of time a bond has been in an unrealized loss position and the reasons for the decline in value. Assessments include judgments about an obligor's or guarantor's current and projected financial position, an issuer's current and projected ability to service and repay its debt obligations, the existence of, and realizable value for, any collateral backing the obligations, and the macro-economic and micro-economic outlooks for specific industries and issuers. Estimating the future cash flows of loan-backed securities also involves assumptions regarding the underlying collateral such as prepayment rates, default and recovery rates, existence of subordinated classes capable of absorbing losses, and third-party servicing abilities.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

In performing its other-than-temporary impairment reviews, the Company, in consultation with its engaged portfolio manager, considers the relevant facts and circumstances relating to each investment and exercises judgment in determining whether a bond is other-than-temporarily impaired. Among the factors considered are whether the decline in fair value results from fundamental credit problems of the issuer, or is interest related, and the likelihood of recovering the amortized cost based on the current and short-term prospects of the issuer. Unrealized losses are determined to be temporary where such losses are primarily the result of market conditions, such as increasing interest rates, unusual market volatility, or industry-related events, and where the Company also believes it is probable that the Company will be able to collect all amounts when due in accordance with the contractual terms of the investment and, furthermore, has the intent and ability to hold the investment until the market recovers or maturity and, therefore, does not have the intent to sell the investment.

The Company defines its exposure to subprime mortgage-related risk as being composed of all fixed income securities primarily backed by mortgage pools with the following characteristics calculated on a weighted average basis:

- First lien mortgages where borrowers have FICO scores less than 650
- First lien mortgages with loan-to-value ratios greater than 95%
- Second lien mortgages where borrowers have FICO scores less than 675
- Borrowers with less than conventional documentation of their income and/or net assets and FICO scores less than 650

At December 31, 2009, the Company’s subprime exposure includes only residential mortgage-backed securities owned by the Company and one of its subsidiaries with a statement value of \$12.8 million and fair value of \$10.9 million, and during 2009, it did not recognize any other-than-temporary impairment losses related to subprime mortgages.

During 2009, the Company recognized \$1.3 million of realized losses related to other-than-temporary impairment writedowns of loan-backed bonds because the present value of cash flows expected to be collected was less than the amortized cost of the security.

The Company’s holding at December 31, 2009 in a loan-backed bond which recognized an other-than-temporary impairment because the present value of cash flows expected to be collected was less than the amortized cost of the security is identified below (in thousands):

<u>CUSIP</u>	<u>Amortized cost before impairment</u>	<u>Impairment recognized</u>	<u>Amortized cost after impairment</u>	<u>Fair value</u>
23242MAA9	\$ 1,439	210	1,229	1,204

The bonds shown in the table below, nearly all of which are rated “A” or better, are U.S. government obligations, or are U.S. government agency mortgage-backed obligations and which, therefore, have minimal credit risk, are subject to normal market fluctuations. Based on the Company’s evaluation of the bonds shown in the table below and the Company’s intent and ability to hold the securities until they

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

recover in value or mature, the Company does not consider the bonds to be other-than-temporarily impaired at December 31, 2009.

The risks inherent in reviewing the impairment of any investment include the risk that market results may differ from expectations; facts and circumstances may change in the future and differ from estimates and assumptions; or the Company may later decide to sell the security and realize a loss as a result of changes in the specific facts and circumstances surrounding a bond, or the outlook for its industry sector or the economy.

As of December 31, 2009 and 2008, the gross unrealized losses segregated between those that were in a loss position for more than twelve months and those that were in a loss position for less than twelve months were as follows:

	2009			2008		
	Number of issues	Gross unrealized losses	Fair value	Number of issues	Gross unrealized losses	Fair value
	(In thousands)					
Bonds in a loss position more than 12 months:						
Special revenue and assessment obligations and all nonguaranteed obligations of agencies and authorities of U.S. governments	1	\$ (225)	3,620	—	\$ —	—
Industrial and miscellaneous ¹	4	(28,155)	146,146	4	(37,986)	210,321
Asset-backed securities	2	(287)	2,947	4	(1,498)	41,388
Mortgage-backed securities	5	(1,938)	26,883	4	(5,522)	13,041
	12	(30,605)	179,596	12	(45,006)	264,750
Bonds in a loss position less than 12 months:						
U.S. governments	2	(39)	3,185	—	—	—
Special revenue and assessment obligations and all nonguaranteed obligations of agencies and authorities of U.S. governments	4	(21)	5,276	2	(182)	4,773
Industrial and miscellaneous	1	(4)	907	28	(7,603)	201,962
Asset-backed securities	2	(60)	21,884	4	(144)	8,304
Mortgage-backed securities	16	(47)	26,626	17	(2,874)	121,334
	25	(171)	57,878	51	(10,803)	336,373
Total bonds in a loss position	37	\$ (30,776)	237,474	63	\$ (55,809)	601,123

¹ Includes three Berkshire Hathaway Insurance Group (Berkshire) (which is rated “AA”) bonds with gross unrealized losses of \$27.5 million and fair values of \$138.8 million at December 31, 2009 and with gross unrealized losses of \$38.0 million and fair values of \$206.3 million at December 31, 2008 (see note 5).

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The following table sets forth the maturity aging schedule of bonds at December 31, 2009. 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	Fair value
(In thousands)		
One year or less	\$ 39,225	39,824
Over one year through five years	376,563	393,305
Over five years through ten years	1,502	1,525
Over ten years	100,000	87,796
Securities not due at a single maturity date	317,667	303,078
Total bonds	\$ 834,957	825,528

At December 31, 2009 and 2008, cash and invested assets carried at \$323.4 million and \$371.4 million, respectively, were on deposit with government authorities as required by law. The Company's cash and invested assets were also encumbered at December 31, 2009 and 2008, by \$183.3 million and \$263.1 million, respectively, related to various collateral requirements.

Proceeds from sales of investments in bonds prior to maturity during 2009 and 2008 were \$64.5 million and \$298.9 million, respectively.

Common Stocks

Gross unrealized gains on common stocks, excluding affiliated companies, at December 31, 2009 and 2008 amounted to \$1.3 million and \$76 thousand, respectively. Gross unrealized losses on common stocks at December 31, 2009 and 2008 amounted to \$0. The cost of common stock held at December 31, 2009 and 2008, excluding affiliated companies, was \$567 thousand and \$731 thousand, respectively. Consideration on sales of unaffiliated common stock totaled \$83 thousand in 2009 and \$1.9 million in 2008.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Investments in Affiliated Companies

The Company's investments in common stocks of affiliated companies at December 31, 2009 and 2008 are summarized below:

	2009		2008	
	Cost	Statement value	Cost	Statement value
	(In thousands)			
Specialty Surplus Insurance Company	\$ 19,229	21,172	19,229	32,406
Kemper Casualty Insurance Company ¹	—	11,590	—	11,433
Kemper Insurance Company of Texas	2,000	2,749	2,000	2,703
Kemper International Corporation	911	2,177	1,433	1,695
LGA-17, Inc.	1,672	1,924	1,734	1,933
	\$ 23,812	39,612	24,396	50,170

¹ The Company's cost basis in Kemper Casualty Insurance Company (KCIC) was reduced to \$0 as a result of a return of capital dividend received in 2008.

Significant Transactions Involving Affiliates

Canada Branch Office

Assets of LMC's Canadian branch, reflected in the Company's statutory balance sheets, totaled \$9.3 million and \$8.5 million at December 31, 2009 and 2008, respectively. The Company repatriated \$15.8 million in 2008. The LMC Canadian branch accounted for approximately \$8.5 million and \$6.7 million, of the Company's statutory surplus at December 31, 2009 and 2008, respectively. Most of the remaining assets of the branch in Canada are encumbered in trust (see note 10). Canadian regulatory approvals are required for any releases of assets from the trust, including releases to pay Canadian claims and expenses.

Other International Operations

Other international operations during 2009 consisted of an Australian subsidiary, in run-off for more than a decade. The Australian subsidiary accounted for approximately \$0.9 million of the Company's statutory surplus at December 31, 2009. LMC has guaranteed most policies issued in Australia, and LMC also reinsures most of those policies for any losses excess of \$50 thousand. The Australian subsidiary remains available for sale.

Other Affiliate Transactions

Dividend distributions from LMC's insurance subsidiaries to LMC are restricted by various state insurance laws. In Illinois, where most of LMC's subsidiaries are domiciled, if such dividend, together with other distributions during the 12 preceding months, would exceed the greater of (a) 10% of the insurer's statutory surplus as regards policyholders as of the preceding December 31, or (b) the statutorily adjusted net income for the preceding calendar year, then such proposed dividend must be reported to the Director

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

of the Department of Insurance (the Director) at least 30 days prior to the proposed payment date and may be paid only if not disapproved. The Illinois insurance laws also prohibit, in the absence of approval by the Director, the payment of any dividend to the extent the dividend would exceed the stock insurance company's earned surplus (such surplus being calculated as exclusive of most unrealized gains). Corrective Orders issued by the Department of Insurance further restrict the payment of dividends by prohibiting any transfers of assets, including any dividend, to LMC from any Illinois domiciled insurance company affiliate without the approval of the Director.

LMC recorded return of capital and income dividends from the following subsidiaries during 2009 and 2008:

	2009	2008
	(In thousands)	
Specialty Surplus Insurance Company ¹	\$ 12,000	1,000
KCIC ²	1,500	3,000
Kemper International Corporation	522	469
LGA-17, Inc.	62	—
AMICO Realty Corporation	32	—
Total	\$ 14,116	4,469

¹ Specialty Surplus Insurance Company's (SSIC) Board of Directors approved a \$12.0 million income dividend payable November 30, 2009, to the Company. SSIC's Board of Directors also approved a \$1.0 million income dividend payable November 28, 2008, to LMC.

² KCIC's Board of Directors approved a \$1.5 million return of capital dividend payable November 30, 2009, to the Company. KCIC's Board of Directors also approved a \$3.0 million return of capital dividend payable November 28, 2008, to LMC.

AMICO's Board of Directors approved a \$4.5 million return of capital dividend and a \$0.5 million income dividend payable November 28, 2008, to LMC.

Other Invested Assets

Other invested assets consisted of the following as of December 31, 2009 and 2008:

	2009	2008
	(In thousands)	
Real estate joint venture	\$ 5,315	5,315
Other notes receivable and equity investments	303	652
Other invested assets	\$ 5,618	5,967

The Company has a real estate ADC arrangement, which is accounted for as a joint venture, through a master limited partnership between a subsidiary of LMC and subsidiaries of a former affiliate, which

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

amounted to \$5.3 million at both December 31, 2009 and 2008. The partnership's underlying investment consisted primarily of a water development project located in California's Sacramento River Valley. During 2003, the partnership abandoned its plans for the water development project.

The Company's \$0.3 million and \$0.7 million note receivable at December 31, 2009 and 2008, respectively, was received in 2007 as a result of a bankruptcy court approved plan of reorganization. The note receivable is performing as of December 31, 2009 and 2008.

(4) Liability for Losses and Loss Adjustment Expenses

The Company establishes a liability for losses and LAE to cover its estimated ultimate liability for property and casualty losses and LAE with respect to reported claims and claims IBNR as of the end of each accounting period. These estimates are then reduced for reinsurance recoverables and discounted to present value. As required by applicable accounting rules, no liabilities are established until a loss, including a loss from a catastrophe, occurs. Loss and LAE liabilities 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 uncertainties of estimating insurance liabilities 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.

As of December 31, 2009 and 2008, the Company carried a liability for losses and LAE of \$940.1 million and \$1.04 billion, respectively, reflecting reinsurance recoverables on unpaid losses of \$830.4 million and \$879.1 million and tabular and nontabular discount of \$360.3 million and \$375.2 million, respectively.

The Company experienced adverse development of \$149.3 million and \$97.6 million, on a net basis, in 2009 and 2008, respectively, related to prior accident years.

The 2009 prior year development is due to:

1. Adverse loss and LAE reserve development of \$134.3 million comprised of (a) a \$90.0 million increase arising primarily from deterioration in workers' compensation, other liability (including a reclassification of excess workers' compensation), products liability, CMP, and personal lines that was offset partially by favorable development in commercial auto liability and surety; (b) a \$30.0 million decrease arising from buybacks, commutations, and novations; and (c) a \$74.3 million increase as a result of an adverse arbitration decision related to a reinsurance recoverable; and
2. A reduction of discount of \$15.0 million comprised of (a) a \$37.9 million decrease related to anticipated amortization of discount; (b) a \$15.4 million increase due to nominal reserve strengthening; (c) a \$9.8 million reduction associated with buybacks, commutations, and novations; and (d) a \$17.3 million increase as a result of an adverse arbitration decision related to a reinsurance recoverable.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The 2008 prior year development is due to:

1. Adverse loss and LAE reserve development of \$33.0 million comprised of (a) a \$123.9 million increase arising primarily from deterioration in workers' compensation, other liability (including a reclassification of excess workers' compensation), products liability, CMP, and personal lines that was offset partially by favorable development in commercial auto liability and surety; and (b) a \$90.9 million decrease arising from buybacks, commutations, and novations; and
2. A reduction of discount of \$64.6 million comprised of (a) a \$48.0 million decrease related to anticipated amortization of discount; (b) a \$16.0 million increase due to nominal reserve strengthening; (c) a \$32.6 million reduction associated with buybacks, commutations, and novations.

The Company's exposure to asbestos and environmental claims arises principally from general liability insurance contracts. Establishing liabilities 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, liabilities for asbestos and environmental claims cannot be estimated with traditional loss reserving techniques. Liabilities for losses 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 liabilities on all known losses and LAE and by computing IBNR losses for future reported claims based on previous experience.

The total asbestos liability for losses and LAE at December 31, 2009 and 2008 of \$106.9 million and \$121.5 million, respectively, includes IBNR liabilities in the amount of \$52.1 million and \$61.7 million gross of reinsurance recoverables and \$32.0 million and \$32.0 million net of reinsurance recoverables, respectively. These IBNR liabilities and the comparable amounts for prior years cover both losses and defense and cost containment expenses. The Company also includes adjusting and other expenses in the amounts shown above. Pursuant to a prescribed accounting practice, the amount of the discount on asbestos liabilities at December 31, 2009 and 2008 is \$34.8 million and \$40.0 million net of reinsurance recoverables, respectively.

The total environmental liability for losses and LAE at December 31, 2009 and 2008 of \$23.9 million and \$27.0 million, respectively, includes IBNR liabilities in the amount of \$7.4 million and \$13.1 million gross of reinsurance recoverables and \$4.3 million and \$9.7 million net of reinsurance recoverables, respectively. These IBNR liabilities and the comparable amounts for prior years cover both losses and defense and cost containment expenses. The Company also includes adjusting and other expenses in the amounts shown above. Pursuant to a prescribed accounting practice, the amount of the discount on environmental liabilities at December 31, 2009 and 2008 is \$4.3 million and \$5.0 million net of reinsurance recoverables, respectively.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

As of December 31, 2009, the amount of reserve credits recorded for high deductibles on unpaid workers' compensation claims was \$248.2 million, and for nonworkers' compensation claims it was \$11.4 million. The workers' compensation amount reflects both Broadspire handled claims and also claims handled by other third-party administrators. The nonworkers' compensation amount reflects only claims handled by Broadspire. Information is not available for the nonworkers' compensation claims not handled by Broadspire. The amount billed and recoverable on paid claims was \$8.5 million at December 31, 2009.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Discounting of Losses and LAE

The Company discounts its liability for losses and LAE for all lines of business pursuant to a prescribed accounting practice. The Company utilizes a cash-flow methodology approach in determining the amount of this discount which is based on the underlying payout patterns for each line of business. The Company segregates a portion of the discount that is associated with permanent total indemnity benefits. This amount is identified as tabular discount. The discount for these claims is based on industry tabular factors and statutory interest rates. Any supplemental discount associated with the Company's higher interest rate assumption is treated as nontabular discount. The Company's tabular and nontabular discounts by line of business as of December 31, 2009 and 2008 were as follows:

	2009	2008
	*Case	*Case
	and IBNR	and IBNR
	(In thousands)	
Tabular discount:		
Workers' compensation	\$ 120,965	133,864
Other (Including Credit, A&H)	7,203	—
Total Tabular Discount	128,168	133,864
Nontabular discount:		
Homeowners/farmowners	32	85
Private passenger auto/truck liability/medical	783	1,004
Commercial auto/truck liability/medical	8,189	8,469
Workers' compensation	151,507	150,110
Commercial multi peril	10,684	13,448
Medical malpractice – claims made	—	11
Medical malpractice – occurrence	10	8
Special liability	723	1,069
Other liability – claims made	4,812	3,875
Other liability – occurrence	33,792	37,654
Special property	(20)	(46)
Auto physical damage	26	(1)
Fidelity/surety	1,092	1,225
Other (including credit, A&H)	54	(60)
Reinsurance nonproportional assumed liability	12,939	13,836
Products liability – occurrence	7,565	10,724
Warranty	—	(72)
Total Non-Tabular Discount	232,188	241,339
Grand total	\$ 360,356	375,203

*Includes liabilities for losses and LAE.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

(5) Reinsurance

The Company utilizes a variety of reinsurance agreements to control exposures to large property-casualty losses including: (i) facultative reinsurance, in which reinsurance is provided for all or a portion of the insurance provided by a single policy; (ii) treaty reinsurance, in which reinsurance is provided for a specified type or category of risks; (iii) catastrophe reinsurance, in which the ceding company is indemnified for an amount of loss in excess of a specified retention with respect to losses resulting from a catastrophic event; and (iv) aggregate excess of loss reinsurance, in which the ceding company is indemnified against additional losses for defined losses and LAE in excess of a defined loss ratio or loss retention for each accident year.

The Company's aggregate excess of loss reinsurance treaties relate to the 1998 through 2002 accident years, and they cover substantially all of the Company's lines of business. Recoveries under the treaties are payable when the paid covered net losses, as defined in the contracts, exceed the retention. Under the aggregate excess of loss reinsurance treaties, interest expense generally accrues on the funds withheld account at a rate of approximately 7% per annum. Additional premiums may also be payable under the terms of certain treaties in future years.

Berkshire Hathaway Insurance Group and Kemper Commercial Insurance Company

In early 2003, shortly after the Kemper Insurance Companies were downgraded to below an "A" level, National Indemnity Company (NICO), a member of "AA" rated Berkshire, provided the Company and its affiliates with immediate access to cut-through agreements issued by NICO. The cut-through agreements were applied to certain standard commercial and specialty lines policies of insurance in-force as of December 23, 2002 and to certain new policies issued by certain of the Kemper Insurance Companies on and after December 23, 2002 until September 30, 2003. With respect to each policy to which the NICO cut-through agreement applies, the cut-through allows a Kemper insured to directly submit claims to NICO in the event the respective Kemper Insurance Company (as the issuer of the policy) is unable to pay such claims as a result of its insolvency or a court or regulatory order prohibiting claim payments due to the issuing company's financial condition.

As an agreed condition for NICO to provide the cut-through agreements, the Company and its affiliates immediately provided collateral available to NICO if and to the extent NICO makes any payments under any cut-through agreements. The collateral includes offset rights granted to NICO for reinsurance proceeds payable by either NICO or its affiliate, National Fire & Marine Insurance Company (National Fire), to the Company or its affiliates; a collateral trust initially in an amount of \$251.1 million as of the end of June 2003, which amount was subject to quarterly reductions by payments of claims (losses and LAE) and mid-term cancellations of policies (the trust amount decreased to \$0 in the third quarter of 2006); and investments of \$257.3 million in Berkshire corporate obligations (Schedule D admitted assets), which the Company has pledged as security to Berkshire. The Berkshire corporate obligations were reduced to \$166.2 million by year-end 2009, with cash in the amount of the reduction being released to the Company in accordance with existing agreements. The investments were further reduced in early 2010, by approximately \$7.8 million, due to a mandatory redemption payment by Berkshire to the Company. If NICO makes no payments under the cut-through agreements, then of the pledged investments, \$100.0 million matures in March 2025. The remaining amount is subject to mandatory redemption annually provided the Company is paying claims on policies covered by the cut-through agreements and NICO is not required to pay any amounts under any cut-through agreement. Because the Berkshire

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

corporate obligations have been pledged as collateral to Berkshire, the Company does not have the intent or, in the absence of a voluntary agreement from Berkshire, the ability to dispose of the investments prior to maturity or redemption. At December 31, 2009 and 2008, respectively, \$24.8 million and \$35.1 million of the Company's gross policy liabilities were protected by the NICO cut-through. As a table below shows, the Company cedes to the Berkshire Hathaway Group (group 31) liabilities totaling \$197.3 million and \$184.7 million at December 31, 2009 and 2008, respectively. Portions of that amount also serve as additional security for any payments that may be made under any NICO cut-through agreements.

NICO also separately provides, for initial and annual fees, an appeals bond facility that the Company and its affiliates use primarily in connection with litigated claims. The Company fully collateralizes the appeal bonds with the pledge of an investment in a Berkshire corporate obligation (Schedule D admitted asset) purchased from Berkshire. At December 31, 2009 and 2008, respectively, the Company has pledged \$75 thousand and \$60.1 million of its assets as collateral for this purpose. The pledged amounts can and do fluctuate, sometimes materially, during each accounting period.

In connection with a now commuted reinsurance arrangement in 2001, the Company entered into a long-term claim administration agreement with National Fire for the servicing of most of the Company's and its affiliates' existing asbestos and environmental claims. The Company paid \$27.5 million in advance for the future servicing of such claims. In accordance with a prescribed accounting practice more fully described in note 2, the Company reflects as an admitted asset the remaining prepaid amount for claim handling services; that amount has declined to approximately \$4.6 million and \$5.7 million at December 31, 2009 and 2008, respectively.

Affiliate Assumed Reinsurance

The significant majority of the business written by members of the Kemper Insurance Companies has historically been ceded to LMC through quota-share reinsurance agreements with some LMC subsidiaries retaining a portion of the business written and through a quota-share pooling agreement by and among LMC, AMICO, and AMM.

AMM is an affiliated mutual insurance company that shares with LMC common management and the same members of their respective boards of directors. AMM has been one of the Kemper Insurance Companies for over 50 years. In 2003, LMC assumed most of AMM's liabilities, agreed to perform for AMM all insurance policy-related obligations including handling and paying claims, and issued a LMC policy to each holder of a policy ever issued by AMM, including any policy no longer in force but excluding any policy that is cut-through reinsured by Unitrin, Inc. The additional LMC policy is substantively identical to the policy previously issued by AMM, although the LMC policy is nonparticipating. The additional LMC policy assures affected AMM policyholders that their claims will be treated equally with the claims of other LMC policyholders not only in the event of a managed run-off of LMC and AMM, but also in the event of any insolvency proceedings with respect to the two companies. AMM remains liable for its policy liabilities in the event LMC does not comply with all the terms of the affected policies. AMM has approximately \$191 million and \$204 million in reinsurance due from LMC as of December 31, 2009 and 2008, respectively.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Other Reinsurance Disclosures

The Company's assumptions from and cessions to unaffiliated reinsurers accounted for as prospective reinsurance were as follows:

	<u>Assumed</u>	<u>Ceded</u>
	(In thousands)	
2009:		
Unearned premiums	\$ 208	1,360
Losses and LAE (including IBNR)	217,663	829,892
2008:		
Unearned premiums	\$ 174	1,948
Losses and LAE (including IBNR)	239,727	877,300

The Company's assumptions from and cessions to affiliated reinsurers accounted for as prospective reinsurance were as follows:

	<u>Assumed</u>	<u>Ceded</u>
	(In thousands)	
2009:		
Unearned premiums	\$ 21	19
Losses and LAE (including IBNR)	2,548	524
2008:		
Unearned premiums	\$ 46	31
Losses and LAE (including IBNR)	4,797	1,767

The Company historically has reinsured portions of the risks it underwrote in an effort to control its exposure to losses and protect surplus. The Company ceded to reinsurers a portion of these risks and paid 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, the Company remains primarily liable as the direct insurer on all risks reinsured. The Company also holds collateral, including escrow funds, letters of credit, and trust funds, under certain reinsurance agreements. The Company monitors the financial condition of reinsurers on an ongoing basis, and reviews its reinsurance arrangements periodically.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

As of December 31, 2009, the Company had unsecured undiscounted aggregate recoverables from outside reinsurers for losses paid, losses unpaid, LAE, and unearned premium that exceed 3% of the Company's total surplus with the following reinsurers (and related group members):

<u>Reinsurer</u>	<u>FEIN code</u>	<u>NAIC group #</u>	<u>NAIC code</u>	<u>Net recoverable</u> (In thousands)
American Home Assurance Co.	13-5124990	12	19380	\$ 154
National Union Fire Insurance Co. of Pittsburgh	25-0687550	12	19445	1,400
Transatlantic Reinsurance Co.	13-5616275	12	19453	<u>6,996</u>
12 Total				<u>8,550</u>
Cologne Reinsurance Co. of America	06-0949141	31	33197	(3)
Finial Reinsurance Co.	06-1325038	31	39136	57,095
General Reinsurance Corp.	13-2673100	31	22039	30,668
National Fire & Marine Insurance Co.	47-6021331	31	20079	35,497
National Reinsurance Corp.	13-1988169	31	34835	<u>327</u>
31 Total				<u>123,584</u>
Federal Insurance Co.	13-1963496	38	20281	<u>1,757</u>
38 Total				<u>1,757</u>
Hartford Fire Insurance Co.	06-0383750	91	19682	<u>1,540</u>
91 Total				<u>1,540</u>
Berkley Insurance Co.	47-0574325	98	32603	34,929
Firemen's Insurance Co. of Washington D.C.	53-0067060	98	21784	323
Tri State Insurance Co. of Minnesota	41-1232071	98	31003	<u>395</u>
98 Total				<u>35,647</u>
American States Insurance Co.	35-0145400	111	19704	960
Employers Insurance Co. of Wausau	39-0264050	111	21458	5,470
Liberty Mutual Insurance Co.	04-1543470	111	23043	<u>(146)</u>
111 Total				<u>6,284</u>
National Casualty Co.	38-0865250	140	11991	2,557
Nationwide Mutual Insurance Co.	31-4177100	140	23787	<u>234</u>
140 Total				<u>2,791</u>
Clearwater Insurance Co.	13-2781282	158	25070	5,016
Clearwater Select Insurance Co.	23-2745904	158	10019	4,908
Odyssey America Reinsurance Corp.	47-0698507	158	23680	<u>7,904</u>
158 Total				<u>17,828</u>

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

<u>Reinsurer</u>	<u>FEIN code</u>	<u>NAIC group #</u>	<u>NAIC code</u>	<u>Net recoverable</u> (In thousands)
Reliance Insurance Co.	23-0580680	159	24457	\$ 3,965
159 Total				<u>3,965</u>
North American Elite Insurance Co.	13-3440360	181	29700	25
Swiss Reinsurance Life & Health America Inc.	06-0839705	181	82627	1,436
Swiss Reinsurance America Corp.	13-1675535	181	25364	219,444
Westport Insurance Corp.	48-0921045	181	39845	33,284
181 Total				<u>254,189</u>
Trinity Universal Insurance Co.	75-0620550	215	19887	3,489
215 Total				<u>3,489</u>
Continental Casualty Co.	36-2114545	218	20443	12,490
218 Total				<u>12,490</u>
Hartford Steam Boiler Inspection & Insurance Munich Reins America, Inc.	06-0384680 13-4924125	361 361	11452 10227	(223) 51,578
361 Total				<u>51,355</u>
Ace American Insurance Co.	95-2371728	626	22667	—
Ace Property & Casualty Insurance Co.	06-0237820	626	20699	1,105
Century Indemnity Co.	06-6105395	626	20710	13,769
626 Total				<u>14,874</u>
General Security National Insurance Co. SCOR Reinsurance Co.	13-3029255 75-1444207	749 749	39322 30058	5,889 18,290
749 Total				<u>24,179</u>
Pennsylvania Mfrs. Assn. Insurance Co. PMA Capital Insurance Co.	23-1642962 23-2153760	767 767	12262 39675	268 2,129
767 Total				<u>2,397</u>
Everest Reinsurance Co.	22-2005057	1120	26921	2,284
1120 Total				<u>2,284</u>
OneBeacon America Insurance Co. Pennsylvania General Insurance Co. White Mountains Reinsurance Co. of America	04-2475442 23-1471444 13-2997499	1129 1129 1129	20621 21962 38776	129 254 4,068
1129 Total				<u>4,451</u>

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

<u>Reinsurer</u>	<u>FEIN code</u>	<u>NAIC group #</u>	<u>NAIC code</u>	<u>Net recoverable</u> (In thousands)
Arch Reinsurance Co.	06-1430254	1279	10348	\$ 1,793
1279 Total				<u>1,793</u>
XL Reinsurance America, Inc.	13-1290712	1285	20583	2,229
1285 Total				<u>2,229</u>
Alea North America Insurance Co.	06-1022232	1325	24899	2,348
1325 Total				<u>2,348</u>
Partner Reinsurance Co. of the U.S.	13-3031176	3483	38636	1,302
PartnerRe Insurance Co. of NY	13-3531373	3483	10006	5
3483 Total				<u>1,307</u>
Northland Insurance Co.	41-6009967	3548	24015	45
St. Paul Fire & Marine Insurance Co.	41-0406690	3548	24767	2,449
Travelers Indemnity Co.	06-0566050	3548	25658	2,032
United States Fidelity & Guaranty Co.	52-0515280	3548	25887	558
3548 Total				<u>5,084</u>
R&Q Reinsurance Co.	23-1740414	4234	22705	1,549
4234 Total				<u>1,549</u>
Maiden Reinsurance Co.	43-1898350	4684	11054	7,652
4684 Total				<u>7,652</u>
AXA Versicherung AG	AA-1340055			1,833
Excess & Casualty Reinsurance Assn. (ECRA)	AA-9995022			10,491
Global Aerospace, Inc.	AA-9995013			82,883
Hannover Rueckversicherungs AG	AA-1340125			2,490
HDI Hftpflichtvrbnd Der Deut Indst Versicher Auf Ge	AA-1340106			2,474
Max Bermuda Ltd.	AA-3190829			4,149
Mutual Reinsurance Bureau	AA-9995035			1,433
New Jersey Unsatisfied Claim & Judgment Fund	AA-9991160			2,704
Texas Workers Compensation	AA-9991444			10,546
Washington State US&H Comp. Act Assigned Risk Plan	ZZ-0000070			1,491
Workers Compensation Reinsurance Assn.	41-1357750		10181	10,929
Grand Total				<u>\$ 725,039</u>

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Reinsurance Assumed and Ceded

The estimated maximum amount of return commission due reinsurers if all of the Company's reinsurance was canceled as of December 31, 2009 is as follows:

	Assumed		Ceded		Net	
	Unearned premium liability	Commission equity	Unearned premium liability	Commission equity	Unearned premium liability	Commission equity
	(In thousands)					
Affiliates	\$ 21	—	19	—	2	—
All other	208	18	1,360	5,067	(1,152)	(5,049)
Total	\$ 229	18	1,379	5,067	(1,150)	(5,049)

Reinsurance Recoverable in Dispute

The Company has reinsurance recoverable balances as of December 31, 2009 with the following reinsurers which are in dispute and in the aggregate exceed 10% of the Company's policyholder surplus:

Name of reinsurer	Total amount in dispute (including IBNR)	Notification	Arbitration	Litigation
Finial Reinsurance Co.	\$ 39,396	—	39,396	—
Century Indemnity Co.	8,822	—	8,822	—
Continental Casualty Co.	4,134	—	4,134	—
Employers Insurance Co. of Wausau	3,995	—	3,995	—
Maiden Reinsurance Co.	2,541	—	—	2,541
National Casualty Co.	1,913	—	1,913	—
Clearwater Insurance Co.	1,750	—	1,750	—
R&Q Reinsurance Co.	1,455	—	1,455	—
Excess and Casualty Reinsurance Assn.	1,233	—	1,233	—
Clearwater Select Insurance Co.	817	—	817	—
TOA Reinsurance Co. of America	195	195	—	—
Odyssey America Reinsurance Corp.	159	—	159	—
Mutual Reinsurance Bureau	87	87	—	—
Nationwide Mutual Insurance Co.	32	—	32	—
Total	\$ 66,529	282	63,706	2,541

In 2007, the Company commenced an arbitration proceeding against a reinsurer (the Reinsurer) seeking to collect amounts due the Company pursuant to certain excess of loss reinsurance agreements encompassing primarily workers compensation losses and LAE. In late December 2009, an arbitration panel entered an Interim Order directing recalculation for certain premiums, losses, and payments under the first year of the affected reinsurance treaty, and ordered the second year be rescinded. As a result of the Interim Order, the

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Company decreased its reinsurance recoverable related balances by \$57.1 million at December 31, 2009. This increase has a material adverse effect on the Company's financial condition and prospects. In February 2010, the Company and Reinsurer resolved the dispute by entering into an agreement to commute all reinsurance treaties between them resulting in no change to the decrease recognized at December 31, 2009.

Reinsurance Accounted for as a Deposit

The Company entered into various reinsurance agreements in previous years which were determined to be of a deposit type nature. The Company had no remaining deposit balance at December 31, 2009, while it had a total remaining deposit balance of \$0.6 million at December 31, 2008.

(6) Federal and Foreign Income Taxes

The December 31, 2009 balances and related disclosures are calculated and presented pursuant to SSAP No. 10R. The December 31, 2008 balances and related disclosures are calculated and presented pursuant to SSAP No. 10 prior to its modification by SSAP No. 10R.

The components of the net deferred tax asset at December 31, 2009 and 2008 are as follows:

		2009		2008
	Ordinary	Capital	Total	Total
		(In thousands)		
Total gross deferred tax assets	\$ 885,932	22,119	908,051	869,887
Valuation allowance adjustment	884,385	21,850	906,235	—
Adjusted gross deferred tax assets	1,547	269	1,816	869,887
Total gross deferred tax liabilities	1,547	269	1,816	3,377
Net deferred tax assets	—	—	—	866,510
Total deferred tax assets nonadmitted	—	—	—	866,510
Net admitted deferred tax assets	\$ —	—	—	—
Decrease in total deferred tax assets nonadmitted			\$ 866,510	

The valuation allowance adjustment has been established due to the Company's runoff status.

The Company has not elected to admit deferred tax assets pursuant to paragraph 10.e. of SSAP No. 10R for the year ended December 31, 2009. The year ended December 31, 2009 election does not differ from the December 31, 2008 year end reporting period.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The amount of admitted adjusted gross deferred tax assets admitted under each component of SSAP No. 10R are as follows:

	2009			2008
	Ordinary	Capital (In thousands)	Total	Total
Admitted under paragraph 10.a.	\$ —	—	—	—
Paragraph 10.b., lesser of:				
Admitted under paragraph 10.b.i.	—	—	—	—
Admitted under paragraph 10.b.ii.	—	—	—	—
Admitted under paragraph 10.b. (lesser of b.i. or b.ii.)	—	—	—	—
Admitted under paragraph 10.c.	1,547	269	1,816	—
Total admitted adjusted gross deferred tax assets	\$ <u>1,547</u>	<u>269</u>	<u>1,816</u>	<u>—</u>

All deferred tax liabilities have been recognized.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

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, 2009 and 2008 are as follows:

	2009	2008
	(In thousands)	
Deferred tax assets:		
Loss carryforwards	\$ 751,086	714,912
Section 197 intangibles	59,399	66,584
Investments	48,168	44,542
Accrued liabilities	29,659	16,766
Receivables	11,933	15,101
Reserves	2,444	5,351
Other, net	5,362	6,631
Total gross deferred tax assets	908,051	869,887
Valuation allowance adjustment	906,235	—
Total adjusted gross deferred tax assets	1,816	869,887
Nonadmitted deferred tax assets	—	866,510
Admitted deferred tax assets	1,816	3,377
Deferred tax liabilities:		
Investments	1,541	2,652
Salvage and subrogation	275	725
Total deferred tax liabilities	1,816	3,377
Net admitted deferred tax asset	\$ —	—

The change in net deferred income taxes as of December 31, 2009 and 2008 comprised the following:

	2009	2008	Change
	(In thousands)		
Total deferred tax assets	\$ 1,816	869,887	(868,071)
Total deferred tax liabilities	1,816	3,377	(1,561)
Net deferred tax asset	\$ —	866,510	(866,510)

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

At December 31, 2009, LMC, AMICO, and AMM had operating loss carryforwards, which originated and expires as follows:

<u>Origination year</u>	<u>Expiration year</u>	<u>LMC</u>	<u>AMICO</u> (In thousands)	<u>AMM</u>
2000	2020	\$ 179,079	4,864	—
2001	2021	404,748	58,692	—
2002	2022	38,885	11,504	—
2003	2023	211,668	74,062	9,011
2004	2024	399,689	3,777	14,888
2005	2025	177,705	—	15,420
2006	2026	178,657	—	13,546
2007	2027	91,136	—	16,401
2008	2028	105,730	—	16,590
2009	2029	80,077	—	16,749
		<u>\$ 1,867,374</u>	<u>152,899</u>	<u>102,605</u>

There were no income taxes incurred in the current and prior year that will be available for recoupment in the event of future net losses.

There were no adjustments in the deferred tax assets (liabilities) for enacted changes in tax laws or tax rates or a change in the tax status of the Company.

Tax returns for the years through 2005 are closed for Internal Revenue Service (IRS) examination. The Company is not currently under examination by the IRS for any open tax years.

LMC files as part of a consolidated federal income tax return, which includes LMC as the common parent corporation and includes or included the following affiliated entities: AMICO, AMICO Realty Corporation, KCIC, Kemper Insurance Corporation, Kemper Insurance Company of Texas, Kemper Realty Corporation, Kemper Technology Services, Inc., LGA-17, Inc., Lou Jones & Associates, and SSIC. AMM files a separate federal income tax return.

(7) Transactions with Affiliates and Related Parties

LMC charges certain affiliated companies for utilizing the services of the employees and the office facilities of LMC. Charges for services for other affiliated companies are based on actual expenses incurred in accordance with their use of the services and facilities.

Affiliate Support for D&O Insurance

In connection with a portion of LMC's and its affiliates' corporate insurance program, a wholly owned subsidiary of LMC, SSIC, extended a reinsurance agreement, effective December 31, 2007 for a three-year period (2008, 2009, and 2010), facultatively reinsuring a corresponding three-year A-side management liability policy issued by an unaffiliated third party to LMC and AMM. SSIC maintains in a trust the

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

\$15.0 million reinsurance premium it received from its affiliates, plus an additional \$0.4 million, for the benefit of the third-party insurer to collateralize the reinsurance obligation. LMC's income, surplus, and liquidity were unchanged by the extension except to the extent of a \$275 thousand administrative fee paid to the unaffiliated third party in 2008.

As a result of favorable loss experience under the D&O insurance program for LMC and its affiliates, SSIC recorded a decrease of liabilities for losses and LAE of approximately \$15 million in 2008. The recording increased surplus of the subsidiary, and consequently the surplus of its parent, by the same amount, but it had no impact on the subsidiary's or LMC's liquidity as the previously described trust securing the subsidiary's related reinsurance obligations continued in place. If any claims arise that are covered under the affiliate D&O insurance program, the Company's surplus would then be reduced by any D&O liability, including loss and LAE reserves, which would then be recorded by the subsidiary.

(8) Employee Benefit Plans

Retention Plans

The Company's workforce decreased to 206 employees at December 31, 2009, from 231 employees at December 31, 2008. To help stabilize the workforce, the Company maintains a retention plan providing for scheduled quarterly payments. The retention payments for 2009 and 2008 totaled \$4.9 million and \$5.0 million, respectively.

As an additional retention plan, the Company maintains an employee severance program that provides a maximum benefit of up to one year of salary depending on the employee's level and service time with the Company. Severance liabilities are not reflected on the Company's statutory balance sheets until a decision is reached that a specific employee or group of employees is to be terminated without cause. Severance payments in 2009 and 2008 totaled \$1.4 million and \$0.8 million, respectively, and severance liabilities recorded at December 31, 2009 and 2008 totaled \$0.8 million and \$1.4 million, respectively. In 2006, with the approval of the Department of Insurance, the Company made a one-time deposit of \$4.75 million in a long-term retention trust to secure its contingent severance obligations.

Incentive Plans

The Company has maintained since 2004 an annual incentive plan linked to successfully achieving or exceeding certain targets as anticipated from time to time in the Company's run-off plan (the Short-Term Plan). In addition to the Short-Term Plan, the Company, with final approval from the Department of Insurance in 2006, established a long-term incentive plan linked to the successful maintenance of the commercial run-off as anticipated in the Company's run-off plan. The Company has accrued approximately \$4.6 million and \$4.5 million under the incentive plans at December 31, 2009 and 2008, respectively. Incentive plan payments totaled \$7.0 million in 2009 and \$6.0 million in 2008.

Deferred Compensation

The Company carried deferred compensation liabilities of approximately \$0.2 million at December 31, 2009 and 2008.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Other Benefit Plans

The Kemper Benefit Plan (the Plan) consists of the health, dental, life, long-term disability, and accident benefits. The Plan is sponsored by the Company and provides benefits covering eligible employees, and eligible dependents of employees of the Company. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

Certain coverages of the Plan require both employer and employee contributions, while others require either an employer or employee contribution. The Company and its employees make specified monthly contributions for the coverages selected. The contribution rates for both the employer and employee are determined annually by the Company. In accordance with provisions of the Plan, eligible employees, and eligible dependents of employees of the Company who incur claims are entitled to receive benefits under the Plan.

Employer and employee contributions for 2009 were \$2.0 million and \$1.1 million, respectively, while 2008 employer and employee contributions were \$2.2 million and \$1.3 million, respectively. For 2009 and 2008, total benefit payments under the Plan were \$3.1 million and \$3.5 million, respectively.

The Company also provides disability benefits to employees who were disabled when the Company self-insured its long-term disability. The related obligation was \$1.2 million and \$1.1 million at December 31, 2009 and 2008, respectively.

(9) Risk-Based Capital

The NAIC utilizes a RBC formula intended for regulatory monitoring of property-casualty insurers. Under RBC 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. For the last six years (and for 2006 through 2008 excluding the benefit of prescribed and permitted accounting practices), LMC's level of surplus has been at the "mandatory control level" under the RBC rules. At this level, the Department of Insurance has substantial authority to exercise control over LMC and its affiliates. The Department of Insurance is mandated to place a company at this level under its control, except where, as is the case with the Company, 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 has discretion to allow the continued run-off. On March 19, 2004, the Company submitted to the Department of Insurance its commercial run-off plan, which was approved on June 9, 2004. The Company updates the run-off plan based on current information from time to time. Details of the plan are confidential pursuant to the state's RBC statute.

Having entered into voluntary run-off in 2003, the Company has been operating under guidance provided within certain agreed to Corrective Orders with the Department of Insurance, pursuant to which the Company has ceased to write virtually all insurance business and is settling its liabilities under the administrative supervision of the Department of Insurance. As required by the Department of Insurance, the Company is operating under a confidential RBC plan (the run-off plan) to address its RBC level. The run-off plan is designed to help the Company meet its goal of resolving, to the maximum extent possible, all valid policyholder claims.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Risks and uncertainties involved in implementing the run-off plan include the need to achieve significant policy buybacks and novations; to complete other surplus-enhancing transactions; to commute certain reinsurance agreements; to complete other liquidity-enhancing 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 the Company by various third parties, including reinsurers as well as insureds and agents; agreements with regulators in various jurisdictions; 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 the Company to collateralize its unsecured obligations or to not timely release collateral back to the Company. Therefore, no assurance can be given that the run-off plan will continue to be successfully implemented.

The Department of Insurance continues to closely monitor the Company's progress in achieving the objectives of the run-off plan. As has been the case for seven years, the Department of Insurance retains the discretion at any time to seek to place the Company in a formal insolvency proceeding (conservatorship or receivership, rehabilitation or liquidation). The risk of a proceeding would be exacerbated if the Company fails to have sufficient liquid assets to meet its current obligations, or if the Company's reported liabilities at any time exceed its reported assets, or if the Company fails to meet the surplus and liquidity projections set forth in the run-off plan.

The events discussed within this note and throughout the notes to the statutory balance sheets (see note 10) raise substantial doubt about the Company's ability to continue as a going concern. The statutory balance sheets and related schedules have been prepared assuming that the Company will continue as a going concern.

The Company has entered into consent agreements with certain other states under which the Company agreed to cease writing business in those jurisdictions. Most recently, in 2008, AMM entered into a consent order restricting AMM from writing business in Alabama. LMC was previously subject to such an order. In addition, in 2005, the Company agreed to its license being suspended in Tennessee, with the Company permitted to maintain its license but not permitted to write any new business. In 2006, the Company appealed its license suspension in the State of North Carolina as not being in the best interests of policyholders or claimants; no action has yet been taken on the appeal. In 2007, the Florida Office of Insurance Regulation notified the Company that its license (certificate of authority to conduct insurance business in Florida) expired by operation of law due to the prior suspension of the license in 2004 (after the Company had entered run-off status). The license is not required for the Company to continue to handle claims, or to liquidate assets or liabilities, from its prior operations.

(10) Commitments, Contingent Liabilities, Liquidity, and Other Contingencies

Ratings

In early 2005, at the Company's request, A.M. Best ceased rating the Company. As of December 31, 2004, A.M. Best had assigned the Company a D (poor) rating. In June and July 2003, respectively, Moody's Investor Services and Standard & Poor's last downgraded the Company's financial strength ratings to Caa3 (very poor) and CCC (very weak), respectively, when, at the Company's request, they ceased rating the Company.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The downgrades to below A- effectively ended the Company's and its affiliates' ability to write most new commercial lines of business or retain existing policyholders. In the first half of 2003, as a result of a combination of various business factors including the ratings downgrades and the Company's deteriorating statutory surplus, the Company substantially ceased underwriting activities other than as required by contract or law. Since July 2003, the Company and most of its affiliates have been subject to Corrective Orders by the Department of Insurance not to write any new or renewal business except as necessary to comply with contractual commitments or as expressly permitted by the Department of Insurance.

Liquidity

As a run-off company, the Company's cash outflows exceed its cash inflows. There are a number of factors that could adversely affect the Company's liquidity position and its adequacy. Accelerated claim payments or imposition of requirements to secure future obligations by court order or otherwise, deterioration of reinsurance collections, increases in operating expenses, and other unanticipated strains on liquidity could cause the Company to have insufficient liquid and unencumbered assets to continue to pay obligations as they become due. As liquidity declines, there can be no assurance that formal proceedings would not be initiated by the Department of Insurance significantly before the Company's projected liquidity would reach \$0. The risk of a formal proceeding (conservatorship or receivership, rehabilitation or liquidation) would be further increased if the Company fails to execute successfully on its commercial run-off plan, if the Company fails to have sufficient liquid assets to meet its current obligations, or if the Company's statutory liabilities at any time would exceed its statutory assets. The Company's \$435.7 million of unencumbered assets at December 31, 2009 shown in the table under ***Securities on Deposit and Encumbered Assets*** below in this note includes approximately \$47.1 million that, although unencumbered, are not immediately available funds, as this amount consists primarily of assets held in subsidiaries.

The Company is addressing potential future liquidity challenges by taking a number of actions, including, but not limited to, seeking the release of what the Company believes is excess collateral held by various governmental agencies, merging or dissolving subsidiaries, converting illiquid assets to liquid assets, negotiating liquidity-enhancing novations, continuing to collect on its reinsurance, and evaluating the possibility of, and implementing, certain reinsurance commutations. The Company's run-off plan anticipates that portions of state deposits will continue to be released as claims are paid and the remaining reserves are reduced. There are significant uncertainties with respect to the legal and regulatory issues related to releases of encumbered assets.

Prompt collection of reinsurance recoverables is a primary driver of the Company's liquidity at all times. Reinsurance provided approximately \$188.7 million of liquidity to the Kemper Insurance Companies during 2009 and approximately \$399 million during 2008. The Company's gross reinsurance recoverables totaled \$937.0 million and \$989.0 million at December 31, 2009 and 2008, respectively.

The Company recognizes the general principle that commutations of ceded reinsurance, if executed, could substantially increase liquidity. Reinsurance commutations, however, would also be anticipated both to decrease surplus, since commutations involve present value or other discounting in return for cash, and to increase the risks of any future adverse development, since the reinsurers would no longer share in such developments. Management remains focused on managing liquidity, surplus, and the balance between them.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Securities on Deposit and Encumbered Assets

Of the Company's cash and invested assets at December 31, 2009, \$507.2 million are encumbered by being on deposit or held in trust or escrow arrangements, compared with \$634.6 million one year earlier, as shown in the following table:

	2009	2008
	(In thousands)	
Special deposits/encumbered assets:		
State deposits	\$ 306,754	352,736
NICO Cut-Through Collateral	166,178	184,115
NICO Appeal Bond Collateral	75	60,133
Canada deposits	9,455	9,805
All other	24,710	27,770
	507,172	634,559
Unencumbered assets:		
Cash and bonds	388,620	502,211
Affiliate common stock	39,612	50,170
Other assets	7,514	6,773
	435,746	559,154
Cash and invested assets	\$ 942,918	1,193,713

The Company received releases of encumbered assets from states totaling \$46.0 million and \$81.4 million during 2009 and 2008, respectively. Releases reflect lower levels of liabilities of the Company that the state deposits have historically secured. There can be no assurance that there will be additional releases.

Where required to post court bonds, including supersedes or appeal bonds, or when using surety bonds to satisfy regulatory deposit requirements, the Company, due to its financial condition, has had to post cash or other security totaling 100% of the bond. At December 31, 2009 and 2008, the Company had pledged invested and other assets of \$0.6 million and \$61.4 million, respectively, for such bonds, most of which are issued by NICO (see note 5).

Of the Company's invested assets at December 31, 2009, \$166.2 million provide collateral for Berkshire affiliates related to the NICO cut-through agreements. This amount reflects a \$17.9 million reduction from a year earlier. Of the cut-through encumbered assets at December 31, 2009, \$66.2 million are subject to release to the Company annually as claim payments are made on policies to which the NICO cut-through agreements are attached so long as NICO is not required to pay any amounts on Kemper policies that have the benefit of cut-through agreements.

The Company is contingently liable to provide up to an estimated additional \$11.1 million in collateral due to ratings triggers in reinsurance agreements where it is a reinsurer. Of this amount, \$3.5 million has been funded with assets of an unrelated third party, Alea Bermuda Ltd. (Alea), for business where the Company from late 1999 to year-end 2001 fronted assumed reinsurance contracts in the U.S. for Alea. Alea's insurance ratings fell to below the "A" level in 2005, and Alea and its affiliates subsequently went into

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

run-off status and have been undergoing related operational changes. Alea's reinsurance obligations to the Company for the fronted liabilities are secured by collateral trust assets of Alea in the amount of \$70.0 million at December 31, 2009. Alea also has handled claims on behalf of the Company since 1999 on both the fronted liabilities and, at December 31, 2009, \$34.2 million of other assumed reinsurance liabilities written by the Company from 1997 through 1999.

In addition to the encumbrances applicable to the Company's cash and invested assets that are reflected in the preceding table, the Company has certain reinsurance related assets which have been pledged or otherwise encumbered. Such encumbered assets include funds held by or deposited with reinsured companies (\$11.2 million at December 31, 2009), certain reinsurance recoverables that serve as additional security for the NICO cut-through (note 5), and reinsurance recoverables for claims paid and to be paid by certain Markel Corporation subsidiaries related to business written by companies that the Company acquired from Markel in 1998 and 1999 (\$0.1 million at December 31, 2009). In addition, one of LMC's wholly owned subsidiaries, SSIC, which was a Markel subsidiary until January 2000, has granted to a Markel entity a security interest in SSIC's reinsurance recoverables related to claims from before 2000 that Markel is responsible for handling and paying; SSIC's related encumbered reinsurance assets totaled \$1.5 million at December 31, 2009.

Structured Settlements

In limited circumstances to settle certain insurance claim liabilities, the Company from time to time since the late 1970 purchased from various life insurance companies structured settlement annuities naming the settling claimants as payees. In many of those settlements, the Company has remained the owner of the respective annuity and contingently liable to the claimant, that is, liable for the periodic payments in the event of the default or insolvency of the life insurance company. In a limited number of these settlements, the Company's purchase of annuities has resulted in a full release from the settling claimants without contingent liability. Where the Company's purchase of annuities has not fully released the Company from contingent liability, the Company has calculated the present value (at a 4.2% discount rate) of future unpaid annuity installments. As shown in the following table, the Company reports that its contingent liabilities for future unpaid annuity installments totaled \$339.2 million at December 31, 2009. These reserves are no longer carried in the statutory balance sheets. Reflecting intercompany reinsurance arrangements, \$189.8 million of the Company's \$339.2 million of contingent liability arises on settlements of claims on policies initially issued by AMM, AMICO, and KICT.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The total value of annuities due from a life insurer in excess of 1% of the Company's surplus is shown in the table below:

<u>Carrier ⁽¹⁾</u>	<u>Location</u>	<u>Reportable amounts</u> (In thousands)
Genworth Life and Annuity Insurance Company	Richmond, VA	\$ 72,540
Executive Life Insurance Company of New York ⁽²⁾	New York, NY	37,247
Symetra Life Insurance Company	Seattle, WA	30,218
Manufacturers Life Insurance Company	Toronto, Canada	22,186
Western National Life Insurance Company	Houston, TX	21,759
Life Insurance Company of North America	Bloomfield, CT	21,517
Fidelity Life Association	Oak Brook, IL	13,503
Monumental Life Insurance Company	Cedar Rapids, IA	13,130
Metropolitan Life Insurance Company	New York, NY	11,935
Aviva Life and Annuity Company	Des Moines, IA	9,118
Presidential Life Insurance Company	Nyack, NY	7,977
Pacific Life Insurance Company	Newport Beach, CA	7,521
Midland National Life Insurance Company	Sioux Falls, SD	7,497
Prudential Insurance Company of America	Newark, NJ	7,302
Protective Life Insurance Company	Birmingham, AL	5,188
Lincoln National Life Insurance Company	Ft. Wayne, IN	4,919
Transamerica Life Insurance Company	Cedar Rapids, IA	4,722
Aurora National Life Assurance Company	East Hartford, CT	3,677
Sun Life Assurance Company of Canada	Toronto, Canada	3,272
Allstate Life Insurance Company of New York	Hauppauge, NY	3,145
American General Life Insurance Company	Houston, TX	2,435
New York Life Insurance Company	New York, NY	2,261
Metropolitan Life Insurance Company of Connecticut	Hartford, CT	2,252
Allstate Life Insurance Company	Northbrook, IL	1,863
AIG Life Insurance Company	Houston, TX	1,679
Canada Life Assurance Company	Toronto, Canada	1,618
Monarch Life Insurance Company ⁽³⁾	Holyoke, MA	1,612
Transamerica Financial Life Insurance Company	Cedar Rapids, IA	1,606
SunAmerica Life Insurance Company	Los Angeles, CA	1,437
American International Life Assurance Company of NY	New York, NY	1,404
United of Omaha Life Insurance Company	Omaha, NE	1,225
Security Benefit Life Insurance Company	Topeka, KS	1,133
Great-West Life Assurance Company	Winnipeg, Canada	1,120
The Ohio National Life Insurance Company	Cincinnati, OH	1,087

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

<u>Carrier</u> ⁽¹⁾	<u>Location</u>	<u>Reportable amounts</u> (In thousands)
Standard Life Assurance Company	Montreal, Canada	\$ 906
AXA Equitable Life Insurance Company	New York, NY	874
Desjardins Financial Security Life Assurance Company	Levis, Canada	631
Stonebridge Life Insurance Company	Cedar Rapids, IA	613
Farmers New World Life Insurance Company	Mercer Island, WA	598
Genworth Life Insurance Company of New York	New York, NY	566
ING Life Insurance and Annuity Company	Atlanta, GA	546
Liberty Life Assurance Company of Boston	Dover, NH	522
Capitol Life Insurance Company ⁽⁴⁾	Dallas, TX	520
Genworth Life Insurance Company	Richmond, VA	435
Washington National Insurance Company	Carmel, IN	359
EMC National Life Company	Des Moines, IA	318
USAA Life Insurance Company	San Antonio, TX	308
Continental Assurance Company	Chicago, IL	236
All other		706
Total		<u>\$ 339,243</u>

(1) All of the life insurance companies listed in the preceding table are rated A- or better by A.M. Best, other than: Presidential Life Insurance Company (B+), Security Benefit Life Insurance Company (B), Washington National Insurance Company (B) and EMC National Life Company (B++); Executive Life Insurance Company of New York (ELNY), Aurora National Life Assurance Company, Desjardins Financial Security Life Assurance Company and Capitol Life Insurance Company are not rated. Monarch Life Insurance Company (Monarch) is rated E, under supervision. In addition, all of the companies are licensed in the state of the Company's domicile, Illinois, other than ELNY, The Great-West Life Assurance Company, Manufacturers Life Insurance Company, Standard Life Assurance Company, and Desjardins Financial Security Life Assurance Company.

(2) ELNY was placed under the supervision of the New York Liquidation Bureau in 1992. ELNY has continued to pay 100% on all its annuities since then; however, the extent of ELNY's ability to continue to pay its obligations as they mature is unknown. There is a reasonable possibility that a liability will be incurred, but the Company believes that an estimate of a liability currently cannot be made with available information.

(3) Monarch was placed in rehabilitation by the Insurance Commissioner of the Commonwealth of Massachusetts in June 1994. The Company is unsure as to the extent of Monarch's ability to pay its obligations as they mature.

(4) The Capitol Life Insurance Company was placed in rehabilitation by the Insurance Commissioner of Texas in September 2003. The Company is unsure as to the extent of the Company's ability to pay its obligations as they mature.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Litigation

In 1996 and 1997, the Company issued surplus notes in the aggregate principal amount of \$700.0 million (note 11). The Company is required to seek the approval of the Director to make each and any semi-annual payments of interest on the surplus notes. Beginning in 2003, the Director has denied the Company's requests for payment of interest on the surplus notes. Following the nonpayment of interest in 2003, several lawsuits were filed in the Circuit Court of Cook County, Illinois by certain holders of surplus notes aggregating approximately \$368.0 million and naming, as defendants, the Company, various directors, or former directors of the Company, and Kemper Commercial Insurance Company, a now dissolved subsidiary of the Company. One case was voluntarily dismissed by the plaintiff, and the other two were consolidated in 2004. The Company was not served with the consolidated amended complaint. This complaint alleged that the Company breached the agreements relating to the surplus notes by adopting a divestiture plan to sell all or substantially all of the Company's assets and ongoing businesses without requiring the acquiring entities to assume the Company's surplus notes or obtaining the consent of a majority of the holders of the surplus notes. The complaint further alleged that the directors breached their fiduciary duties and committed corporate waste, and that the Company and Kemper Commercial Insurance Company engaged in a fraudulent conveyance. The complaint, among other things, sought a declaratory judgment of the parties' rights, an injunction against further asset sales, and monetary damages. In May 2006, the Circuit Court entered a stipulation and order whereby the lawsuit was dismissed without prejudice with leave to reinstate no earlier than October 2008.

In addition to the above, 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 balance sheets due to established liabilities and anticipated insurance and reinsurance recoverables, but there can be no assurance that such matters will not become material due to future developments, including any changes with respect to the financial condition of the Company.

Other Items

Lease Commitments

The Company leases office space and equipment under various noncancelable operating lease agreements. Rental expense for 2009 and 2008 was \$3.8 million and \$3.9 million, respectively.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

At December 31, 2009, the total aggregate minimum rental payments on operating leases are \$3.8 million. Excluding any impact of any decisions to exercise options to reduce rented office space, the Company's future minimum rental payments for the next four years are as follows:

	Minimum payments
	(In thousands)
Year ending December 31:	
2010	\$ 1,388
2011	1,030
2012	1,070
2013	270
	<u>\$ 3,758</u>

Certain rental commitments have renewal options extending through the year 2010. Some of these renewals are subject to adjustments in future periods.

Assessments

The Company is liable for guaranty fund assessments related to certain unaffiliated companies that have become insolvent during the years 2007 and prior. The Company's statutory balance sheets include provisions for all known assessments that are expected to be levied against the Company as well as an estimate of amounts (net of estimated future premium tax recoveries) that the Company believes it will be assessed in the future for which the insurance industry has estimated the cost to cover losses to policyholders. The Company is also contingently liable for any future guaranty fund assessments related to insolvencies of unaffiliated insurance companies for which the insurance industry has been unable to estimate the cost to cover losses to policyholders. No specific amount can be reasonably estimated for such insolvencies as of December 31, 2009. The Company has accrued a liability of \$1.7 million for guaranty fund assessments as of December 31, 2009, compared with \$2.4 million at December 31, 2008. In addition, the Company has accrued a liability for premium and loss based assessments of \$7.0 million as of December 31, 2009, compared with \$29.2 million at December 31, 2008 (see note 2).

SeaBright Insurance Company

Following the 2003 sale by LMC of 100% of the capital stock of Kemper Employers Insurance Company (KEIC) to SeaBright Insurance Holdings, Inc., the purchaser renamed KEIC as SeaBright Insurance Company. As part of the 2003 sale transaction, LMC provided a stop loss reinsurance agreement to KEIC, now SeaBright, and collateralized that reinsurance with a collateral trust. The Company's assets in that collateral trust totaled approximately \$3.8 million and \$2.8 million at December 31, 2009 and 2008, respectively; the increase in 2009 was due to a deposit of additional assets reflecting revised actuarial calculations of the secured liabilities, in accordance with the existing 2003 agreements. SeaBright also provides, for agreed fees, certain claim handling services with respect to approximately 340 claims (accounting for \$16.7 million of net liabilities at December 31, 2009) under policies issued by LMC's Eagle insurance operations prior to the 2003 sale of KEIC. The Eagle operations merged into AMICO in 2004.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

Broadspire

In July 2003, LMC sold its NATLSCO, Inc. subsidiary and related claim service operations (together subsequently renamed Broadspire). The 2003 sales agreement with Broadspire provided for certain contingent consideration (earn-out) based on the revenue and net income of the sold business for a four-year period beginning January 1, 2004 (the Earn-Out Period). The sales agreement required the acceleration and payment of remaining earn-out if Broadspire sold assets of NATLSCO during the Earn-Out Period. In an arbitration proceeding, the Company is disputing the accuracy of the amounts paid by Broadspire for the 2004 and 2005 earn-out periods. In addition, in a series of three transactions between December 2004 and November 2006, Broadspire disposed of NATLSCO and certain of its assets. In 2006, Broadspire paid \$3.6 million as a buy-out of the remaining earn-out (due to the asset dispositions) that Broadspire admits is due under the sales agreement. The Company is disputing the accuracy of Broadspire's calculations, and is involved in arbitration proceedings with Broadspire related to the asset sales. In accordance with the Manual, the Company is not carrying an admitted asset for any future recoveries from Broadspire.

Also in connection with the 2003 transaction, the Company entered into a long-term claim administration agreement with Broadspire for the servicing of most of the Company's existing workers' compensation, general liability, and employer liability claims. The Company paid in advance for the future servicing of such claims, a portion of which payment was placed in trust by Broadspire to be drawn down monthly over an eight-year period beginning January 1, 2004. The Company was not obligated to add any assets to the trust. At December 31, 2009, the amount remaining in this trust was \$4.5 million, down from \$6.8 million one year earlier. The Company receives the interest on Broadspire's trust assets. In accordance with a prescribed accounting practice more fully described in note 1, the Company reflects as an admitted asset the remaining prepaid amount for claim handling services; that amount has declined to approximately \$12.0 million as of December 31, 2009 from \$13.7 million as of December 31, 2008.

Kemper Auto & Home: Renewal Rights and Cut-Through

Following the sale in 2002 of the Company's and its affiliates' U.S. personal lines business to Unitrin, and its subsidiaries including Trinity Universal Insurance Company (Trinity), Unitrin operates this business under the name Kemper Auto & Home. Unitrin has a 100-year license to use the Kemper name in the acquired personal lines businesses. Unitrin did not acquire then in-force or previously issued policies nor renewal rights to policies issued in Alaska, Michigan, Delaware, or Arkansas or to policies produced by independent agents whose authority to write new business had been terminated prior to April 19, 2002. Pursuant to the 2002 sale agreement, Unitrin continues to monitor and service the Company's run-off of its retained personal lines policies. Through early 2005, the Company and certain of its affiliates fronted for Trinity, at Trinity's expense, personal lines policies in states where Trinity (or an affiliate) was seeking licenses and making form and rate filings necessary for the issuance of policies in place of renewals of policies originally issued by the Company or its affiliates. As of December 31, 2009 and 2008, respectively, approximately \$3.5 million and \$6.6 million of the Company's gross liabilities were from fronted policies that are 100% reinsured by (ceded to) Unitrin. Not only are these reinsured policies fully administered (including claims handled) by Unitrin subsidiaries, such policies are covered by a cut-through provision allowing the insureds to seek direct recourse to a Unitrin subsidiary in the event of any insolvency of the Company.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus
December 31, 2009 and 2008

(11) Surplus

The Company had the following surplus notes issued and outstanding as of December 31, 2009:

<u>Description</u>	<u>Interest rate</u>	<u>Maturity date</u>	<u>Par or face value</u>	<u>Carrying value</u>	<u>Interest paid in 2009 and 2008</u> (In thousands)	<u>Inception to-date interest paid</u>	<u>Accrued interest at December 31, 2009</u>
30-Year Notes	9.15%	07/01/2026	\$ 400,000	399,123	—	238,612	—
40-Year Notes	8.30	12/01/2037	200,000	199,507	—	83,461	—
100-Year Notes	8.45	12/01/2097	100,000	99,726	—	42,485	—
			<u>\$ 700,000</u>	<u>698,356</u>	<u>—</u>	<u>364,558</u>	<u>—</u>

The unamortized discount at issuance has been charged directly against surplus. The unamortized discount amounted to \$1.6 million at December 31, 2009 and 2008.

All surplus notes were issued pursuant to Rule 144A of the Securities Act of 1933. All surplus notes are unsecured and subordinated to all present and future indebtedness, policy claims, and prior claims of the Company. The surplus notes are not entitled to a sinking fund. As it relates to the surplus notes, the Company is not restricted from incurring any future indebtedness, policy claims, or prior claims. Under statutory accounting, the surplus notes are part of surplus for financial statement purposes. The 30-year notes and the 40-year notes may not be redeemed at the option of the Company or any holder of the notes prior to maturity. Upon the occurrence and during the continuation of certain events, as described in the Offering Circular, the Company has the right, if certain conditions are met, to shorten the maturity of the 100-year notes, or subject to the prior written approval of the Director, to redeem them in whole but not in part.

Each payment of interest on and/or repayment of principal of the surplus notes may be made only with the prior approval of the Director, which approval will only be granted if, in the judgment of the Director, the financial condition of the Company warrants the making of such payments and the Company's surplus reflects sufficient funds to cover the amount of such payment. The Director has denied the Company's 2009 and 2008 requests for payment of interest on the surplus notes due on June 1 and July 1, and on December 1, and January 1. All payments of interest scheduled since January 1, 2003 have not been paid due to disapprovals by the Director based on the Company's financial condition. The cumulative amount of interest that was scheduled to be paid but is unpaid, plus the amount otherwise accruing in 2009 for which scheduled interest payment dates have not yet arrived, totaled \$433.6 million as of December 31, 2009. In accordance with statutory accounting principles, this total amount is not reflected as a liability on the Company's statutory balance sheets.

(12) Fair Value of Financial Instruments

Fair values are estimated 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 values are based on quoted market prices when available and appropriate. Otherwise, fair values for financial instruments are generally determined using discounted cash flow models and assumptions that are

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

based on judgments regarding current and future economic conditions and the risk characteristics of the investments. Although fair values 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 values 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 presented does not represent the underlying value of the Company. For example, the Company's subsidiaries are not considered financial instruments, and their value has not been incorporated into the fair value estimates. In addition, tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair values 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 are determined using quoted market prices from an orderly market at the reporting date for those or similar investments. If quoted market prices from an orderly market are not available, the fair value is determined using an income approach valuation technique (present value using the discount rate adjustment technique) that considers, among other things, interest rates, the issuer's credit spread, prepayments, performance of the underlying collateral for loan-backed securities and illiquidity by sector and maturity.

Cash equivalents and short-term investments: Fair values for money market funds are based on quoted market prices. Fair values for other instruments approximate amortized cost.

Cash: The statement value reported for cash approximates fair value.

Unaffiliated common stocks: Fair values for unaffiliated private placement common stocks are based on a discounted cash flow income approach and the offering price of a new stock issue (cost approach). At December 31, 2008, fair values for unaffiliated common stocks were based on a quoted market price from an orderly market and on a price obtained from the Securities Valuation Office of the NAIC.

Notes receivable: The fair value of notes receivable is determined in good faith by the Company's engaged portfolio manager based on the estimated timing of cash receipts and a discount rate appropriate for the borrower's credit status.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus

December 31, 2009 and 2008

The statement values and fair values of the Company's financial instruments at December 31, 2009 and 2008 were as follows:

	2009		2008	
	Statement value	Fair value	Statement value	Fair value
	(In thousands)			
Financial instruments recorded as assets:				
Bonds	\$ 834,957	825,528	1,048,797	1,004,543
Cash, cash equivalents, and short-term investments	60,836	60,843	87,973	88,002
Unaffiliated common stocks	1,896	1,896	807	1,519
Notes receivable	303	359	652	894

The Company's financial assets carried at fair value have been classified, for disclosure purposes, based on a fair value hierarchy defined by SSAP No. 100, *Fair Value Measurements*. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's classification is determined based on the lowest level input that is significant to its fair value measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1 – Inputs are unadjusted quoted prices for identical assets in active markets accessible at the measurement date.

Level 2 – Inputs include quoted prices for similar assets in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Examples of other inputs include market interest rates, volatilities, spreads, yield curves, prepayment speeds and default rates.

Level 3 – Includes unobservable inputs that are supported by little or no market activity and are significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what assumptions hypothetical market participants would use to determine a transaction price for the asset at the reporting date.

The following table summarizes assets measured at fair value on a recurring basis at December 31, 2009:

	2009			Statement value
	Fair Value Measurement Category			
	Level 1	Level 2	Level 3	
	(In thousands)			
Unaffiliated common stocks	\$ —	—	1,896	1,896

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus
December 31, 2009 and 2008

The following table reconciles the beginning and ending balances of assets measured at fair value on a recurring basis using significant Level 3 inputs at December 31, 2009:

	2009
	Unaffiliated common stocks
	(In thousands)
Statement value January 1, 2009	\$ —
Total gains or losses:	
Realized included in net income	(160)
Unrealized included in surplus	(1,328)
Net purchases and sales	—
Net transfers in or out of Level 3	728
Statement value December 31, 2009	\$ 1,896

Certain financial assets are measured at fair value on a nonrecurring basis, such as certain bonds valued at the lower of cost or fair value, or investments that are impaired during the reporting period. The following table summarizes the assets measured at fair value on a nonrecurring basis, as of December 31, 2009 and the net gains and losses recorded on assets measured at fair value on a nonrecurring basis during 2009:

	December 31, 2009			2009 Net gains/losses	
	Statement value	Fair Value Measurement Category			
		Level 1	Level 2		Level 3
	(In thousands)				
Bonds	\$ 3,374	—	—	3,374	(82)

During 2009, the Company realized \$1.3 million of impairment writedowns on bonds included in the above table (see note 3). The Company carries the above bonds at fair value because they are rated NAIC 3 or below and fair value is lower than amortized cost. Unrealized losses are recorded in surplus. The fair values for the above bonds held at December 31, 2009 were determined based on a price determined by the Company's engaged portfolio manager using a discount rate adjustment technique pricing model.

(13) Reconciliation of Audited Statutory Financial Statement to Annual Statement as Filed

Subsequent to the filing of the Company's 2009 Annual Statement on or about March 1, 2010, the Company became aware of certain facts that provided additional evidence with respect to conditions or circumstances that existed at the date of filing. These additional facts affected the estimates inherent in the process of preparing the 2009 Annual Statements and are referred to as Type I subsequent events in SSAP No. 9, *Subsequent Events*. In accordance with SSAP No. 9, all information that becomes available prior to the issuance of the statutory financial statements relating to a material Type I subsequent event shall be used by management to determine the related accounting estimate.

LUMBERMENS MUTUAL CASUALTY COMPANY

Notes to Combined Statutory Statements of Admitted Assets, Liabilities, and Surplus
December 31, 2009 and 2008

As such, the Company has recorded the following adjustments in the accompanying statutory financial statements which are different from the amounts filed in the Company's 2009 Annual Statements:

	<u>Surplus</u>
As filed in 2009 Annual Statements	\$ 19,316,031
2009 adjustments related to:	
Misapplication of facts related to development of certain losses and LAE	<u>(4,989,148)</u>
Total adjustments	<u>(4,989,148)</u>
As per the accompanying combined statutory financial statements	<u>\$ 14,326,883</u>

(14) Subsequent Event

The Company performed an evaluation of subsequent events through May 28, 2010, the date the combined statutory financial statements were issued, and determined there were no recognized or unrecognized subsequent events that would require an adjustment or additional disclosure in the combined statutory financial statements as of December 31, 2009 except for the following.

In July 2003, the Company sold its NATLSCO, Inc. subsidiary and related claim service operations (together subsequently renamed Broadspire). The 2003 sales agreement with Broadspire provided for certain contingent consideration (earn-out) based on the revenue and net income of the sold business for a four-year period beginning January 1, 2004 (the Earn-Out Period). The sales agreement required the acceleration and payment of the remaining earn-out if Broadspire sold assets of NATLSCO during the Earn-Out Period. In an arbitration proceeding, the Company is disputing the accuracy of the amounts paid by Broadspire for the 2004 and 2005 earn-out periods. In addition, in a series of three transactions between December 2004 and November 2006, Broadspire disposed of NATLSCO and certain of its assets. The Company is disputing the accuracy of Broadspire's calculations, and is involved in arbitration proceedings with Broadspire related to the asset sales. In accordance with the Manual, the Company is not carrying an admitted asset for any future recoveries from Broadspire. In the second quarter of 2010, the Company received \$3.5 million as a result of the arbitrator's ruling on the 2004 Earn-Out Period.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investments

December 31, 2009

The following is a summary of certain financial data as of and for the year ended December 31, 2009 for purposes of complying with the Manual. Such data is included in LMC's, AMICO's, and AMM's 2009 Annual Statements as filed with the Department of Insurance.

Investment categories	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount	Percentage	Amount	Percentage
Bonds:				
U.S. Treasury securities	\$ 34,863,526	3.714%	\$ 34,863,526	3.698%
U.S. government agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government sponsored agencies	92,097,774	9.810	92,097,774	9.767
Non-U.S. government (including Canada, excluding mortgage-backed securities)	75,727	0.008	75,727	0.008
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
Revenue and assessment obligations	24,543,124	2.614	24,543,124	2.603
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	9,569	0.001	9,569	0.001
Issued or guaranteed by FNMA and FHLMC	97,073	0.010	97,073	0.010
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	97,777,593	10.415	97,777,593	10.370
All other	116,755,710	12.437	116,755,710	12.382
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	434,450,129	46.276	434,450,129	46.075
Unaffiliated non U.S. securities (including Canada)	34,589,530	3.684	34,589,530	3.668

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investments

December 31, 2009

Investment categories	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount	Percentage	Amount	Percentage
Equity interests:				
Other equity securities:				
Affiliated (a)	\$ 35,511,002	3.783%	\$ 39,612,040	4.201%
Unaffiliated	1,895,670	0.202	1,895,670	0.201
Other equity interests including tangible personal property under lease:				
Affiliated	5,315,221	0.566	5,315,221	0.564
Cash, cash equivalents and short-term investments	<u>60,835,707</u>	<u>6.480</u>	<u>60,835,707</u>	<u>6.452</u>
Total cash and invested assets	<u>\$ 938,817,355</u>	<u>100.000%</u>	<u>\$ 942,918,393</u>	<u>100.000%</u>

(a) Admitted assets differ from Manual basis due to an accounting allowance from the Department. Please see note 1 to the 2009 audited statutory financial statements for further information.

See accompanying independent auditors' report.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investment Risks Interrogatories

December 31, 2009

The following interrogatories as of and for the year ended December 31, 2009 are for the purpose of complying with the 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: \$1,135,222,738.
- Ten largest exposures to a single issuer/borrower/investment:

<u>Issuer</u>	<u>Description of exposure</u>	<u>Amount</u>	<u>Percentage of total admitted assets</u>
1. Berkshire Hathaway Inc	Bond	\$ 166,252,873	14.6%
2. Dreyfus Cash Mgmt CL A FD	Class 1 MMF	31,369,303	2.8
3. Specialty Surplus Insurance Co	Affiliate Common	21,172,073	1.9
4. Wells Fargo Company	Bond	20,739,536	1.8
5. FNR 2005-97 HB - Mtg. Multi-Class	Bond	15,387,277	1.4
6. General Elec Cap Corp	Bond	14,996,662	1.3
7. BACM 2002-2 A3 - Mtg Multi-Class	Bond	14,600,821	1.3
8. FNR 2009-70 NL - Mtg Multi-Class	Bond	13,957,872	1.2
9. TXU 2004-1 A2 - Asset Backed	Bond	13,440,480	1.2
10. FHR 3578 AN - Mtg Multi-Class	Bond	13,431,615	1.2

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

<u>Bonds</u>	<u>Amount</u>	<u>Percentage of total admitted assets</u>	<u>Preferred stocks</u>	<u>Amount</u>	<u>Percentage of total admitted assets</u>
NAIC-1	\$ 881,616,789	77.7%	P/RP-1	\$ —	—%
NAIC-2	11,892,597	1.0	P/RP-2	—	—
NAIC-3	—	—	P/RP-3	—	—
NAIC-4	1,203,894	0.1	P/RP-4	—	—
NAIC-5	—	—	P/RP-5	—	—
NAIC-6	—	—	P/RP-6	—	—

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investment Risks Interrogatories

December 31, 2009

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	\$ 25,285,253		2.2%
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. Largest foreign investment exposures by 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. Largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign rating:

Not applicable.

10. Ten largest nonsovereign (i.e., nongovernmental) 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.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investment Risks Interrogatories

December 31, 2009

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 ten largest 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.

Name of issuer	Amount	Percentage of total admitted assets
1. Specialty Surplus Insurance Co	\$ 21,172,073	1.9%
2. Kemper Casualty Insurance Co	11,589,816	1.0
3. Delta Wetlands ADC Joint Venture	5,315,221	0.5
4. Kemper Insurance Company of Texas	2,749,113	0.2
5. Kemper International Corp	2,177,350	0.2
6. LGA-17 Inc	1,923,688	0.2
7. Facility Ins Hldg Corp	1,328,370	0.1
8. Shorebank Corp	567,300	0.1

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.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Investment Risks Interrogatories

December 31, 2009

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.
19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments in mezzanine real estate loans.
Are assets held in investments in mezzanine real estate loans 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 19.
20. Amounts and percentages of the reporting entity's total admitted assets subject to securities lending agreements, repurchase and reverse repurchase agreements, and dollar repurchase and dollar reverse repurchase agreements:
None.
21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:
None.
22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:
None.
23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:
None.

See accompanying independent auditors' report.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Reinsurance Risk Interrogatories

December 31, 2009

1. The reporting entity does have risks reinsured under quota-share reinsurance contracts with other entities that include a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit, or any similar provisions). The amount of reinsurance credit taken on the two contracts containing such provisions reflects the reduction in quota-share coverage caused by the limiting provisions.
2. The reporting entity ceded risks under a reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during 2009: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contracts contain one or more of the following features or other features that would have similar results:
 - a. A contract term longer than two years and the contract is noncancelable by the reporting entity during the contract term;
 - b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
 - c. Aggregate stop loss reinsurance coverage;
 - d. An unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions that are only triggered by a decline in the credit status of the other party;
 - e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
 - f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Reinsurance Risk Interrogatories

December 31, 2009

3. The following information is provided for contracts meeting the provisions of paragraph 2. above:
- a. A summary of the reinsurance contract terms and management's principal objectives in entering into the reinsurance contracts is presented below:

Summary of Reinsurance Contract Terms	Related Management's Objectives
<p>Workers' Compensation and/or Employers Liability Excess of Loss Reinsurance Agreement – This contract, with a term from March 1, 2001 to March 1, 2002, provides coverage of \$750,000 xs \$250,000 per occurrence for workers' compensation business written by the Kemper Risk Management Division. Reinsurance Premium is 4.93% of Subject Net Written Premium, with a ceding commission of 17%. There is Additional Premium dependent on loss experience. The Aggregate Limit is the lesser of 8.0% of SNWP or \$60 million. There is an Experience Account maintained by the reinsurer reflecting net premiums paid less margin less paid losses plus an interest credit. This contract is being reported pursuant to Interrogatory 9.1(d) – an unconditional or unilateral right to commute the reinsurance contract.</p>	<p>Workers' Compensation and/or Employers Liability Excess of Loss Reinsurance Agreement – The Company had recently purchased coverage for its workers' compensation XOL for this layer in the traditional reinsurance markets. Due to the historical frequency of past losses in this layer, traditional reinsurance capacity was not available at a premium that Company management deemed acceptable. Rather than keep this layer of exposure on a net basis (i.e. unreinsured), the Company decided to reinsure this layer under a finite risk reinsurance agreement that combined elements of both risk retention and risk transfer. This reinsurance agreement effectively serves as a transition layer between the Company's net retention (the first \$250,000 per occurrence) and traditional reinsurance coverage (excess of \$1 million per occurrence).</p>

LUMBERMENS MUTUAL CASUALTY COMPANY

Combined Supplemental Schedule of Reinsurance Risk Interrogatories

December 31, 2009

- b. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the statutory balance sheets is presented in the table below:

	<u>As reported</u>	<u>Reinsurance interrogatory effect</u> (In thousands)	<u>Restated without interrogatory reinsurance</u>
Year ended December 31, 2009:			
Assets	\$ 1,122,786	(20,319)	1,102,467
Liabilities	<u>1,108,460</u>	<u>20,004</u>	<u>1,128,464</u>
Surplus	<u>\$ 14,326</u>	<u>(40,323)</u>	<u>(25,997)</u>

4. During 2009, the reporting entity did not cede any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:
- The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statements; or
 - Twenty five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.
5. The reporting entity did not cede any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during 2009 that was either:
- Accounted for as reinsurance (either prospective or retrospective) under SSAP and as a deposit under GAAP; or
 - Accounted for as reinsurance under GAAP and as a deposit under SSAP.

See accompanying independent auditors' report

LUMBERMENS MUTUAL CASUALTY COMPANY

Combining Statutory Statements of Admitted Assets, Liabilities, and Surplus

Schedule IV

December 31, 2009

Admitted Assets	LMC	AMM	AMICO	ELIMINATION	COMBINED
Cash, cash equivalents, and short-term investments	\$ 59,334,760	560,135	940,812	—	60,835,707
Common stocks:					
Affiliated	57,411,372	—	—	(19,990,219) A	37,421,153
Unaffiliated	1,377,491	—	518,179	—	1,895,670
Bonds	805,880,134	10,755,289	18,321,357	—	834,956,780
Investment in affiliate held for sale	2,190,887	—	—	—	2,190,887
Other invested assets	5,618,196	—	—	—	5,618,196
Total cash and invested assets	931,812,840	11,315,424	19,780,348	(19,990,219)	942,918,393
Reinsurance recoverable on paid losses and loss adjustment expenses	70,193,501	—	—	—	70,193,501
Other admitted assets	58,424,262	—	—	—	58,424,262
Funds held by or deposited with reinsured companies	11,184,035	—	—	—	11,184,035
Accrued retrospective premiums	9,741,523	—	—	—	9,741,523
Funds held by claim service provider	8,292,510	—	—	—	8,292,510
Agents' balances and uncollected premiums	7,957,054	—	—	—	7,957,054
Investment income due and accrued	6,139,131	115,605	251,047	—	6,505,783
Amounts billed and receivable under high deductible policies	4,664,498	—	—	—	4,664,498
Equities and deposits in pools and associations	2,546,939	—	—	—	2,546,939
Federal and foreign income tax recoverable	383,396	—	—	(64,357) B	319,039
Receivable from subsidiaries and affiliates	251,269	—	24,981	(237,376) C	38,874
Total admitted assets	\$ <u>1,111,590,958</u>	<u>11,431,029</u>	<u>20,056,376</u>	<u>(20,291,952)</u>	<u>1,122,786,411</u>

A) Elimination of statutory equity of insurance affiliate.

B) Netting of federal income tax receivable and payable.

C) Elimination of intercompany receivable and payable.

See accompanying independent auditors' report.

Liabilities and Surplus	LMC	AMM	AMICO	ELIMINATION	COMBINED
Liabilities:					
Losses and loss adjustment expenses	\$ 940,113,044	—	—	—	940,113,044
Amounts withheld for others	72,666,145	—	—	—	72,666,145
Accounts payable and other liabilities	45,158,743	—	—	—	45,158,743
Reinsurance payable on paid losses and loss adjustment expenses	22,869,036	—	—	—	22,869,036
Other expenses payable	11,418,403	900	1,800	—	11,421,103
Taxes, licenses, and fees payable	9,326,453	—	—	—	9,326,453
Unearned premium	2,569,021	—	—	—	2,569,021
Funds held under reinsurance treaties	2,133,617	—	—	—	2,133,617
Remittances and items not allocated	1,029,380	—	—	—	1,029,380
Net adjustments in assets and liabilities due to foreign exchange rates	434,296	—	—	—	434,296
Commissions payable	407,204	—	—	—	407,204
Ceded reinsurance premiums payable	331,486	—	—	—	331,486
Payable to subsidiaries and affiliates	—	237,376	—	(237,376) C	—
Federal and foreign income tax payable	—	—	64,357	(64,357) B	—
Total liabilities	1,108,456,828	238,276	66,157	(301,733)	1,108,459,528
Common Stock	—	—	6,449,529	(6,449,529) A	—
Paid-in and contributed surplus	—	—	12,285,998	(12,285,998) A	—
Guaranty fund	1,500,000	1,500,000	—	—	3,000,000
Surplus notes	698,355,598	—	—	—	698,355,598
Unassigned surplus (deficit)	(696,721,468)	9,692,753	1,254,692	(1,254,692) A	(687,028,715)
Total surplus	3,134,130	11,192,753	19,990,219	(19,990,219)	14,326,883
Total liabilities and surplus	\$ 1,111,590,958	11,431,029	20,056,376	(20,291,952)	1,122,786,411

LUMBERMENS MUTUAL CASUALTY COMPANY

Combining Statutory Statements of Admitted Assets, Liabilities, and Surplus

Schedule IV

December 31, 2008

Admitted Assets	LMC	AMM	AMICO	ELIMINATION	COMBINED
Cash, cash equivalents, and short-term investments	\$ 86,360,360	1,462,023	150,161	—	87,972,544
Common stocks:					
Affiliated	67,223,478	—	—	(18,768,417) A	48,455,061
Unaffiliated	806,589	—	—	—	806,589
Bonds	1,020,334,355	9,726,103	18,736,853	—	1,048,797,311
Investment in affiliate held for sale	1,714,942	—	—	—	1,714,942
Other invested assets	5,966,691	—	—	—	5,966,691
Total cash and invested assets	1,182,406,415	11,188,126	18,887,014	(18,768,417)	1,193,713,138
Reinsurance recoverable on paid losses and loss adjustment expenses	85,675,362	—	—	—	85,675,362
Other admitted assets	56,361,412	—	—	—	56,361,412
Funds held by or deposited with reinsured companies	12,246,065	—	—	—	12,246,065
Accrued retrospective premiums	17,251,970	—	—	—	17,251,970
Funds held by claim service provider	8,334,447	—	—	—	8,334,447
Agents' balances and uncollected premiums	14,977,686	—	—	—	14,977,686
Investment income due and accrued	9,234,897	138,838	362,237	—	9,735,972
Amounts billed and receivable under high deductible policies	11,088,052	—	—	—	11,088,052
Equities and deposits in pools and associations	8,794,227	—	—	—	8,794,227
Federal and foreign income tax recoverable	623,957	—	—	(305,930) B	318,027
Reinsurance accounted for as a deposit	599,510	—	—	—	599,510
Receivable from subsidiaries and affiliates	278,250	—	—	(278,250) C	—
Total admitted assets	\$ <u>1,407,872,250</u>	<u>11,326,964</u>	<u>19,249,251</u>	<u>(19,352,597)</u>	<u>1,419,095,868</u>

A) Elimination of statutory equity of insurance affiliate.

B) Netting of federal income tax receivable and payable.

C) Elimination of intercompany receivable and payable.

See accompanying independent auditors' report.

Liabilities and Surplus	LMC	AMM	AMICO	ELIMINATION	COMBINED
Liabilities:					
Losses and loss adjustment expenses	\$ 1,040,398,919	—	—	—	1,040,398,919
Amounts withheld for others	124,464,509	—	—	—	124,464,509
Accounts payable and other liabilities	44,422,490	—	—	—	44,422,490
Reinsurance payable on paid losses and loss adjustment expenses	16,041,492	—	—	—	16,041,492
Other expenses payable	14,270,656	900	1,800	—	14,273,356
Taxes, licenses, and fees payable	33,073,387	—	—	—	33,073,387
Unearned premium	3,663,958	—	—	—	3,663,958
Funds held under reinsurance treaties	2,741,570	—	—	—	2,741,570
Remittances and items not allocated	12,676,987	—	—	—	12,676,987
Net adjustments in assets and liabilities due to foreign exchange rates	1,485,005	—	—	—	1,485,005
Commissions payable	500,233	—	—	—	500,233
Ceded reinsurance premiums payable	960,829	—	—	—	960,829
Payable to subsidiaries and affiliates	—	214,790	173,104	(278,250)	109,644
Federal and foreign income tax payable	—	—	305,930	(305,930)	—
	<u>1,294,700,035</u>	<u>215,690</u>	<u>480,834</u>	<u>(584,180)</u>	<u>1,294,812,379</u>
Total liabilities					
Common Stock	—	—	6,449,529	(6,449,529)	—
Paid-in and contributed surplus	—	—	12,285,998	(12,285,998)	—
Guaranty fund	1,500,000	1,500,000	—	—	3,000,000
Surplus notes	698,355,598	—	—	—	698,355,598
Unassigned surplus (deficit)	(586,683,383)	9,611,274	32,890	(32,890)	(577,072,109)
	<u>113,172,215</u>	<u>11,111,274</u>	<u>18,768,417</u>	<u>(18,768,417)</u>	<u>124,283,489</u>
Total surplus					
Total liabilities and surplus	<u>\$ 1,407,872,250</u>	<u>11,326,964</u>	<u>19,249,251</u>	<u>(19,352,597)</u>	<u>1,419,095,868</u>