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$4.2 Billion Takeover Offer for Liberty Mutual

Bid by Liberty Mutual Defense Fund

Liberty Mutual Insurance Company, which is attempting to convert to a mutual holding company structure, today received a $4.2 billion takeover offer from Liberty Mutual Defense Fund (LMDF).

According to a letter faxed by LMDF to Edmund F. Kelly, chairman, president, and CEO of Liberty Mutual, LMDF's goal is to acquire Liberty on terms that are more favorable to Liberty's policyholders than those in Liberty's proposed mutual holding company. (In a mutual holding company conversion, policyholders receive no compensation.)

In recent years the mutual insurance holding company structure has been discredited, and it is reviled by consumer organizations, sophisticated policyholders, and many insurance agents and brokers. The mutual insurance holding company concept has also fallen out of favor on Wall Street. Only one mutual insurance holding company, AmerUs, completed a public offering of shares. (It subsequently did a full demutualization.) And Principal Mutual, the largest company to convert to a mutual holding company, has also thrown in the towel on the concept and is planning a full demutualization.

LMDF said that it was seeking to acquire Liberty because Liberty has "put itself into play" by attempting to change its corporate structure and create a mutual holding company.

Liberty Mutual is the seventh largest property-casualty insurance company in America. According to LMDF, Liberty is particularly valuable to its 660,000 policyholders. Last year it had direct written premiums of $1.5 billion. Policyholders' surplus (after subtracting surplus notes) is about $4.2 billion.

Under LMDF's acquisition proposal, Liberty's policyholders would receive approximately 2.8 times their average annual premiums. Thus, a policyholder paying $2,000 in premiums per year would expect to receive $5,600 of value.

Two former insurance commissioners, James Hunt and Robert Hunter, have agreed to serve on LMDF's board if Liberty accepts the acquisition proposal. David Schiff would also serve on the board. (LMDF was conceived in the editorial offices of *Schiff's Insurance Observer*.)

The full text of LMDF's offer to acquire Liberty Mutual appears below.

✦

June 28, 2001

Mr. Edmund F. Kelly,
Chairman, President & CEO
The Board of Directors
Liberty Mutual Insurance Company

Dear Mr. Kelly:

This letter constitutes an offer to acquire Liberty Mutual Insurance Company ("Liberty") for at least $4.2 billion. The offer is being made by Liberty Mutual Defense Fund ("LMDF"), which is affiliated with *Schiff's Insurance Observer*.

LMDF's goal is to acquire Liberty on better terms than those offered to Liberty's policyholders pursuant to Liberty's proposed Mutual Holding Company conversion. Therefore, LMDF is offering to acquire Liberty for 100% of Liberty's full value. This will be accomplished by merging Liberty into LMDF in a tax-free transaction in which Liberty's policyholders will own 100% of LMDF upon completion of the transaction. LMDF will then become a publicly-held company. It is anticipated that its shares will trade on the New York Stock Exchange.

Under LMDF's offer, Liberty's policyholders will receive approximately $4.2 billion in the form of LMDF common stock. Since Liberty has 660,000 policyholders, the $4.2 billion works out to an average of $6,363 per policyholder. Viewed another way, each Liberty policyholder will receive approximately 2.8 times his average annual premium in LMDF's common stock.

One reason LMDF is seeking to acquire Liberty is because Liberty has put itself into play by seeking to change its corporate structure and transfer policyholders' rights to a Mutual Holding Company.

The terms of LMDF's offer are much better for Liberty's policyholders than the terms that have been proposed to them by Liberty in the current draft of the proposed Plan of Reorganization that Liberty expects to file with the Massachusetts Department of Insurance.

LMDF does not plan to remove any of Liberty's directors, officers, and employees, or alter their compensation. The only change contemplated in the composition of the board of directors will be the addition of David Schiff (editor of *Schiff's Insurance Observer*), James Hunt (Fellow of the Society of Actuaries and Former Vermont Commissioner of Banking & Insurance) and Robert Hunter (Consumer Federation of America's Director of Insurance, former Texas Insurance Commissioner, and former Federal Insurance Administrator). *continued*

LMDF is eager to acquire Liberty in a friendly transaction. (Due to Liberty's prominence and the unique nature of mutual insurance companies, this letter is being made public.) LMDF's offer has numerous advantages over Liberty's proposed Mutual Holding Company reorganization. These advantages include the following:

1) Liberty policyholders will receive a tangible asset—publicly-traded common stock—in exchange for their interests.

2) Depending upon market conditions and other factors, the price at which LMDF's stock initially trades may result in a market valuation that is somewhat higher or lower than $4.2 billion. Regardless of the price at which the stock trades, LMDF's stock will be worth substantially more than the "membership rights" that Liberty policyholders would receive in the reorganization plan Liberty will submit to the Massachusetts Department of Insurance.

3) Liberty's policyholders—for whose benefit Liberty is supposed to be run—may choose to avail themselves of the price offered in the market and liquidate some or all of their LMDF shares.

4) Policyholders will be able to sell some or all of their LMDF shares and still maintain their policies. That right is not available to them under Liberty's proposed plan.

5) Under LMDF's plan, Liberty's policyholders can hold their shares in LMDF and profit further if those shares appreciate over time. Under Liberty's proposed reorganization, there can be no assurance that policyholders will ever receive any value for their membership interests or that they will ever be able to participate from any appreciation in Liberty.

6) Policyholders are guaranteed to receive value. Under the plan to be proposed by Liberty, policyholders will be forced to relinquish valuable rights, yet there can be no assurance that they will ever receive any compensation for parting with these rights. In fact, under your plan, if a "member" ceases to be a policyholder he will lose all value that he had accrued to that point.

7) The "membership rights" offered to policyholders in Liberty's proposed reorganization have no tangible value, are illiquid, and non-transferable. Members will not be able to receive dividends from Liberty's Mutual Holding Company.

8) Liberty's proposed reorganization sets up conflicts of interests between the "members" (who are policyholders) and Liberty's directors and officers, who are likely to have an equity interest in one of the downstream stock companies. These conflicts are avoided in LMDF's offer.

9) LMDF's proposal will provide the combined entity (LMDF and Liberty) with greater access to capital than will be available to Liberty under Liberty's proposed reorganization. Only one Mutual Holding Company has completed a public offering of stock in its insurance subsidiary, and it is acknowledged that the stock market has not received the Mutual Holding Company structure favorably. LMDF's holding-company structure, on the other hand, is employed by virtually all publicly-held insurance companies and is widely accepted. As a result, additional capital, should that be desired, will be available on better terms under LMDF's proposal. For the same reason, stock acquisitions are also likely to be available on more favorable terms.

10) As shareholders in LMDF, Liberty's policyholders will have greater rights than they currently have, or would have in Liberty's proposed reorganization.

11) Since LMDF's holding-company structure is the most common form of insurance-company ownership and has been tested by time, it is likely to be viewed more favorably by rating agencies than the Mutual Holding Company structure Liberty has proposed.

LMDF's offer is good for Liberty's policyholders. I would be pleased to discuss the terms of this offer with you in further detail, and look forward to your Board accepting the offer and recommending it to your policyholders.

Sincerely,

David Schiff

David Schiff
Information Agent for Liberty Mutual Defense Fund
Editor, *Schiff's Insurance Observer*

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