

Liberty Mutual Holding Company Inc.

Second Quarter 2009

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

	June 30, 2009	December 31, 2008
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of \$52,425 and \$49,902)	\$ 52,194	\$ 47,731
Equity securities, available for sale, at fair value (cost of \$1,043 and \$1,279)	957	1,184
Trading securities, at fair value (cost of \$1 and \$1)	1	1
Short-term investments	740	1,193
Mortgage loans	1,070	1,090
Other investments	2,509	2,728
Total investments	57,471	53,927
Cash and cash equivalents	6,236	5,848
Premium and other receivables (net of allowance of \$115 and \$136)	8,071	7,834
Reinsurance recoverables (net of allowance of \$350 and \$344)	15,425	15,309
Deferred income taxes (net of valuation allowance of \$145 and \$131)	2,574	3,166
Deferred acquisition costs and acquired in-force policy intangibles	2,591	2,541
Goodwill	4,675	4,645
Prepaid reinsurance premiums	1,791	1,565
Separate account assets	3,295	3,062
Other assets	6,391	6,419
Total assets	\$ 108,520	\$ 104,316
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	\$ 49,121	\$ 48,727
Life	6,325	6,258
Other policyholder funds and benefits payable	3,153	3,031
Unearned premiums	13,373	12,944
Funds held under reinsurance treaties	1,855	1,855
Current maturities of long-term debt	300	-
Long-term debt	5,752	6,089
Separate account liabilities	3,295	3,062
Other liabilities	13,501	12,190
Total liabilities	96,675	94,156
Policyholders' equity:		
Unassigned equity	13,050	12,720
Accumulated other comprehensive loss	(1,205)	(2,560)
Total policyholders' equity	11,845	10,160
Total liabilities and policyholders' equity	\$ 108,520	\$ 104,316

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues				
Premiums earned	\$ 6,959	\$ 6,004	13,841	\$ 11,942
Net investment income	697	754	1,034	1,511
Fee and other revenues	201	185	382	387
Net realized gains, excluding other-than-temporary impairment losses	35	69	154	88
Other-than-temporary impairment losses:				-
Total other-than-temporary impairment losses (Note 1)	(57)	(64)	(203)	(95)
Change in portion of loss recognized in other comprehensive income	(5)	-	28	-
Net impairment losses recognized in earnings	(62)	(64)	(175)	(95)
Total revenues	7,830	6,948	15,236	13,833
Claims, Benefits and Expenses				
Benefits, claims and claim adjustment expenses	5,035	4,540	10,079	8,954
Insurance operating costs and expenses	1,117	922	2,112	1,867
Amortization of deferred policy acquisition costs	1,120	942	2,284	1,855
Interest expense	123	93	245	176
Interest credited to policyholders	55	39	99	89
Total claims, benefits and expenses	7,450	6,536	14,819	12,941
Income before income tax expense	380	412	417	892
Income tax expense	106	112	115	232
Net income	\$ 274	\$ 300	302	\$ 660

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(unaudited)

	Six Months Ended June 30,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 302	\$ 660
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	166	149
Realized investment losses	21	7
Undistributed private equity investment losses (gains)	401	(114)
Premium, other receivables, and reinsurance recoverables	(554)	(350)
Deferred policy acquisition costs	(70)	(119)
Liabilities for insurance reserves	596	1,520
Taxes payable, net of deferred	(243)	(121)
Other, net	369	60
Total adjustments	686	1,032
Net cash provided by operating activities	988	1,692
Cash flows from investing activities:		
Purchases of investments	(9,244)	(6,451)
Sales and maturities of investments	7,420	8,674
Property and equipment purchased, net	(157)	(164)
Payment for purchase of companies, net of cash acquired	-	(143)
Other investing activities	967	(277)
Net cash (used in) provided by investing activities	(1,014)	1,639
Cash flows from financing activities:		
Net activity in policyholder accounts	34	35
Debt financing, net	(24)	1,138
Net security lending activity and other financing activities	388	1,412
Net cash provided by financing activities	398	2,585
Effect of exchange rate changes on cash	16	12
Net increase in cash and cash equivalents	388	5,928
Cash and cash equivalents, beginning of period	5,848	3,199
Cash and cash equivalents, end of period	\$ 6,236	\$ 9,127

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

(Unaudited)

	Six Months Ended June 30,	
	2009	2008
Balance at beginning of the period	\$ 10,160	\$ 12,366
Net income	302	660
Other comprehensive (loss) income, net of taxes:		
Unrealized gains (losses) on securities	1,266	(832)
Foreign currency translation and other adjustments	117	112
Total other comprehensive income (loss), net of taxes	1,383	(720)
Total comprehensive income (loss)	1,685	(60)
Cumulative effect of accounting change (Note 1)	-	(41)
Balance at end of the period	\$ 11,845	\$ 12,265

See accompanying notes to the unaudited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2008 consolidated financial statements to conform to the 2009 presentation. All material intercompany transactions and balances have been eliminated.

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

Adoption of New Accounting Standards

Effective June 30, 2009, the Company adopted Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 165, *Subsequent Events*, ("SFAS 165"). SFAS 165 establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, SFAS 165 specifies the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize these events or transactions, and the respective required disclosures. See Note 8 for details.

Effective January 1, 2009, the Company adopted FASB Staff Position ("FSP") No. FAS 115-2 and 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, ("FSP FAS 115-2 and 124-2"). FSP FAS 115-2 and 124-2 amended the accounting for other-than-temporary impairment of debt securities, requires the establishment of a policy for determining when "credit losses" exist, and provides guidance on determining the amount of impairment to be recognized in the statement of income. As a result of the adoption, the Company recognized an increase of \$28 (net of tax) to policyholders' unassigned equity and a corresponding decrease to accumulated comprehensive loss.

Effective January 1, 2009, the Company adopted FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, ("FSP FAS 157-4"). FSP FAS 157-4 amended Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ("SFAS 157") to provide additional guidance on whether a market is inactive, and if so, whether a transaction in that market is distressed. The adoption of FSP FAS 157-4 did not have a material impact on the Company's consolidated financial statements.

Effective January 1, 2009, the Company adopted the following accounting pronouncements which had no material impact on the Company's consolidated financial statements:

- SFAS No. 141(R), *Business Combinations*
- SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*
- SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*
- FASB Staff Position FAS 142-3, *Determination of the Useful Life of Intangible Assets*
- Emerging Issues Task Force ("EITF") issue No. 08-6, *Equity Method Investment Accounting Considerations*

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS 115* ("SFAS 159"). The Company has not made any fair value elections under SFAS 159.

Effective January 1, 2008, the Company adopted SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 provides guidance on how to measure fair value when required under existing accounting standards. The Statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value based on the requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, ("SFAS 133") are impacted by the application of SFAS 157. The adoption of SFAS 157 did not have a material effect on the Company's results of operations, financial position or liquidity. See Note 5 for further detail.

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Effective January 1, 2008, the Company adopted EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*, (“EITF 06-4”). This issue provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. The adoption of EITF 06-4 resulted in a decrease to policyholders’ unassigned equity of \$41.

Effective January 1, 2008, the Company adopted EITF issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*, (“EITF 06-10”). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Accounting Principles Board Opinion 12. The adoption of EITF 06-10 had no impact on the Company’s consolidated financial statements.

Future Adoption of New Accounting Standards

In March 2009, the FASB unanimously voted that the FASB Accounting Standards Codification (“the Codification”) be effective July 1, 2009. Codification will result in the Company changing historical references to existing accounting standards to be in line with the new topical format of the codified standards. The implementation of the Codification is not intended to change existing U.S. GAAP and therefore will not impact the Company’s consolidated financial statements.

In December 2008, the FASB issued FSP FAS 132(R)-1, *Employers’ Disclosures about Postretirement Benefit Plan Assets*, (“FSP FAS 132(R)-1”). FSP FAS 132(R)-1 amends Statement of Financial Accounting Standards No. 132 (revised 2003), *Employers’ Disclosures about Pensions and Other Postretirement Benefits*, to expand an employer’s disclosures (similar to the requirements of SFAS 157) about plan assets of a defined benefit pension or other postretirement plan. The Company is required to adopt the disclosure requirements of FSP FAS 132(R)-1 effective for December 31, 2009 year end reporting. The adoption of FSP FAS 132(R)-1 is not expected have a material impact on the Company’s consolidated financial statements.

Accumulated Other Comprehensive Loss

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

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

	June 30, 2009	December 31, 2008
Unrealized losses on securities	\$(191)	\$(1,457)
Foreign currency translation & other adjustments	144	51
Accumulated pension liability adjustments	(1,130)	(1,154)
Cumulative effect of accounting change	(28)	-
Accumulated other comprehensive loss	<u>\$(1,205)</u>	<u>\$(2,560)</u>

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation

On September 22, 2008, the Company, through its subsidiaries, acquired all outstanding shares of common stock of Safeco Corporation for a total purchase price of \$6,244. Preliminary goodwill and intangible assets (excluding acquired in-force policy intangibles) recognized from the transaction was \$3,546. The Company is in the process of finalizing the fair value of the acquired business and related integration efforts; therefore, the allocation of the purchase price is subject to refinement. The results of operations of Safeco Corporation are included in the Company’s financial statements subsequent to September 22, 2008.

Integration Activities

As part of the Safeco Corporation acquisition, management has received board authorization to implement certain integration efforts, principally employee and contract terminations. Changes to the restructuring reserves for the three months ended June 30, 2009 are as follows:

	2009
Balance at March 31, 2009	\$48
Net adjustments to liability	12
Payments applied against liability	(25)
Balance at June 30, 2009	<u>\$35</u>

Indiana Seguros, S.A.

On January 9, 2008, the Company through its Brazilian subsidiary, Liberty International Brazil Ltda., acquired Indiana Seguros, S.A., a writer of auto insurance in Brazil for \$143. Goodwill recognized from the transaction was \$93. The results of operations of Indiana Seguros, S.A. are included in the Company’s financial statements subsequent to January 9, 2008.

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Dispositions

On January 22, 2009, the Company established Liberty Mutual Middle Market, a new market segment in Commercial Markets that combines the Business Market and Wausau Insurance market segments. As part of this change, the Company eliminated its direct distribution channel to its mid-sized commercial lines customers and retired the Wausau brand. Middle Market provides Liberty Mutual products and services exclusively through independent agents and brokers. As part of this change, on February 27, 2009, the Company completed the sale of the policy renewal rights of the existing Business Market and Wausau Insurance policyholders in various portions to three nationally recognized brokerage firms.

(3) REINSURANCE

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a “funds held” basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of \$195 that are amortized into income using the effective interest method over the estimated settlement periods. At June 30, 2009, and December 31, 2008, deferred gains related to these reinsurance arrangements were \$709 and \$725, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three months and six months ended June 30, 2009 was \$29 and \$58, respectively, as compared to \$30 and \$59 for the three months and six months ended June 30, 2008, respectively. Deferred gain amortization for the three months and six months ended June 30, 2009 and 2008 was \$17 and \$33, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were \$2,150 and \$2,165 as of June 30, 2009, and December 31, 2008, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002 renewal, premium and loss activity subsequent to December 31, 2001 is now accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph.

In 2006, the Company entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. (“Mystic Re”), a Cayman Islands domiciled reinsurer, to provide \$525 of additional reinsurance coverage for the Company in the event of a Northeast hurricane. The reinsurance agreements were collateralized through a trust and guarantee received by Mystic Re from the issuance of catastrophe bonds and provided coverage for hurricane-related losses from Washington, D.C. to Maine based on industry insured losses as reported by Property Claim Services. As of December 31, 2008, \$325 of the original \$525 of Mystic Re matured. As of May 31, 2009, the remaining \$200 matured. As no events attached to these issues, the respective collateral was released. Mystic Re does not have any other reinsurance in force.

In 2007, the Company entered into a multi-year property catastrophe reinsurance agreement with Mystic Re II Ltd. (“Mystic Re II”), a Cayman Islands domiciled reinsurer, to provide \$150 of additional reinsurance coverage for the Company in the event of a Northeast and/or Florida hurricane event. In the first quarter of 2009, the Company entered into another agreement with Mystic Re II to provide \$225 of additional reinsurance coverage for the Company in the event of a U.S. hurricane or earthquake event. The reinsurance agreements are collateralized through a trust and guarantee received by Mystic Re II from the issuance of catastrophe bonds and provide coverage for hurricane or earthquake-related losses based on industry insured losses as reported by Property Claim Services. The Company has not recorded any recoveries under these programs. Mystic Re II does not have any other reinsurance in force.

In 2009, the Company entered into Property Catastrophe reinsurance programs for which the Company has received \$219 of collateral. The Company has not recorded any recoveries under these programs.

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(dollars in millions)

(unaudited)

(4) DEBT OUTSTANDING

Debt outstanding at June 30, 2009, and December 31, 2008, includes the following:

Current maturities of long-term debt were \$300 and zero as of June 30, 2009 and December 31, 2008, respectively.

Long-term debt:

	June 30, 2009	December 31, 2008
4.875% Notes, due 2010 ¹	\$ -	\$300
7.25% Notes, due 2012 ¹	204	204
8.00% Notes, due 2013	260	260
7.86% Medium Term Notes, due 2013	25	25
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014 ²	200	200
6.70% Notes, due 2016	250	250
7.00% Subordinated Notes, due 2067 ³	300	300
8.50% Surplus Notes, due 2025	150	150
7.875% Surplus Notes, due 2026	250	250
7.63% Notes, due 2028	3	3
7.00% Notes, due 2034	245	250
6.50% Notes, due 2035	490	500
7.50% Notes, due 2036	477	500
7.80% Subordinated Notes, due 2087 ⁴	700	700
10.75% Subordinated Notes, due 2088 ⁵	1,250	1,250
7.697% Surplus Notes, due 2097	500	500
	5,804	6,142
Unamortized discount	(52)	(53)
Total long-term debt excluding current maturities	\$5,752	\$6,089

¹ Reflects debt originally issued by Safeco. On December 29, 2008, \$281 of the outstanding \$300 4.875% notes due 2010 and \$187 of the outstanding \$204 7.25% notes due 2012 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.

² Reflects debt originally issued by Ohio Casualty. On December 29, 2008, \$180 of the outstanding \$200 7.30% senior notes were exchanged for a like principal amount of newly issued LMGI notes.

³ The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.

⁴ The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

⁵ The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

Short-term debt

On March 11, 2009, Liberty Mutual Insurance Company became a member of the Federal Home Loan Bank of Boston. To date, no funds have been borrowed.

The Company periodically issues commercial paper to meet short-term operating needs. The total facility was \$1,000 at June 30, 2009, and December 31, 2008, and is supported by two credit facilities totaling \$750. There was zero commercial paper issued and outstanding at June 30, 2009, and December 31, 2008.

On September 2, 2008, Liberty Mutual Insurance Company ("LMIC") entered into a \$750 364-day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

On April 5, 2007, LMGI entered into a \$250 3-year unsecured revolving credit facility for general corporate purposes. To date, no funds have been borrowed under the facility.

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a \$20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of June 30, 2009, no borrowings were outstanding under the facility.

Long-term debt

As part of its overall capital strategy, the Company may issue, repurchase or exchange debt depending on market considerations. Debt repurchases, if any, may be done through open market or other appropriate transactions. In June 2009, the Company repurchased \$5 of the 7.00% Notes due 2034, \$10 of the 6.50% Notes due 2035 and \$23 of the 7.50% Notes due 2036. A gain of \$11 was recorded on the transactions and is included in fee and

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other revenues in the Consolidated Statements of Income. The Company continues to periodically repurchase debt securities depending on market conditions subject to applicable limitations.

On December 29, 2008, LMGI exchanged \$281 of the outstanding \$300 Safeco 4.875% Senior Notes due 2010 for a like principal amount of newly issued LMGI 4.875% Senior Notes due 2010. LMGI exchanged \$187 of the outstanding \$204 Safeco 7.25% Senior Notes due 2012 for a like principal amount of newly issued LMGI 7.25% Senior Notes due 2012. LMGI exchanged \$180 of the outstanding \$200 Ohio Casualty 7.30% Senior Notes due 2014 for a like principal amount of newly issued LMGI 7.30% Senior Notes due 2014. The above transactions were not deemed to be substantial modifications to the Safeco and Ohio Casualty Senior Notes. Safeco and Ohio Casualty received and accepted the requisite consents to enable each to execute a supplemental indenture governing the Safeco and Ohio Casualty Senior Notes that remain outstanding. The supplemental indenture eliminated substantially all restrictive covenants and eliminated or modified certain events of default.

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

On May 29, 2008, LMGI issued Series C junior subordinated notes (the "Series C Notes") with a face amount of \$1,250. The Series C Notes are scheduled for redemption on June 15, 2058, with a final maturity of June 15, 2088. LMGI may redeem the Series C Notes in whole or in part, on June 15, 2038, and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or prior to June 15, 2038, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 10.75% up to, but excluding, the final fixed rate interest payment date. In the event the Series C Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 7.12%, payable quarterly in arrears. LMGI has the right to defer interest payments on the Series C Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Series C Notes, LMGI entered into a Replacement Capital Covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, decrease or purchase the Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Notes, and may not be enforced by the holders of the Series C Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036).

(5) SFAS 157 – FAIR VALUE MEASUREMENT

The Company adopted SFAS 157 effective January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 provides guidance on how to measure fair value when required under existing accounting standards. The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value based on the requirements of Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*, are impacted by the application of SFAS 157. The Company has variable annuity contracts containing embedded derivatives that are affected by SFAS 157, but the impact is immaterial.

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The hierarchy requires the use of market observable information when available for assessing fair value. The following table summarizes the Company's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2009, along with a brief description of the valuation technique for each type of asset and liability:

<i>Assets, at Fair Value</i>	Level 1	Level 2	Level 3	Total
Fixed maturities, available for sale	\$1,221	\$50,008	\$965	\$52,194
Equity securities, available for sale	494	428	35	957
Trading securities	-	1	-	1
Short-term investments	22	718	-	740
Other investments	-	56	77	133
Separate account assets	964	1,581	12	2,557
Other assets	9	67	17	93
Total assets	\$2,710	\$52,859	\$1,106	\$56,675
<i>Liabilities, at Fair Value</i>				
Life insurance obligations	\$ -	\$ -	\$165	\$165
Total liabilities	\$ -	\$ -	\$165	\$165

Fixed maturities and short-term investments are recorded at fair value in the Company's financial statements. In instances where there are quoted prices in active markets for identical instruments, as is the case within the US Treasury market, these securities are categorized as Level 1 of the fair value hierarchy. For securities where the fair value of fixed income securities are estimated using recently executed transactions, market price quotations, bond spreads, or models that have inputs from published interest rate yield curves, these securities are generally categorized as Level 2 of the hierarchy. Additionally, in some instances where fixed maturity securities use significant inputs that are unobservable, they are categorized as Level 3 of the hierarchy.

Equity and trading securities are recorded at fair value in the Company's financial statements. The fair value of common stocks are generally based on quoted prices in active markets. As such, common stocks are generally categorized as Level 1 of the fair value hierarchy. The fair value of preferred stocks are generally determined by quoted prices for similar instruments in active markets, hence they are categorized as Level 2 of the fair value hierarchy.

Other investments include primarily international loans, foreign cash deposits and co-investments. International loans and cash deposits are primarily valued using quoted prices for similar instruments in active markets; these assets are categorized as Level 2 of the fair value hierarchy. Co-investments are valued using internal management estimates; they are categorized as Level 3 of the hierarchy. Limited partnership investments, which represent the remainder of the other investment balance on the consolidated balance sheet, are not subject to SFAS 157 and therefore are excluded from the above table.

Separate account assets, which primarily consist of fixed maturity and equity securities, are measured based on the methodologies discussed above. The activity in separate account assets is offset by an equal amount for separate account liabilities, which results in a net zero impact for the Company.

Other assets primarily consist of fixed maturities, short-term investments, and equity securities of captive companies sponsored by the Company. These assets are measured based on the methodology for individual securities as discussed above.

Life insurance obligations include certain variable annuity contracts which contain guaranteed minimum income benefits that under SFAS 133 contain embedded derivatives and are bifurcated from the host contract and carried at fair value. The measurements on these embedded derivatives is computed on a recurring basis using assumptions predominately classified as Level 3 (significant unobservable) inputs. While some inputs are observable in the market such as risk free rates, volatility and historical equity returns, the underlying future policyholder behavior inputs are highly unobservable. These assumptions include mortality, lapse, and the underlying take-up rate with regard to annuitization.

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The following table sets forth the fair values of assets on a recurring basis classified as Level 3 within the fair value hierarchy:

	Balance January 1, 2009	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer in and/ or out of Level 3	Balance June 30, 2009
Fixed maturities	\$897	\$(2)	\$24	\$86	\$(40)	\$965
Equity securities	110	(4)	9	-	(80)	35
Short-term investments	73	-	-	(73)	-	-
Other investments	62	(4)	1	18	-	77
Separate account assets	2	-	-	-	10	12
Other assets	27	(12)	-	2	-	17
Total assets	\$1,171	\$(22)	\$34	\$33	\$(110)	\$1,106
Life insurance obligations	\$223	\$(33)	\$-	\$(25)	\$-	\$165
Total liabilities	\$223	\$(33)	\$-	\$(25)	\$-	\$165

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held at June 30, 2009.

For the six months ended June 30, 2009, there were impairments of \$10 recognized for items measured at fair value on a nonrecurring basis.

(6) BENEFIT PLANS

The net benefit costs for the three months ended June 30, 2009, and 2008, include the following components:

Three months ended June 30,	Pension Benefits		Supplemental * Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit costs						
Service costs	\$ 48	\$ 35	\$ 3	\$ 3	\$ 7	\$ 6
Interest costs	68	61	5	4	12	9
Expected return on plan assets	(61)	(64)	-	-	-	(1)
Amortization of unrecognized:						
Net loss	14	3	3	1	1	(1)
Prior service cost	1	1	-	-	-	-
Net transition (assets)/obligation	(1)	(1)	-	-	2	2
Net periodic benefit costs	\$ 69	\$ 35	\$ 11	\$ 8	\$ 22	\$ 15

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

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

The net benefit costs for the six months ended June 30, 2009, and 2008, include the following components:

Six months ended June 30,	Pension Benefits		Supplemental * Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit costs						
Service costs	\$ 99	\$ 70	\$ 6	\$ 5	\$ 14	\$ 11
Interest costs	135	120	10	8	24	19
Expected return on plan assets	(123)	(130)	-	-	-	(1)
Amortization of unrecognized:						
Net loss	27	5	5	2	1	(1)
Prior service cost	3	3	1	1	(1)	(1)
Net transition (assets)/obligation	(3)	(3)	-	-	4	4
Net periodic benefit costs	\$ 138	\$ 65	\$ 22	\$ 16	\$ 42	\$ 31

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

(7) COMMITMENTS AND CONTINGENT LIABILITIES

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

The Company has been in various insurance coverage disputes with Armstrong World Industries (“Armstrong”) for over twenty years relating to asbestos liabilities and insurance covering the period of 1973 to 1981. In July 2004, the Company prevailed in a favorable arbitration ruling before an appellate panel regarding Armstrong's available insurance coverage. Armstrong has filed, in the United States District Court for the Eastern District of Pennsylvania, a motion to vacate the 2004 appellate arbitration award that was favorable to the Company. The Company has filed a cross-motion seeking to confirm the award. Both motions have been briefed and remain pending at this time. Armstrong also filed a Chapter 11 Bankruptcy petition in the United States Bankruptcy Court for the District of Delaware in December 2000. A plan of reorganization was confirmed in August 2006, and Armstrong formally emerged from bankruptcy as of October 2, 2006. A declaratory judgment action, filed against the Company by Armstrong in 2002, is also pending in the United States District Court for the Eastern District of Pennsylvania. In that action, Armstrong is seeking coverage for asbestos claims under insurance policies issued to it during the period of 1977 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability, and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania coverage action is currently in the initial discovery stages after being reactivated at a Rule 16 Scheduling Conference on October 22, 2007. In June 2008, a separate action was filed against Liberty Mutual in Cook County, Illinois, in which a number of plaintiffs seek to have Liberty Mutual pay the balance of their pre-bankruptcy Armstrong settlements. The Armstrong Asbestos Bodily Injury Trust (the “Trust”) subsequently intervened in this Illinois state court action, asserting a number of the same claims as are at issue in the Pennsylvania Coverage Action. The Company intends to vigorously defend its position in all pending coverage litigation, including any argument that coverage issues were finally determined in the bankruptcy proceedings. Management believes that if the various litigations proceed, the ultimate liability, if any, to Armstrong will not be resolved for at least one year and may possibly not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and an adverse outcome could have a material adverse effect on the Company's business, financial condition, and results of operations.

As of June 30, 2009, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of \$1,033, \$401, and \$448, respectively. As of June 30, 2009, the Company had commitments to purchase various residential mortgage-backed securities at a cost of \$847 (fair value of \$849) and various corporate and municipal securities at a cost of \$276 (fair value of \$279).

(8) SUBSEQUENT EVENTS

Management has assessed and concluded that there were no material subsequent events through July 28, 2009, the date of the second quarter 2009 earnings release.