

**Liberty Mutual Holding Company Inc.**

**Third Quarter 2007**

**Consolidated Financial Statements**

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

|   | Three Months Ended<br>Sept 30, |          | Nine Months Ended<br>Sept 30, |           |
|---|--------------------------------|----------|-------------------------------|-----------|
|   | 2007                           | 2006     | 2007                          | 2006      |
| <b>Revenues</b>                                   |                                |          |                               |           |
| Premiums earned                                   | \$ 5,596                       | \$ 4,921 | \$ 16,163                     | \$ 14,767 |
| Net investment income                             | 759                            | 664      | 2,142                         | 1,858     |
| Fee and other revenues                            | 215                            | 187      | 578                           | 576       |
| Net realized investment gains                     | 19                             | 242      | 144                           | 311       |
| Total revenues                                    | 6,589                          | 6,014    | 19,027                        | 17,512    |
| <b>Claims, Benefits and Expenses</b>              |                                |          |                               |           |
| Benefits, claims and claim adjustment expenses    | 4,121                          | 3,548    | 11,953                        | 11,015    |
| Insurance operating costs and expenses            | 930                            | 829      | 2,713                         | 2,421     |
| Amortization of deferred policy acquisition costs | 860                            | 738      | 2,443                         | 2,102     |
| Other expenses                                    | 137                            | 105      | 379                           | 293       |
| Total claims, benefits and expenses               | 6,048                          | 5,220    | 17,488                        | 15,831    |
| Income before income tax expense                  | 541                            | 794      | 1,539                         | 1,681     |
| Federal and foreign income tax expense            | 137                            | 238      | 446                           | 510       |
| Net income  | \$ 404                         | \$ 556   | \$ 1,093                      | \$ 1,171  |

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

|   | September 30,<br>2007 | December 31,<br>2006 |
|---|-----------------------|----------------------|
| <b>Assets:</b>  |                       |                      |
| Investments   |                       |                      |
| Fixed maturities, available for sale, at fair value (amortized cost of \$45,795 and \$40,981) | \$ 45,447             | \$ 41,102            |
| Equity securities, available for sale, at fair value (cost of \$2,648 and \$1,664)            | 3,757                 | 2,619                |
| Trading securities, at fair value (cost of \$15 and \$14)                                     | 16                    | 22                   |
| Other investments   | 2,125                 | 1,646                |
| Short-term investments  | 744                   | 1,550                |
| Mortgage loans  | 559                   | 322                  |
| Total investments   | 52,648                | 47,261               |
| Cash and cash equivalents   | 3,892                 | 3,512                |
| Premium and other receivables (net of allowance of \$103 and \$101)                           | 6,933                 | 6,075                |
| Reinsurance recoverables (net of allowance of \$317 and \$315)                                | 15,625                | 15,564               |
| Deferred income taxes (net of valuation allowance of \$109 and \$101)                         | 1,354                 | 1,490                |
| Deferred acquisition costs and acquired in-force policy intangibles                           | 1,979                 | 1,662                |
| Goodwill and intangible assets  | 2,357                 | 907                  |
| Prepaid reinsurance premiums  | 1,339                 | 1,230                |
| Property, plant and equipment, net  | 1,763                 | 1,660                |
| Other assets  | 3,374                 | 3,088                |
| Separate account assets   | 3,176                 | 3,049                |
| Total assets  | \$ 94,440             | \$ 85,498            |
| <b>Liabilities:</b>   |                       |                      |
| Unpaid claims and claim adjustment expenses and future policy benefits:                       |                       |                      |
| Property and casualty   | \$ 42,758             | \$ 38,606            |
| Life  | 5,960                 | 5,591                |
| Other policyholder funds and benefits payable   | 2,769                 | 2,658                |
| Unearned premiums   | 10,968                | 9,343                |
| Funds held under reinsurance treaties   | 1,919                 | 1,823                |
| Short-term debt   | 896                   | 171                  |
| Long-term debt  | 4,379                 | 3,175                |
| Other liabilities   | 9,560                 | 10,187               |
| Separate account liabilities  | 3,176                 | 3,049                |
| Total liabilities   | 82,385                | 74,603               |
| <b>Policyholders' equity:</b>   |                       |                      |
| Unassigned equity   | 11,196                | 10,092               |
| Accumulated other comprehensive income  | 859                   | 803                  |
| Total policyholders' equity   | 12,055                | 10,895               |
| Total liabilities and policyholders' equity   | \$ 94,440             | \$ 85,498            |

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)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2007                               | 2006      |
| Balance at beginning of the period                    | \$ 10,895                          | \$ 8,858  |
| Net income  | 1,093                              | 1,171     |
| Other comprehensive income (loss), net of taxes:      |                                    |           |
| Unrealized losses on securities                       | (217)                              | (94)      |
| Foreign currency translation and other adjustments    | 273                                | 71        |
| Total other comprehensive income (loss), net of taxes | 56                                 | (23)      |
| Total comprehensive income                            | 1,149                              | 1,148     |
| Cummulative effect of accounting change (Note 1)      | 11                                 | -         |
| Balance at end of the period                          | \$ 12,055                          | \$ 10,006 |

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(Unaudited)

|   | Nine Months Ended September 30, |                |
|---|---------------------------------|----------------|
|   | 2007                            | 2006           |
|   | <u>2007</u>                     | <u>2006</u>    |
| <b>Cash flows from operating activities:</b>                                      |                                 |                |
| Net income  | \$ 1,093                        | 1,171          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |                |
| Depreciation and amortization   | 147                             | 157            |
| Realized investment gains   | (144)                           | (311)          |
| Undistributed private equity investment gains                                     | (263)                           | (194)          |
| Premium, other receivables, and reinsurance recoverables                          | 178                             | (70)           |
| Deferred policy acquisition costs   | (281)                           | (157)          |
| Liabilities for insurance reserves  | 2,247                           | 2,226          |
| Taxes payable, net of deferred  | (16)                            | 74             |
| Other, net  | (34)                            | (38)           |
| Total adjustments   | <u>1,834</u>                    | <u>1,687</u>   |
| Net cash provided by operating activities   | <u>2,927</u>                    | <u>2,858</u>   |
| <b>Cash flows from investing activities:</b>                                      |                                 |                |
| Purchases of investments  | (15,729)                        | (15,089)       |
| Sales and maturities of investments   | 15,156                          | 11,872         |
| Property and equipment purchased, net   | (198)                           | (652)          |
| Payment for purchase of companies, net of cash acquired                           | (2,695)                         | (45)           |
| Other investing activities  | (263)                           | 184            |
| Net cash used in investing activities   | <u>(3,729)</u>                  | <u>(3,730)</u> |
| <b>Cash flows from financing activities:</b>                                      |                                 |                |
| Net activity in policyholder accounts   | 19                              | 48             |
| Debt financing, net   | 1,713                           | 635            |
| Net security lending activity and other financing activities                      | (550)                           | 463            |
| Net cash provided by financing activities   | <u>1,182</u>                    | <u>1,146</u>   |
| Net increase in cash and cash equivalents   | 380                             | 274            |
| Cash and cash equivalents, beginning of period                                    | <u>3,512</u>                    | <u>3,155</u>   |
| Cash and cash equivalents, end of period  | <u>\$ 3,892</u>                 | <u>3,429</u>   |

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 2006 consolidated financial statements to conform with the 2007 presentation. All material intercompany transactions and balances have been eliminated.

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

#### Adoption of New Accounting Standards

In June 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*" ("FIN 48"). FIN 48 requires companies to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The amount recognized is the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability is recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty (if applicable) on the excess. FIN 48 requires a tabular reconciliation of the change in the aggregate unrecognized tax benefits claimed, or expected to be claimed, in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Discussion is also required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next 12 months. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption, the Company recognized a decrease of approximately \$11 in the liability for unrecognized tax benefits, which was accounted for as an increase to retained earnings.

As of the date of adoption of FIN 48, the total amount of unrecognized tax benefits was approximately \$107, including approximately \$85 related to tax positions that would impact the annual effective rate. The Company recognizes interest and penalties related to unrecognized tax benefits in Federal and foreign income tax expense and had approximately \$39 accrued as of January 1, 2007. The Company does not expect any material changes to the unrecognized benefits within 12 months of the reporting date.

The IRS is currently reviewing the Company's federal tax returns for the 1999 through 2005 tax years. Any adjustments that might result from the IRS examination of these income tax returns are not expected to have a material impact on the financial position, liquidity or results of operations of the Company.

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position No. 05-1, "*Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*" ("SOP 05-1"). This SOP provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB Statement No. 97, "*Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*" ("FAS 97"). As defined by the SOP, an internal replacement is a modification in product benefits, features, rights, or coverage that occurs by exchange of a contract for a new contract, or by amendment, endorsement, rider, or by election of a feature or coverage within an existing contract. The Company adopted SOP 05-1 on January 1, 2007. The adoption of SOP 05-1 did not have a material impact to the Company's consolidated financial statements.

In February 2006, the FASB released Statement of Financial Accounting Standards No. 155, "*Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140*" ("SFAS 155"). SFAS 155 nullifies the guidance in the FASB's Derivatives Implementation Group Issue D1 "*Application of Statement 133 to Beneficial Interests in Securitizated Assets*", which had deferred the bifurcation requirements of Statement of Financial Accounting Standards No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" ("SFAS 133"), for certain beneficial interests in securitized financial assets. SFAS 155 requires beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or hybrid instruments that contain an embedded derivative requiring bifurcation. SFAS 155 is effective for all financial instruments acquired, issued or subject to a re-measurement (new basis) event occurring after the beginning of an entity's fiscal year that begins after September 15, 2006. In January 2007, the FASB issued Derivative Implementation Group Issue No. B40, "*Embedded Derivatives: Application of Paragraph 13(b) to Securitizated Interests in Prepayable Financial Assets*" ("DIG B40"). DIG B40 provided limited exemption from bifurcation of embedded derivatives as required by paragraph 13(b) of SFAS 133. The Company adopted SFAS 155 on January 1, 2007. Management has concluded the exemption applies for the Company's investment in its mortgage backed securities and as a result, adoption of SFAS 155 did not have a material impact to the Company's consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

**Future Adoption of New Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). This statement 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 reporting entity's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Quantitative and qualitative disclosures will focus on the inputs used to measure fair value for both recurring and non-recurring fair value measurements and the effects of the measurements in the financial statements. The Company is required to adopt SFAS 157 effective January 1, 2008. The Company is in the process of evaluating the impact of adoption.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS 158"). This statement requires an entity to: (a) recognize an asset for the funded status of defined benefit plans that are over-funded and a liability for plans that are under-funded, measured as of the employer's fiscal year end; and (b) recognize changes in the funded status of defined benefit plans, other than for the net periodic benefit cost included in net income, in accumulated other comprehensive income. For pension plans the funded status must be based on the projected benefit obligation, which includes an assumption for future salary increases. For postretirement plans the funded status is based on the accumulated postretirement benefit obligation. The Company is required to adopt SFAS 158 effective December 31, 2007. The actual impact to the Company will depend on the discount rate, other valuation assumptions, and the actual value of plan assets as of December 31, 2007. The impact is expected to be less than 5% of equity.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS 115" ("SFAS 159"). SFAS 159 permits all entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date eliminating complex hedge accounting provisions. The decision about whether to elect the fair value option is applied on an instrument by instrument basis and is irrevocable unless a new election date occurs and is applied only to an entire instrument. SFAS 159 also provides guidance on disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company January 1, 2008. The Company is in the process of evaluating the impact of adoption.

In September 2006, the Emerging Issues Task Force (EITF) released, issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Opinion 12. EITF 06-4 is effective for the Company for fiscal years beginning after December 15, 2007. The Company is in the process of evaluating the impact of adoption but it is not expected to be material.

**Accumulated Other Comprehensive Income**

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

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

|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| Unrealized gains on securities                   | \$427                 | \$644                |
| Foreign currency translation & other adjustments | 452                   | 179                  |
| Minimum pension liability                        | (20)                  | (20)                 |
| Accumulated other comprehensive income           | <u>\$859</u>          | <u>\$803</u>         |

**(2) ACQUISITIONS AND GOODWILL**

On August 24, 2007, the Company, through its subsidiaries, acquired all outstanding shares of common stock of Ohio Casualty Corporation ("Ohio Casualty") for \$2,777. Preliminary goodwill and intangible assets (including acquired in-force policy intangibles) recognized from the transaction was \$1,544. The Company is in the process of finalizing the fair value of the acquired business and related restructuring efforts, therefore, the allocation of the purchase price is subject to refinement. The results of operations of Ohio Casualty are included in the Company's financial statements subsequent to August 24, 2007.

## LIBERTY MUTUAL HOLDING COMPANY INC.

### Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

On September 5, 2006, and during the course of the fourth quarter of 2006, the Company, through its Spanish subsidiary, Liberty Seguros Compania de Seguros y Reaseguros S.A. ("Liberty Seguros"), acquired 90.425% of Şeker Sigorta A.Ş., a mid-sized insurer located in Istanbul, Turkey. Goodwill recognized from the transaction was \$78. The results of operations for the acquired business, which are not material, are included in the financial statements subsequent to September 2006.

### (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 September 30, 2007, and December 31, 2006, deferred gains related to these reinsurance arrangements were \$805 and \$839, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three months and nine months ended September 30, 2007, was \$29 and \$86, respectively, as compared to \$27 and \$80, for the three months and nine months ended September 30, 2006, respectively. Deferred gain amortization for the three months and nine months ended September 30, 2007, was \$16 and \$45, respectively, as compared to \$15 and \$45 for the three months and nine months ended September 30, 2006, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were \$2,242 and \$2,258 as of September 30, 2007, and December 31, 2006, 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, Liberty Mutual Insurance Company ("LMIC") 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 LMIC and its affiliates in the event of a Northeast hurricane. The reinsurance agreements are fully collateralized by proceeds received by Mystic Re from the issuance of catastrophe bonds and provide coverage for hurricane-related losses from Washington, D.C., to Maine based on industry-insured losses as reported by Property Claim Services. In 2007, LMIC supplemented this reinsurance in a similar transaction with Mystic Re II Ltd. ("Mystic Re II") a Cayman Islands domiciled reinsurer, to provide \$150 of additional reinsurance coverage for LMIC and its affiliates in the event of a Northeast and/or Florida hurricane event. The Company has not recorded any recoveries under these programs. Neither Mystic Re nor Mystic Re II has any other reinsurance in force.



**LIBERTY MUTUAL HOLDING COMPANY INC.**

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

**(4) DEBT OUTSTANDING**

Debt outstanding at September 30, 2007, and December 31, 2006, includes the following:

Short-term debt:

|                                      | <b>2007</b> | <b>2006</b> |
|--------------------------------------|-------------|-------------|
| Commercial paper                     | \$ -        | \$ -        |
| Revolving credit facilities          | 894         | 50          |
| Current maturities of long-term debt | 2           | 121         |
| Total short-term debt                | \$896       | \$171       |

Long-term debt:

|  | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
| 6.75% Notes, due 2008                                    | \$ 15       | \$ 15       |
| 5.00% Notes, due 2008                                    | 4           | 4           |
| 8.00% Notes, due 2013                                    | 260         | 260         |
| 5.75% Notes, due 2014                                    | 500         | 500         |
| 7.30% Notes, due 2014 <sup>1</sup>                       | 200         | -           |
| 6.70% Notes, due 2016                                    | 250         | 250         |
| 7.00% Subordinated Notes, due 2067 <sup>2</sup>          | 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                                    | 250         | 250         |
| 6.50% Notes, due 2035                                    | 500         | 500         |
| 7.50% Notes, due 2036                                    | 500         | 500         |
| 7.80% Subordinated Notes, due 2087 <sup>3</sup>          | 700         | -           |
| 7.697% Surplus Notes, due 2097                           | 500         | 500         |
| 7.10% - 7.86% Medium Term Notes, with various maturities | 25          | 27          |
|  | 4,407       | 3,209       |
| Unamortized discount <sup>4</sup>                        | (28)        | (34)        |
| Total long-term debt excluding current maturities        | \$4,379     | \$3,175     |

<sup>1</sup> Assumed as part of Ohio Casualty acquisition on August 24, 2007.

<sup>2</sup> The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements (see discussion in Liquidity and Capital Resources section in the MD&A).

<sup>3</sup> The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements (see discussion in Liquidity and Capital Resources section in the MD&A).

<sup>4</sup> Reflects purchase accounting adjustment of \$8 related to the \$200 Ohio Casualty Notes due in 2014.

**Short-term Debt**

The Company issues commercial paper to meet short-term operating needs. The total facility was \$1,000 at September 30, 2007, and \$600 at December 31, 2006, and is supported by a \$750 line of credit facility. On June 25, 2007, Liberty Mutual Group Inc. ("LMGI") increased its commercial paper program, guaranteed by LMIC, from \$600 to \$1,000. Commercial paper issued and outstanding at September 30, 2007, and December 31, 2006, was \$0.

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

On May 4, 2007, LMIC redeemed its \$121 8.20% Surplus Note at maturity.

On June 15, 2007, LMIC and certain insurance affiliates entered into a \$1,250 short-term revolving credit facility, guaranteed by LMIC, to facilitate the pending acquisition of Ohio Casualty. Funds outstanding under the facility at September 30, 2007 were \$830.

The Company's Venezuelan subsidiary, Inversora Segucar, C.A., entered into a \$90 million revolving credit facility to provide liquidity for working capital purposes. Inversora Segucar also has short-term loans outstanding. As of September 30, 2007, total short-term loans and borrowings under the Venezuelan credit facility were approximately \$64 million.

**LIBERTY MUTUAL HOLDING COMPANY INC.**

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

**Long-term Debt**

On August 24, 2007, the Company assumed \$200 of 7.30% Notes due 2014 as a result of the Ohio Casualty acquisition (the "Notes"). The fair value of the Notes as established as a result of Ohio Casualty purchase accounting is \$208 and is reflected in the Consolidated Balance Sheets.

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 March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of \$1,000, consisting of \$700 Series A junior subordinated notes (the "Series A Notes") and \$300 Series B junior subordinated notes (the "Series B Notes"). The Notes are scheduled for redemption on March 15, 2037; the final maturity of the Series A Notes is March 7, 2087; and the final maturity of the Series B Notes is March 7, 2067. LMGI may redeem (a) the Series B Notes in whole or in part, on March 15, 2017, and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or (b) prior to March 15, 2037, for the Series A Notes or March 15, 2017, for the Series B Notes, (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 7.800% for the Series A Notes and 7.000% for the Series B Notes up to, but excluding, the final fixed rate interest payment date. In the event the 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 3.576% for the Series A Notes and three-month LIBOR plus 2.905% for the Series B Notes, payable quarterly in arrears. LMGI has the right to defer interest payments on the Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Notes, LMGI entered into a Replacement Capital Covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, defease 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 A Notes or the Series B 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) BENEFIT PLANS**

The net benefit costs for the three months ended September 30, 2007, and 2006, include the following components:

| Three months ended September 30,         | Supplemental *   |      |                  |      |                         |      |
|--|------------------|------|------------------|------|-------------------------|------|
|  | Pension Benefits |      | Pension Benefits |      | Postretirement Benefits |      |
|  | 2007             | 2006 | 2007             | 2006 | 2007                    | 2006 |
| Components of net periodic benefit costs |                  |      |                  |      |                         |      |
| Service costs                            | \$36             | \$37 | \$2              | \$2  | \$5                     | \$4  |
| Interest costs                           | 53               | 45   | 4                | 3    | 7                       | 6    |
| Expected return on plan assets           | (56)             | (50) | -                | -    | -                       | -    |
| Amortization of unrecognized:            |                  |      |                  |      |                         |      |
| Net loss                                 | 9                | 16   | 1                | 2    | (1)                     | (1)  |
| Prior service cost                       | 2                | -    | 1                | 1    | -                       | -    |
| Net transition (assets)/obligation       | (2)              | (1)  | -                | -    | 3                       | 3    |
| Net periodic benefit costs               | \$42             | \$47 | \$8              | \$8  | \$14                    | \$12 |

**LIBERTY MUTUAL HOLDING COMPANY INC.**

Notes to Consolidated Financial Statements

(dollars in millions)

(unaudited)

The net benefit costs for the nine months ended September 30, 2007, and 2006, include the following components:

| Nine months ended September 30,          | Supplemental *   |       |                  |      |                         |      |
|--|------------------|-------|------------------|------|-------------------------|------|
|  | Pension Benefits |       | Pension Benefits |      | Postretirement Benefits |      |
|  | 2007             | 2006  | 2007             | 2006 | 2007                    | 2006 |
| Components of net periodic benefit costs |                  |       |                  |      |                         |      |
| Service costs                            | \$106            | \$113 | \$6              | \$7  | \$14                    | \$14 |
| Interest costs                           | 151              | 136   | 10               | 10   | 22                      | 20   |
| Expected return on plan assets           | (165)            | (148) | -                | -    | (1)                     | (1)  |
| Amortization of unrecognized:            |                  |       |                  |      |                         |      |
| Net loss                                 | 27               | 44    | 3                | 6    | -                       | -    |
| Prior service cost                       | 3                | 1     | 2                | 2    | (2)                     | (2)  |
| Net transition (assets)/obligation       | (5)              | (4)   | -                | -    | 7                       | 7    |
| Net periodic benefit costs               | \$117            | \$142 | \$21             | \$25 | \$40                    | \$38 |

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

The 2007 benefit costs include provisions for the Ohio Casualty benefit plans assumed on August 24, 2007.

**(6) 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 1973 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability, and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania coverage action is currently in the initial pleading stages and, while it has been inactive by agreement of the parties since 2002, the court recently reactivated the case at a Rule 16 Scheduling Conference on October 22, 2007.

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 the ultimate liability, if any, to Armstrong will not be resolved for at least one year and very likely may not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and an adverse outcome could have a material adverse effect on the Company's business, financial condition, and results of operations.

As of September 30, 2007, the Company had unfunded commitments in traditional private equity partnerships, real estate partnerships, energy, and commercial mortgage loans of \$869, \$392, \$499, and \$83, respectively. As of September 30, 2007, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair market value of \$50 and various corporate and municipal securities at a cost and fair market value of \$63.