Management's Discussion & Analysis of
Financial Condition and Results of Operations

Quarter Ended September 30, 2007

Management's Discussion & Analysis of Financial Condition and Results of Operations

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three and nine months ended September 30, 2007 and 2006. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2006 Annual Report, Third Quarter 2007 Consolidated Financial Statements (unaudited), Third Quarter 2007 Financial Supplement and First and Second Quarter MD&A, located on the Company's Investor Relations website at www.libertymutual.com/investors. The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

Index

Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements that are intended to enhance the reader's ability to assess the Company's future financial and business performance. Forward-looking statements include, but are not limited to, statements that represent the Company's beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "may," "expects," "should," "believes," "anticipates," "estimates," "intends" or similar expressions. Because these forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond the Company's control or are subject to change, actual results could be materially different.

In particular, the sufficiency of the Company's reserves for (i) asbestos, (ii) environmental ((i) and (ii) together "A&E"), and (iii) toxic tort (i.e., claims that arise primarily from exposure to chemical or other hazardous substances, including welding rod and silica related claims), as well as its results of operations, financial condition and liquidity, to the extent impacted by the sufficiency of the Company's A&E and toxic tort reserves, are subject to a number of potential adverse developments including adverse developments involving A&E and toxic tort claims and the related level and outcome of litigation, the willingness of parties, including the Company, to settle disputes, the interpretation of aggregate policy coverage limits, the Company's ability to recover reinsurance for A&E, toxic tort and other claims, the legal, economic, regulatory, and legislative environments, and their impact on the future development of A&E and toxic tort claims, and the impact of bankruptcies of various asbestos producers and related peripheral businesses.

Some of the other factors that could cause actual results to differ include, but are not limited to, the following: the Company's inability to obtain price increases due to competition or otherwise; the performance of the Company's investment portfolios, which could be adversely impacted by unanticipated developments in U.S. and global financial markets, interest rates and rates of inflation; weakening U.S. and global economic conditions; insufficiency of, or changes in, loss reserves; the occurrence of catastrophic events, both natural and man-made, including terrorist acts, with a severity or frequency exceeding the Company's expectations; exposure to, and adverse developments involving, environmental claims and related litigation; the impact of claims related to exposure to potentially harmful products or substances, including, but not limited to, lead paint, silica and other potentially harmful substances; adverse changes in loss cost trends, including inflationary pressures in medical costs and auto and home repair costs; developments relating to coverage and liability for mold claims; the effects of corporate bankruptcies on surety bond claims; adverse developments in the cost, availability and/or ability to collect reinsurance; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the recent acquisition of Ohio Casualty Corporation and its subsidiaries, in accordance with its business strategy; the ability of the Company's subsidiaries to pay dividends to the Company; adverse results or other consequences from legal proceedings; the impact of regulatory investigations or reforms, including governmental actions regarding the compensation of brokers and agents and the purchase and sale of nontraditional products and related disclosures; unusual loss activity resulting from adverse weather conditions, including storms, hurricanes, hail, snowfall and winter conditions; repatriation of foreign earnings; judicial expansion of policy coverage and the impact of new theories of liability; the impact of legislative actions, including Federal and state legislation related to asbestos liability reform; larger than expected assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings; the loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of Personal Lines policies; and amendments and changes to the risk-based capital requirements. The Company's forward-looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs. For a detailed discussion of these and other cautionary statements, visit the Company's Investor Relations web site at www.libertymutual.com/investors. The Company undertakes no obligation to update these forward-looking statements.

EXECUTIVE SUMMARY

The following highlights do not address all of the matters covered in the other sections of Management's Discussion & Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to the investing public. This summary should be read in conjunction with the other sections of Management's Discussion & Analysis of Financial Condition and Results of Operations and the Company's unaudited financial statements.

Three Months Ended September 30, 2007 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2007 were $6.589 billion, an increase of $575 million over the same period in 2006.
- Net written premium for the three months ended September 30, 2007 was $5.795 billion, an increase of $636 million over the same period in 2006.
- Net investment income for the three months ended September 30, 2007 was $759 million, an increase of $95 million over the same period in 2006.
- Net operating income[1] for the three months ended September 30, 2007 was $390 million, an increase of $3 million over the same period in 2006. Results in the period reflect a $67 million after-tax increase in asbestos reserves related to the completion of the Company's comprehensive ground-up study.
- Cash flow from operations for the three months ended September 30, 2007 was $1.131 billion, a decrease of $103 million from the same period in 2006.
- The combined ratio before catastrophes[2] and net incurred losses attributable to prior years[3] for the three months ended September 30, 2007 was 98.7%, an increase of 3.5 points over the same period in 2006. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the three months ended September 30, 2007 increased 1.0 point to 99.0%.

Nine Months Ended September 30, 2007 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2007 were $19.027 billion, an increase of $1.515 billion over the same period in 2006.
- Net written premium for the nine months ended September 30, 2007 was $16.959 billion, an increase of $1.146 billion over the same period in 2006.
- Net investment income for the nine months ended September 30, 2007 was $2.142 billion, an increase of $284 million over the same period in 2006.

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[1] Net operating income is a non-GAAP financial measure defined by the Company as net income excluding after-tax realized investment gains and losses.

[2] Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[3] Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years (excluding prior year losses related to natural catastrophes and the events of September 11, 2001) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains.

- Net operating income for the nine months ended September 30, 2007 was $991 million, an increase of $37 million over the same period in 2006. Results in the period include a $67 million after-tax increase in asbestos reserves related to the completion of the Company's comprehensive ground-up study.

- Cash flow from operations for the nine months ended September 30, 2007 was $2.927 billion, an increase of $69 million over the same period in 2006.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2007 was 98.1%, an increase of 2.4 points over the same period in 2006. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the nine months ended September 30, 2007 increased 0.4 points to 100.1%.

Financial Condition as of September 30, 2007

- Total assets were $94.440 billion as of September 30, 2007, an increase of $8.942 billion over December 31, 2006. The increase is primarily due to the acquisition of Ohio Casualty,

- Policyholders' equity was $12.055 billion as of September 30, 2007, an increase of $1.160 billion over December 31, 2006.

- Statutory surplus as regards policyholders for the combined operations of Liberty Mutual Insurance Company ("LMIC") and its U.S. affiliates was $13.641 billion as of September 30, 2007, an increase of $1.510 billion over December 31, 2006.

Other 2007 3rd Quarter Highlights

Acquisitions and New Markets

- On August 24, 2007, the Company, through its subsidiaries, acquired all outstanding shares of common stock of Ohio Casualty Corporation ("Ohio Casualty") for approximately $2.8 billion. The results of operations of Ohio Casualty are included in the Company's financial statements subsequent to August 24, 2007.

- On September 17, 2007 the Company, through a branch of its Spanish subsidiary Liberty Seguros Compania de Seguros y Reaseguros S.A., began selling private passenger automobile insurance in Poland.

- On October 10, 2007, the Company through its Brazilian subsidiary, Liberty International Brasil Ltda., signed an agreement to buy 100% of Indiana Seguros, S.A. The acquisition is subject to regulatory approval and is expected to close in the fourth quarter of 2007.

Changes in Debt / Credit Facilities

- In the third quarter of 2007, the Company borrowed $1 billion of funds under the $1.25 billion short-term revolving credit facility established on June 15, 2007 to facilitate the acquisition of Ohio Casualty. As of September 30, 2007, $830 million was outstanding.

Asbestos Update

- In the third quarter of 2007, the Company completed its comprehensive biennial ground-up asbestos reserve study and increased its asbestos reserves by $95 million, which reflects management's best estimate of the reserve requirement. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. In addition, an internationally known actuarial consulting firm performed its own independent review of the Company's asbestos reserves and confirmed the reasonableness of the reserve increase.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI"), net operating income ("NOI") and net written premium as non-GAAP financial measures. PTOI is defined by the Company as pre-tax income excluding net realized gains (losses), extraordinary items, discontinued operations and cumulative effects of changes in accounting principles. NOI is defined by the Company as net income excluding after-tax realized gains and losses. PTOI and NOI are considered by the Company to be appropriate indicators of underwriting and operating results and are consistent with the way the Company internally evaluates performance, except that limited partnership results recognized on the equity method are not included in internal PTOI or NOI. Net realized investment gains (losses) are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results. Federal and foreign income taxes are significantly impacted by permanent differences and valuation allowances. References to "direct written premium" represent the amount of premium recorded for policies issued during a fiscal period excluding assumed reinsurance and ignoring the effects of ceded reinsurance. References to "net written premium" represent the amount of premium recorded for policies issued during a fiscal period including audits, retrospectively rated premium related to loss sensitive policies, and assumed premium, less ceded premium. Assumed and ceded reinsurance premiums include premium adjustments for reinstatement of coverage when a loss has used some portion of the reinsurance provided, generally under catastrophe treaties ("reinstatement premium"). In addition, the majority of workers compensation premium is adjusted to the "booked as billed" method through the Corporate & Other segment. "Premium earned," which is the portion of premium that applies to the expired part of the policy period, is a GAAP measure. The Company believes that net written premium is a performance measure useful to investors as it generally reflects current trends in the Company's sale of its insurance products.

The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

Overview – Consolidated

Consolidated net written premium (NWP) by significant line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Private passenger automobile	$1,663	$1,499	10.9%	$4,701	$4,269	10.1%
Workers compensation	1,139	1,156	(1.5)	3,743	3,609	3.7
Homeowners	573	507	13.0	1,469	1,324	11.0
Commercial multiple peril / Fire	449	408	10.0	1,253	1,184	5.8
International local businesses[1]	286	272	5.1	965	827	16.7
Commercial automobile	322	296	8.8	885	853	3.8
LIU[2] reinsurance	296	159	86.2	877	846	3.7
General liability	239	211	13.3	705	642	9.8
LIU inland marine program[3]	160	70	128.6	424	199	113.1
LIU third party	148	106	39.6	411	338	21.6
Group disability and life	116	99	17.2	349	297	17.5
Surety	84	66	27.3	228	188	21.3
LIU first party[3]	80	62	29.0	227	209	8.6
Individual life	61	76	(19.7)	205	580	(64.7)
Assumed voluntary reinsurance	24	42	(42.9)	83	88	(5.7)
Other	155	130	19.2	434	360	20.6
Total net written premium[4]	$5,795	$5,159	12.3%	$16,959	$15,813	7.2%

1 Local international businesses, selling small commercial and other personal lines products locally, excluding private passenger automobile.
2 Liberty International Underwriters (LIU).
3 Effective in the first quarter of 2007, the LIU inland marine program has been reported separately from LIU first party. The prior period has been restated to reflect this change.
4 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business in the above table.

Consolidated net written premium by SBU was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Personal Markets	$1,535	$1,487	3.2%	$4,228	$4,086	3.5%
Commercial Markets	988	992	(0.4)	3,283	3,093	6.1
Agency Markets	1,656	1,479	12.0	4,854	4,548	6.7
International	1,442	1,036	39.2	4,249	3,527	20.5
Corporate and Other[1]	174	165	5.5	345	559	(38.3)
Total net written premium (NWP)	$5,795	$5,159	12.3%	$16,959	$15,813	7.2%
Foreign exchange effect on growth			1.1			1.1
NWP growth excluding foreign exchange			11.2%			6.1%

1 Includes Individual life operations and internal reinsurance.
NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2007 was $5.795 billion and $16.959 billion, respectively, increases of $636 million and $1.146 billion over the same periods in 2006. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $164 million and $432 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect organic growth in all of International's local businesses in Latin America and Europe, primarily Venezuela, Portugal and Spain, the acquisition of Seker Sigorta A.S., a property and casualty insurer located in Turkey, in September of 2006, and the strengthening of foreign currencies versus the U.S. dollar. The increases in both periods also reflect strong customer retention and new business growth in both Personal Markets and Agency Markets, and the acquisition of Ohio Casualty, partially offset by lower average premium per policy in Personal Markets due to mandated rate decreases in Massachusetts.
- Workers compensation net written premium decreased $17 million and increased $134 million in the quarter and year-to-date, respectively. The decrease in the quarter primarily reflects rate decreases and lower retention in Commercial Markets and at Summit, partially offset by new business growth and the acquisition of Ohio Casualty. The year-to-date change also reflects new business writings and higher customer retention at Wausau. In addition, the changes in both periods reflect a decrease of $33 million and an increase of $18 million in audit and retrospective premium in the quarter and year-to-date, respectively, and a $12 million decrease and $23 million increase in the adjustment to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium. Both periods were further impacted by a decrease in Summit's premium due to mandated rate decreases in Florida.
- Homeowners net written premium, including internal reinsurance premium, increased $66 million and $145 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect strong customer retention, new business growth, primarily in non-coastal areas, in both Personal Markets and Agency Markets, including the acquisition of Ohio Casualty. The year-to-date increase also reflects the impact of rate increases from Personal Markets policies issued.
- Commercial multiple peril / fire, including internal reinsurance premium, increased $41 million and $69 million in the quarter and year-to-date, respectively. The increases in both periods reflect strong retention, new business growth in Commercial Markets' Liberty Mutual Property segment, strong customer retention and new business writings in Agency Markets, and the acquisition of Ohio Casualty.
- International local businesses net written premium (excluding private passenger automobile), including internal reinsurance premium, increased $14 million and $138 million in the quarter and

year-to-date, respectively. The increases in both periods primarily reflect organic growth within International's local businesses in Latin America, namely Venezuela and Colombia, and the strengthening of foreign currencies versus the U.S. dollar.

- Commercial automobile net written premium increased $26 million and $32 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect the acquisition of Ohio Casualty, partially offset by modest rate decreases in both Commercial Markets and Agency Markets, and lower retention in Commercial Markets.
- LIU reinsurance net written premium, including internal reinsurance premium, increased $137 million and $31 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect growth in non-catastrophe related exposures, partially offset by management's decision to reduce its catastrophe exposure in the U.S. and to a lesser extent Europe. The increase in the quarter also reflects the timing of new business written as compared to prior periods.
- General liability net written premium, including internal reinsurance premium, increased $28 million and $63 million in the quarter and year-to-date, respectively. The increase in the quarter is primarily driven by new business writings. Year-to-date results reflect higher audit and retrospective premium of $37 million, partially offset by modest rate decreases.
- LIU inland marine program net written premium increased $90 million and $225 million in the quarter and year-to-date, respectively. The increases in both periods are primarily due to International's continued expansion in this line and a change in the terms of the program.
- LIU third party net written premium, including internal reinsurance premium, increased $42 million and $73 million in the quarter and year-to-date, respectively. The increases in both periods are primarily due to a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by a decline in rates as a result of more competitive market conditions.
- Group disability and life net written premium increased $17 million and $52 million in the quarter and year-to-date, respectively, due primarily to the impact of an expanded sales force and broader market penetration.
- Surety net written premium increased $18 million and $40 million in the quarter and year-to-date, respectively, due to the acquisition of Ohio Casualty, an increase in the average size of contract bonds and the non-renewal of a 2006 reinsurance program in Agency Markets.
- LIU first party net written premium, including internal reinsurance premium, increased $18 million in the quarter and year-to-date. The changes reflect a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by rate decreases as a result of more competitive market conditions.
- Individual life net written premium decreased $15 million and $375 million in the quarter and year-to-date, respectively, due to the decline in immediate annuity sales.
- Other net written premium increased $25 million and $74 million in the quarter and year-to-date, respectively, due to increases in internal reinsurance.

More detailed explanations of the changes in net written premium by line of business are included in the related discussion of financial results for each segment.

For a more complete description of the Company's business operations, products and distribution channels, please visit the Company's Investor Relations web site at www.libertymutual.com/investors.

Results of Operations – Consolidated

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$6,589	$6,014	9.6%	$19,027	$17,512	8.7%
PTOI before catastrophes and net incurred losses attributable to prior years	$543	$686	(20.8%)	$1,695	$1,925	(11.9%)
Catastrophes[1]	(60)	(131)	(54.2)	(241)	(417)	(42.2)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(95)	-	NM	(96)	(3)	NM
- All other[3]	134	(3)	NM	37	(135)	NM
Pre-tax operating income	522	552	(5.4)	1,395	1,370	1.8
Realized investment gains, net	19	242	(92.1)	144	311	(53.7)
Federal and foreign income tax expense	(137)	(238)	(42.4)	(446)	(510)	(12.5)
Net income	$404	$556	(27.3%)	$1,093	$1,171	(6.7%)
Net operating income	$390	$387	0.8%	$991	$954	3.9%
Cash flow from operations	$1,131	$1,234	(8.3%)	$2,927	$2,858	2.4%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance reduction of zero and $3 million for the three and nine months ended September 30, 2007, respectively, and $1 million for the comparable periods of 2006.

3 Net of earned premium attributable to prior years of $4 million and $39 million for the three and nine months ended September 30, 2007, respectively, and ($18) million and $16 million for the comparable periods of 2006. Net of amortization of deferred gains on retroactive reinsurance of $21 million and $69 million for the three and nine months ended September 30, 2007, respectively, and $15 million and $46 million for the comparable periods of 2006.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2007 were $6.589 billion and $19.027 billion, respectively, increases of $575 million and $1.515 billion over the same periods in 2006. The major components of revenues are net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2007 was $5.596 billion and $16.163 billion, respectively, increases of $675 million and $1.396 billion over the same periods in 2006. The increases in both periods primarily reflect the acquisition of Ohio Casualty and the earned premium associated with the changes in net written premium in 2006 and the first nine months of 2007. In addition, earned premium from LIU's reinsurance business also increased primarily as a result of a higher level of written premium in the second half of 2006, primarily due to rate increases on property business.

Net investment income for the three and nine months ended September 30, 2007 was $759 million and $2.142 billion, respectively, increases of $95 million and $284 million over the same periods in 2006. The increases in both periods primarily reflect an increase in interest income due to higher invested assets driven by strong cash flow from operations and the proceeds received from the Company's August 2006 and March 2007 debt offerings. Both periods also reflect an increase in investment income related to limited partnerships, limited liability companies, and commercial mortgage loans due to the Company's increased investment in those asset classes consistent with its diversification strategy. The increase in year-to-date dividend income also reflects the increased investment in equity securities. These increases in net investment income, however, were constrained by lower yields on the fixed maturity portfolio, due primarily to the Company's increased investment in tax-exempt securities.

Net realized investment gains for the three and nine months ended September 30, 2007 were $19 million and $144 million, respectively, decreases of $223 million and $167 million from the same periods in 2006. The decreases in both periods are driven by a $235 million gain on the sale of a restricted equity holding in the third quarter of 2006 with no comparably sized gain recurring in 2007. On a year-to-date basis, this decrease was partially offset by a $38 million increase in gains from foreign equities; a decrease in impairment losses, and a $32 million gain from the sale of a company owned property.

Fee and other revenues for the three and nine months ended September 30, 2007 were $215 million and $578 million, respectively, increases of $28 million and $2 million over the same periods in 2006. The increases in both periods reflect the reclassification of contractholder charges and assessments related to SFAS 97 business within Spain and Portugal from net written premium to fee and other revenue, partially offset by lower revenues from the production of oil and gas from the subsidiary operations of Liberty Energy Holdings, LLC ("Liberty Energy") and lower fee revenues associated with the Company's involuntary market servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $6.048 billion and $17.488 billion, respectively, increases of $828 million and $1.657 billion over the same periods in 2006. The increases in both periods are primarily due to business growth and general cost increases in each of the Company's SBUs, the acquisition of Ohio Casualty, an increase in variable annuity reserves, and higher interest expense. In addition, International's net commission expense increased in both periods due to lower ceding commission recognized by LIU's third party business resulting from the reduction in reinsurance utilization, higher acquisition costs in the local businesses, primarily Latin America and Europe, and higher net commission recognized on LIU's inland marine program due to a change in the terms of the program. The increases in both periods also reflect higher losses due to large loss events in LIU's reinsurance business. Large loss events include losses from the floods in the United Kingdom, Hurricane Dean, and the European storm Kyrill, as well as other loss events. The year-to-date increase also reflects higher acquisition costs related to the Personal Markets' advertising program. The increases in both periods were partially offset by lower direct catastrophe losses and a decrease in policyholder benefits due to the decline in immediate annuity sales. Claims, benefits and expenses in both periods were impacted by a decrease in net incurred losses attributable to prior years due to favorable development on prior year loss reserves related to private passenger auto, commercial multiple peril / fire, International local businesses and commercial auto, partially offset by an increase in workers compensation reserves and an increase in asbestos reserves related to the Company's biennial ground-up asbestos reserve study completed in the third quarter of 2007.

	Three Months Ended September 30,			Nine Months Ended September 30,		
CONSOLIDATED	**2007**	**2006**	**Change (Points)**	**2007**	**2006**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	70.3%	68.1%	2.2	69.9%	68.6%	1.3
Underwriting expense ratio	28.1	26.8	1.3	27.9	26.8	1.1
Dividend ratio	0.3	0.3	-	0.3	0.3	-
Subtotal	98.7	95.2	3.5	98.1	95.7	2.4
Catastrophes[1]	1.1	2.7	(1.6)	1.6	3.0	(1.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	1.7	-	1.7	0.6	-	0.6
- All other	(2.5)	0.1	(2.6)	(0.2)	1.0	(1.2)
Total combined ratio[2]	99.0%	98.0%	1.0	100.1%	99.7%	0.4

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 The combined claim and expense ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined claim and expense ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less fee income (primarily related to the Company's involuntary market servicing carrier operations and managed care income) and less installment charges; and the ratio of policyholder dividends to earned premium. Provisions for uncollectible premium and reinsurance are not included in the combined ratio unless related to an asbestos and environmental commutation.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2007 was 98.7% and 98.1%, respectively, increases of 3.5 points and 2.4 points over the comparable periods in 2006. The increase in the claims and claim adjustment expense ratio in both periods reflects large loss events related to LIU's reinsurance business, an increase in non-catastrophe related property losses in Agency Markets and a more competitive rate environment, partially offset by higher earned premium primarily associated with internal property catastrophe reinsurance which had no corresponding losses. The year-to date increase also reflects higher loss trends on European auto business. In addition, the claims and claim adjustment expense ratio increased in both periods as the Personal Markets' current accident year loss ratios in both periods were recorded at levels higher than 2006, reflective of the uncertainty associated with the continuation of favorable auto liability loss trends and lower premium rates. The increases in both periods also reflect a higher underwriting expense ratio due primarily to an increase in International's net commission expense, lower fee revenues associated with the Company's involuntary market servicing carrier operations due to lower involuntary market premium volume, and a one-time write-off associated with an Agency Markets information technology system replacement.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2007 was 99.0% and 100.1%, respectively, increases of 1.0 points and 0.4 points over the comparable periods in 2006. The changes in both periods reflect an increase in asbestos reserves related to the Company's actuarial reserve study completed in the third quarter of 2007. In addition, both periods reflect the impact of favorable net incurred loss development attributable to prior years related to private passenger auto, commercial multiple peril / fire, International local businesses and commercial auto lines, and lower catastrophe losses.

PTOI for the three and nine months ended September 30, 2007 was $522 million and $1.395 billion, respectively, a decrease of $30 million and an increase of $25 million versus the same periods in 2006.

Federal and foreign income tax expense for the three and nine months ended September 30, 2007 was $137 million and $446 million, respectively, decreases of $101 million $64 million from the same periods in 2006. The Company's effective tax rates for the three and nine months ended September 30, 2007 were 25% and 29%, respectively, compared to 30% for the same periods in 2006. The current quarter rate reflects a cumulative adjustment to arrive at an adjusted annual rate of 29% versus 31% recorded through the first six months of 2007, primarily as a result of increased investment income from tax-preferenced securities and a lower expected effective tax rate associated with international operations. The Company's effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three and nine months ended September 30, 2007 was $404 million and $1.093 billion, respectively, decreases of $152 million and $78 million from the same periods in 2006.

PERSONAL MARKETS

Overview – Personal Markets

Personal Markets net written premium by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Private passenger automobile	$1,024	$1,014	1.0%	$2,905	$2,853	1.8%
Homeowners and other	511	473	8.0	1,323	1,233	7.3
Total net written premium	$1,535	$1,487	3.2%	$4,228	$4,086	3.5%

Net written premium for the three and nine months ended September 30, 2007 was $1.535 billion and $4.228 billion, respectively, increases of $48 million and $142 million over the same periods in 2006. The increases in both periods reflect new business growth and strong customer retention in both auto and homeowners and rate increases on homeowners policies.

Private passenger automobile net written premium for the three and nine months ended September 30, 2007 was $1.024 billion and $2.905 billion, respectively, increases of $10 million and $52 million over the same periods in 2006. The increases in both periods are driven by a 3.0% increase in voluntary policies in force as compared to September 30, 2006, due to strong customer retention and new business growth, partially offset by lower average premium per policy. The lower average premium per policy is primarily driven by mandatory rate decreases in Massachusetts, which became effective in April of 2007.

Homeowners and other net written premium for the three and nine months ended September 30, 2007 was $511 million and $1.323 billion, respectively, increases of $38 million and $90 million over the same periods in 2006. The increases in both periods are due to rate increases and a 3.4% increase in policies in force as compared to September 30, 2006 due to strong customer retention and new business growth, primarily in non-coastal areas.

Results of Operations – Personal Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$1,484	$1,404	5.7%	$4,334	$4,160	4.2%
PTOI before catastrophes and net incurred losses attributable to prior years	$231	$232	(0.4)	$594	$636	(6.6)
Catastrophes[1]	(42)	(37)	13.5	(170)	(177)	(4.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	44	20	120.0	118	20	NM
Pre-tax operating income	233	215	8.4	542	479	13.2
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax expense	(69)	(77)	(10.4)	(162)	(168)	(3.6)
Net income	$164	$138	18.8%	$380	$311	22.2%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company’s external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd’s Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured cat losses are not reported net of net catastrophe reinsurance premium earned.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2007 were $1.484 billion and $4.334 billion, respectively, increases of $80 million and $174 million over the same periods in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2007 was $1.383 billion and $4.040 billion, respectively, increases of $69 million and $142 million over the same periods in 2006. The increases in both periods reflect the earned premium associated with growth in net written premium for both the voluntary auto and homeowners lines of business in 2006 and the first nine months of 2007, partially offset by a reduction in involuntary market policies.

Net investment income for the three and nine months ended September 30, 2007 was $86 million and $251 million, respectively, increases of $10 million and $31 million over the same periods in 2006. The increases in both periods primarily reflect a higher invested asset base due to strong cash flow from operations.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $1.251 billion and $3.792 billion, respectively, increases of $62 million and $111 million over the same periods in 2006. The increases in both periods reflect business growth, an increase in advertising costs and higher current accident year losses reflective of the uncertainty associated with the continuation of favorable loss trends, partially offset by a decrease in expenses related to the reduction non-sales personnel staffing, lower premium taxes, a decrease in claim costs related to improved claim handling initiatives and favorable incurred loss development attributable to prior years, primarily in automobile lines, as compared to the same periods in 2006. The increase in the quarter also reflects an increase in profit share expense related to operations acquired from Prudential Financial, Inc. (“PruPac”) and higher catastrophe losses.

PERSONAL MARKETS	Three Months Ended September 30, 2007	2006	Change (Points)	Nine Months Ended September 30, 2007	2006	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	64.6%	63.2%	1.4	66.2%	64.2%	2.0
Underwriting expense ratio	24.3	24.7	(0.4)	24.8	24.7	0.1
Dividend ratio	-	-	-	-	-	-
Subtotal	88.9	87.9	1.0	91.0	88.9	2.1
Catastrophes[1]	3.0	2.8	0.2	4.2	4.6	(0.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.3)	(1.5)	(1.8)	(2.9)	(0.5)	(2.4)
Total combined ratio	88.6%	89.2%	(0.6)	92.3%	93.0%	(0.7)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured cat losses are not reported net of net catastrophe reinsurance premium earned.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2007 was 88.6% and 92.3%, a decrease of 0.6 points and 0.7 points from the same periods in 2006. The decreases in both periods primarily reflect continued favorable incurred loss development attributable to prior years primarily related to the auto liability line of business, resulting in 3.3 points and 2.9 points of favorable development in the three and nine months ended September 30, 2007. These decreases in both periods were partially offset by a higher current accident year claims and claim adjustment expense ratio, as the current accident year has been recorded at a level reflective of the uncertainty associated with the continuation of favorable loss trends. The decrease in the quarter also reflects a lower underwriting expense ratio due to the reduction in the staffing of non-sales personnel and lower premium taxes, partially offset by higher advertising costs and increased profit share expense related to PruPac. The year-to-date decrease in the combined ratio also reflects lower catastrophe losses and the aforementioned reduction in the staffing of non-sales personnel, partially offset by higher advertising costs.

PTOI for the three and nine months ended September 30, 2007 was $233 million and $542 million, respectively, increases of $18 million and $63 million over the same periods in 2006.

Federal and foreign income tax expense for the three and nine months ended September 30, 2007 was $69 million and $162 million, respectively, decreases of $8 million and $6 million from the same periods in 2006, as a result of higher pre-tax income offset by a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preferred investment income.

Net income for the three and nine months ended September 30, 2007 was $164 million and $380 million, respectively, increases of $26 million and $69 million over the same periods in 2006.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets net written premium by market segment was as follows:

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Business Market	$371	$361	2.8%	$1,294	$1,247	3.8%
National Market	297	342	(13.2)	1,049	1,025	2.3
Group Market	116	99	17.2	349	297	17.5
Liberty Mutual Property	83	76	9.2	271	235	15.3
Other Markets[1]	121	114	6.1	320	289	10.7
Total net written premium	$988	$992	(0.4%)	$3,283	$3,093	6.1%

1 Effective January 1, 2007, net written premium associated with the involuntary pools for Wausau, previously included in Commercial Markets, is included in Agency Markets. The prior period has been restated to reflect this change.

Commercial Markets net written premium by line of business was as follows:

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Workers compensation	$493	$509	(3.1%)	$1,743	$1,674	4.1%
General liability	119	120	(0.8)	400	376	6.4
Group disability and life	116	99	17.2	349	297	17.5
Commercial automobile	109	110	(0.9)	318	316	0.6
Commercial multiple peril / Fire	56	54	3.7	217	201	8.0
Assumed voluntary reinsurance	24	42	(42.9)	80	88	(9.1)
Other	71	58	22.4	176	141	24.8
Total net written premium	$988	$992	(0.4%)	$3,283	$3,093	6.1%

Net written premium for the three and nine months ended September 30, 2007 was $988 million and $3.283 billion, respectively, a decrease of $4 million and an increase of $190 million versus the same periods in 2006. The decrease in the quarter primarily reflects a decrease in the amount of audit and retrospective premiums recorded in the National Market segment as compared to the same period in 2006 and a decrease in assumed voluntary reinsurance premium related to an underwriting decision to discontinue writing certain Florida catastrophe reinsurance previously written in 2006. Both periods also reflect new business writings across all market segments and lines of business, an increase in Group disability and life premium due to the impact of an expanded sales force and broader market penetration and an increase in commercial multiple peril/fire and other lines premium growth due to strong retention and new business growth in the Liberty Mutual Property segment. Both periods also reflect modest rate decreases and lower retention levels across most lines of business due to the more competitive market environment. The change in year-to-date also reflects an increase in audit and retrospective premium of $97 million as compared to 2006 primarily in the workers compensation and general liability lines of business.

Results of Operations – Commercial Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006[3]**	**Change**	**2007**	**2006[3]**	**Change**
Revenues	$1,286	$1,217	5.7%	$3,796	$3,467	9.5%
PTOI before catastrophes and net incurred losses attributable to prior years	$115	$105	9.5%	$309	$307	0.7%
Catastrophes[1]	3	(14)	NM	(5)	(65)	(92.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	(25)	(35)	(28.6)	(53)	(58)	(8.6)
Pre-tax operating income	93	56	66.1	251	184	36.4
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax expense	(29)	(21)	38.1	(76)	(65)	16.9
Net income	$64	$35	82.9%	$175	$119	47.1%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 hurricanes and the 2005 hurricanes. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance are reported net of the Company’s reasonable assumption of expected catastrophe activity (defined as “net catastrophe reinsurance premium earned”). Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of $9 million and $19 million for the three and nine months ended September 30, 2007, respectively, and ($19) million and ($24) million for the comparable periods of 2006. Net of amortization of deferred gains on retroactive reinsurance of $15 million and $49 million for the three and nine months ended September 30, 2007, respectively, and $7 million and $22 million for the comparable periods of 2006.

3 Effective January 1, 2007, the results associated with the involuntary pools for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

NM = Not Meaningful.

Revenues for the three and nine months ended September 30, 2007 were $1.286 billion and $3.796 billion, respectively, increases of $69 million and $329 million over the same periods in 2006. The major components of revenues are net premium earned, net investment income, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2007 was $1.057 billion and $3.109 billion, respectively, increases of $69 million and $315 million over the same periods in 2006. The increases in both periods primarily reflect the earned premium associated with the changes in net written premium in 2006 and the first nine months of 2007.

Net investment income for the three and nine months ended September 30, 2007 was $154 million and $453 million, respectively, increases of $17 million and $48 million over the same periods in 2006. The increases in both periods primarily reflect a higher invested asset base due to strong cash flow from operations.

Fee and other revenues for the three and nine months ended September 30, 2007 were $75 million and $234 million, respectively, decreases of $17 million and $34 million from the same periods in 2006. The decreases in both periods primarily reflect lower fee revenues associated with the Company’s involuntary market servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $1.193 billion and $3.545 billion, respectively, increases of $32 million and $262 million over the same periods in 2006. The increases in both periods primarily reflect business growth and general cost increases, partially offset by lower catastrophe losses. The year-to-date result also reflects an increase in non-catastrophe property losses as compared to 2006.

COMMERCIAL MARKETS	Three Months Ended September 30,			Nine Months Ended September 30,		
	2007	2006[2]	Change (Points)	2007	2006[2]	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	80.9%	82.3%	(1.4)	82.3%	81.6%	0.7
Underwriting expense ratio	19.9	18.0	1.9	19.5	19.4	0.1
Dividend ratio	0.3	0.2	0.1	0.3	0.2	0.1
Subtotal	101.1	100.5	0.6	102.1	101.2	0.9
Catastrophes[1]	(0.3)	1.5	(1.8)	0.2	2.6	(2.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	2.6	4.0	(1.4)	1.9	2.3	(0.4)
Total combined ratio	103.4%	106.0%	(2.6)	104.2%	106.1%	(1.9)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Effective January 1, 2007, the results associated with the involuntary pools for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

The Commercial Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2007 was 101.1% and 102.1%, respectively, increases of 0.6 points and 0.9 points over the comparable periods in 2006. The changes in both periods reflect a higher underwriting expense ratio driven primarily by a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the pools, partially offset by earned premium growth. The change in the quarter also reflects a decrease in the claims and claim adjustment expense ratio primarily due to large property losses recorded in the third quarter of 2006 which did not recur in 2007 and a decrease in assumed involuntary losses associated with certain pools. In addition, the claims and claim adjustment expense ratio on a year-to-date basis reflects an increase in non-catastrophe related property losses and the impact of a more competitive rate environment.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2007 was 103.4% and 104.2%, respectively, decreases of 2.6 points and 1.9 points from the same periods in 2006. Results in both periods reflect lower catastrophe losses as 2006 included additional losses attributable to the 2005 U.S. hurricanes related to assumed voluntary reinsurance lines. In addition, net incurred losses attributable to prior years decreased in both periods.

PTOI for the three and nine months ended September 30, 2007 was $93 million and $251 million, respectively, increases of $37 million and $67 million over the same periods in 2006.

Federal and foreign income tax expense for the three and nine months ended September 30, 2007 was $29 million and $76 million, respectively, increases of $8 million and $11 million over the same periods in 2006, as a result of higher pre-tax income offset by a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preference investment income.

Net income for the three and nine months ended September 30, 2007 was $64 million and $175 million, respectively, increases of $29 million and $56 million over the same periods in 2006.

AGENCY MARKETS

Overview – Agency Markets

Agency Markets net written premium by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006[1]**	**Change**	**2007**	**2006[1]**	**Change**
Regional Companies[2]	$970	$925	4.9%	$2,737	$2,599	5.3%
Ohio Casualty[3]	113	-	NM	113	-	NM
Wausau	338	330	2.4	1,059	997	6.2
Summit	128	136	(5.9)	648	707	(8.3)
Surety	79	65	21.5	223	183	21.9
Other[2]	28	23	21.7	74	62	19.4
Total net written premium	$1,656	$1,479	12.0%	$4,854	$4,548	6.7%

[1] Effective January 1, 2007, net written premium associated with the involuntary pools for Wausau, previously included in Commercial Markets, is included in Agency Markets. The prior period has been restated to reflect this change.
[2] Effective January 1, 2007, the results associated with the National Council on Compensation Insurance involuntary business, which were previously included in Other, are included in Regional Companies. Reclassifications have been made to the prior period to reflect this change, with no overall impact to Agency Markets.
[3] As of August 24, 2007, the results include the acquisition of Ohio Casualty.
NM = Not meaningful

Agency Markets net written premium by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Commercial Lines						
Workers compensation total:	$581	$573	1.4%	$2,056	$2,016	2.0%
- Wausau	251	252	(0.4)	839	783	7.2
- Summit	128	136	(5.9)	648	707	(8.3)
- All other	202	185	9.2	569	526	8.2
Commercial multiple peril	368	331	11.2	963	906	6.3
Commercial automobile	211	186	13.4	562	536	4.9
General liability	94	71	32.4	233	209	11.5
Surety	84	66	27.3	228	188	21.3
Other	55	53	3.8	158	143	10.5
Subtotal	$1,393	$1,280	8.8%	$4,200	$3,998	5.1%
Personal Lines						
Private passenger automobile	$154	$117	31.6%	$389	$327	19.0%
Homeowners	95	73	30.1	232	196	18.4
Other	14	9	55.6	33	27	22.2
Subtotal	$263	$199	32.2%	$654	$550	18.9%
Total net written premium	$1,656	$1,479	12.0%	$4,854	$4,548	6.7%

Net written premiums for the three and nine months ended September 30, 2007 were $1.656 billion and $4.854 billion, respectively, increases of $177 million and $306 million over the same periods in 2006. The increases in both periods are primarily due to the acquisition of Ohio Casualty, stable to higher retention levels and new business writings in most commercial lines of business at Wausau and Regional Companies. These increases in both periods were partially offset by modest rate decreases in most states due to a more competitive market environment and significant rate decreases in California due to workers compensation reform. In addition, surety premium increased due to an increase in the average size of contract bonds and the non-renewal of a reinsurance program. Private passenger automobile premium, excluding the results of Ohio Casualty and the impact of the non-standard runoff business (GoAmerica), increased 22.4% and 20.6% in the quarter and year-to-date, respectively. The increases in both periods reflect a 20.0% increase in voluntary policies in force (excluding GoAmerica) due to new business growth, increased utilization of multivariate pricing models and an increase in distribution focus and resources, which also had a favorable impact on homeowner's growth. These increases were partially offset by a decrease in Summit's workers compensation premium due to mandated rate decreases in Florida.

Results of Operations – Agency Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007[4]**	**2006[3]**	**Change**	**2007[4]**	**2006[3]**	**Change**
Revenues	$1,830	$1,584	15.5%	$5,089	$4,627	10.0%
PTOI before catastrophes and net incurred losses attributable to prior years	$143	$144	(0.7%)	$412	$441	(6.6%)
Catastrophes[1]	(21)	(36)	(41.7)	(66)	(120)	(45.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	(1)	-	NM
- All other[2]	214	23	NM	292	56	NM
Pre-tax operating income	336	131	156.5	637	377	69.0
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax expense	(101)	(46)	119.6	(191)	(132)	44.7
Net income	$235	$85	176.5%	$446	$245	82.0%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of ($4) million and $15 million for the three and nine months ended September 30, 2007, respectively, and $6 million and $39 million for the comparable periods of 2006. Net of amortization of deferred gains on retroactive reinsurance of $2 million and $5 million for the three and nine months ended September 30, 2007, respectively, and $3 million and $8 million for the comparable periods of 2006.

3 Effective January 1, 2007, the results associated with the involuntary pools for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

4 As of August 24, 2007, the results include the acquisition of Ohio Casualty.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2007 were $1.830 billion and $5.089 billion, respectively, increases of $246 million and $462 million over the same periods in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2007 were $1.650 billion and $4.599 billion, respectively, increases of $209 million and $389 million over the same periods in 2006. The increases in both periods reflect the acquisition of Ohio Casualty and the earned premium associated with the changes in net written premium in 2006 and the first nine months of 2007.

Net investment income for the three and nine months ended September 30, 2007 was $157 million and $425 million, respectively, increases of $37 million and $77 million over the same periods in 2006. The increases in both periods reflect the acquisition of Ohio Casualty and higher invested assets due to strong cash flow from operations.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $1.494 billion and $4.452 billion, increases of $41 million and $202 million over the same periods in 2006. The increases in both periods primarily reflect the acquisition of Ohio Casualty, business growth, an increase in non-catastrophe related property losses, and general cost increases, partially offset by an increase in the amount of favorable incurred loss development attributable to prior years related to workers compensation, commercial multiple peril, commercial auto and surety lines and lower catastrophe losses.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
AGENCY MARKETS	**2007[3]**	**2006[2]**	**Change (Points)**	**2007[3]**	**2006[2]**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	67.7%	66.9%	0.8	68.1%	66.1%	2.0
Underwriting expense ratio	31.7	30.0	1.7	31.0	30.6	0.4
Dividend ratio	0.9	0.9	-	0.9	1.0	(0.1)
Subtotal	100.3	97.8	2.5	100.0	97.7	2.3
Catastrophes[1]	1.2	2.5	(1.3)	1.4	2.8	(1.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(12.9)	(1.5)	(11.4)	(6.3)	(1.2)	(5.1)
Total combined ratio	88.6%	98.8%	(10.2)	95.1%	99.3%	(4.2)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Effective January 1, 2007, the results associated with the involuntary pools for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

3 As of August 24, 2007, the results include the acquisition of Ohio Casualty.

The Agency Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2007 was 100.3.% and 100.0%, respectively, increases of 2.5 point and 2.3 points over the comparable periods in 2006. The increases in both periods primarily reflect a higher claims and claim adjustment expense ratio due primarily to higher non-catastrophe related property losses and a more competitive rate environment. The increases in the underwriting expense ratio in both periods reflect a one-time write-off associated with an information technology system replacement.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2007 was 88.6% and 95.1%, respectively, decreases of 10.2 points and 4.2 points from the same periods in 2006. The decreases in both periods primarily reflect increases in the amount of favorable net incurred losses attributable to prior years related to workers compensation, commercial multiple peril, commercial auto and surety lines and lower catastrophe losses.

PTOI for the three and nine months ended September 30, 2007 was $336 million and $637 million, respectively, increases of $205 million and $260 million over the same periods in 2006.

Federal and foreign income tax expense for the three and nine months ended September 30, 2007 was $101 million and $191 million, respectively, increases of $55 million and $59 million over the same periods in 2006, due to the acquisition of Ohio Casualty, not included in the prior year results, partially offset by a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three and nine months ended September 30, 2007 was $235 million and $446 million, respectively, increases of $150 million and $201 million over the same periods in 2006.

INTERNATIONAL

Overview – International

International net written premium by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
International Local Businesses Total	$771	$640	20.5%	$2,365	$1,915	23.5%
- Latin America	444	335	32.5	1,235	991	24.6
- Europe	282	271	4.1	1,000	824	21.4
- Asia Pacific	45	34	32.4	130	100	30.0
Liberty International Underwriters	671	396	69.4	1,884	1,612	16.9
Total net written premium (NWP)	$1,442	$1,036	39.2%	$4,249	$3,527	20.5%
Foreign exchange effect on growth			5.6%			5.0%
NWP growth excluding foreign exchange			33.6%			15.5%

The Company's International operations provide insurance products and services through 1) Local Businesses, selling personal and small commercial lines products locally and 2) Liberty International Underwriters ("LIU") which sells specialty commercial lines insurance and reinsurance products worldwide.

International's six major lines of business are as follows:

(1) Local businesses: personal and small commercial insurance;
(2) LIU reinsurance: includes multi-line insurance and reinsurance with an emphasis on property, treaty casualty, personal accident, aviation and reinsurance through Lloyd's Syndicate 4472;
(3) LIU inland marine program: cell phone replacement coverage for lost or damaged devices;
(4) LIU third party: includes casualty, excess casualty, D&O, E&O, professional liability and other;
(5) LIU first party: includes marine, energy, engineering, aviation, and property; and
(6) LIU other: includes workers compensation, commercial auto, and residual value.

International net written premium by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006[1]**	**Change**	**2007**	**2006[1]**	**Change**
Local businesses – private passenger auto	$486	$368	32.1%	$1,407	$1,088	29.3%
Local businesses – all other	285	272	4.8	958	827	15.8
LIU reinsurance	294	159	84.9	825	846	(2.5)
LIU inland marine program[1]	160	70	128.6	424	199	113.1
LIU third party	134	106	26.4	394	338	16.6
LIU first party[1]	75	62	21.0	214	209	2.4
LIU other	8	(1)	NM	27	20	35.0
Total net written premium	$1,442	$1,036	39.2%	$4,249	$3,527	20.5%

1 Effective in the first quarter of 2007, LIU inland marine program has been reported separately from LIU first party. The prior period has been restated to reflect this change.
NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2007 was $1.442 billion and $4.249 billion, respectively, increases of $406 million and $722 million over the same periods in 2006. The increases in both periods reflect organic growth in all local businesses, primarily in Latin America and Europe, the acquisition of Seker Sigorta A.S., a property and casualty insurer located in Turkey, in September of 2006, and the strengthening of foreign currencies versus the U.S. dollar. Growth in both periods also reflects the continued expansion of LIU's inland marine program business as well as a change in the terms of the program. The increases in LIU's third and first party business in both periods are primarily due to a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by a decline in rates as a result of a more competitive market. The increase in the quarter in LIU's reinsurance business is primarily due to the timing of new business written as compared to prior periods. The year-to-date decrease in LIU's reinsurance business reflects management's decision to reduce its catastrophe exposure in the U.S. and to a lesser extent Europe, partially offset by growth in non-catastrophe related exposures.

Results of Operations – International

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$1,565	$1,201	30.3%	$4,511	$3,565	26.5%
PTOI before catastrophes and net incurred losses attributable to prior years	$59	$152	(61.2%)	$338	$400	(15.5%)
Catastrophes[1]	-	(40)	(100.0)	-	(46)	(100.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	18	38	(52.6)	40	(19)	NM
Pre-tax operating income	77	150	(48.7)	378	335	12.8
Realized investment (losses) gains, net	(11)	1	NM	-	25	(100.0)
Federal and foreign income tax expense	(14)	(29)	(51.7)	(105)	(95)	10.5
Net income	$52	$122	(57.4%)	$273	$265	3.0%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to external reinsurance assumed through Lloyd's Syndicate 4472 except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of reinstatement premiums.

2 Net of earned premium attributable to prior years of ($1) million and $5 million for the three and nine months ended September 30, 2007, respectively, and ($5) million and $1 million for the comparable periods of 2006.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2007 were $1.565 billion and $4.511 billion, respectively, increases of $364 million and $946 million over the same periods in 2006. The major components of revenues are net premium earned, net investment income and net realized investment gains and losses.

Net premium earned for the three and nine months ended September 30, 2007 was $1.383 billion and $4.031 billion, respectively, increases of $302 million and $827 million over the same periods in 2006. The increases in both periods reflect the impact of business growth, consistent with the increase in net written premium from local businesses, LIU's inland marine program and LIU's third party business. Earned premium from LIU's reinsurance business also increased primarily as a result of a higher level of written premium in the second half of 2006, primarily due to rate increases on property business.

Net investment income for the three and nine months ended September 30, 2007 was $132 million and $385 million, respectively, increases of $25 million and $90 million over the same periods in 2006. The increases in both periods reflect a higher invested asset base due to strong cash flows from operations, higher yields and the impact of foreign exchange.

Net realized investment (losses) gains for the three and nine months ended September 30, 2007 were ($11) million and zero, respectively, decreases of $12 million and $25 million from the same periods in 2006. The decline in both periods is primarily attributable to losses realized on investment transactions in Venezuela, Spain and LIU's United Kingdom and Australian operations, partially offset by fewer realized losses in 2007 within LIU's reinsurance operations as compared with the same periods in 2006.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $1.499 billion and $4.133 billion, respectively, increases of $449 million and $928 million over the same periods in 2006. The increases in both periods primarily reflect business growth, losses related to the floods in the United Kingdom and Hurricane Dean, as well as other loss events, and higher net commission expense. The increase in net commission expense primarily reflects lower ceding commission recognized by LIU's third party business due to a reduction in reinsurance utilization, higher acquisition costs in the local businesses, primarily Latin America and Europe, and higher net commission expense recognized on LIU's inland marine program due to the change in the terms of the program. In addition, the increase year-to-date reflects losses related to the European storm Kyrill and the unfavorable impact of foreign exchange fluctuations. The change in year-to-date foreign exchange gains primarily reflects the strengthening of the Colombian peso versus the U.S. dollar on U.S. dollar denominated investments. The year-to-date change also reflects favorable incurred loss development attributable to prior years from the local businesses, primarily auto business in Spain, and LIU's third party business, partially offset by adverse development in LIU's reinsurance business and the non-recurrence of favorable development from LIU's other line of business in 2006. In the quarter, the amount of favorable incurred loss development attributable to prior years decreased as a result of a favorable 2006 reserve adjustment in LIU's reinsurance business which did not recur in 2007.

	Three Months Ended September 30,			Nine Months Ended September 30,		
INTERNATIONAL	**2007**	**2006**	**Change (Points)**	**2007**	**2006**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	73.5%	63.9%	9.6	68.9%	66.2%	2.7
Underwriting expense ratio	31.2	29.9	1.3	31.2	28.9	2.3
Dividend ratio	-	-	-	-	-	-
Subtotal	104.7	93.8	10.9	100.1	95.1	5.0
Catastrophes[1]	-	3.4	(3.4)	-	1.5	(1.5)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(1.3)	(3.5)	2.2	(1.0)	0.5	(1.5)
Total combined ratio	103.4%	93.7%	9.7	99.1%	97.1%	2.0

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to external reinsurance assumed through Lloyd's Syndicate 4472 except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of reinstatement premiums.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2007 was 104.7% and 100.1%, respectively, increases of 10.9 points and 5.0 points over the comparable periods in 2006. The increases in the claim and claim adjustment expense ratio in both periods reflect an increase in large loss events from LIU's reinsurance business, as well as higher loss trends on European auto business, particularly Spain. In the quarter, large loss events related to LIU's reinsurance business includes losses related to the floods in the United Kingdom, Hurricane Dean, and European storm Kyrill, as well as other loss events. These increases in the loss ratio were partially offset by changes in the terms of LIU's inland marine program and improved loss experience on LIU's third party businesses. The increases in both periods also reflect a higher underwriting expense ratio due to an increase in net commission expense.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2007 was 103.4% and 99.1%, respectively, increases of 9.7 points and 2.0 points over the same periods in 2006. These increases are driven by the increases in claims, benefits, and expenses discussed above, partially offset by lower catastrophe losses and a decrease in year-to-date net incurred losses attributable to prior years.

PTOI for the three and nine months ended September 30, 2007 was $77 million and $378 million, respectively, a decrease of $73 million and an increase of $43 million versus the same periods in 2006.

Federal and foreign income tax expense for the three and nine months ended September 30, 2007 was $14 million and $105 million, respectively, a decrease of $15 million and an increase of $10 million versus the same periods in 2006. The effective tax rates for the three and nine months ended September 30, 2007 were 21% and 28%, respectively, compared to 19% and 26% for the same periods in 2006. Federal and foreign income taxes reflect the different tax structures within the countries where International operates.

Net income for the three and nine months ended September 30, 2007 was $52 million and $273 million, respectively, a decrease of $70 million and an increase of $8 million versus the same periods in 2006.

CORPORATE and OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Individual life, which provides life insurance and annuities for individuals and also issues structured settlement contracts and administers separate account contracts. Individual life is licensed and sells its products in all 50 states, the District of Columbia and Canada.

- Certain internal discontinued operations, composed of: asbestos, environmental, toxic tort exposures, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation, certain distribution channels related to PruPac, and Commercial assumed voluntary reinsurance business.

- Interest expense on the Company's outstanding domestic debt.

- Internal reinsurance programs, primarily catastrophe treaties where the SBUs choose to purchase more reinsurance coverage than the Company purchases for the consolidated group and, effective in 2007, loss development associated with Commercial Market pre-2005 fully insured workers compensation business.

- The Company reports its written premiums on workers compensation contracts on the "booked as billed" method. Commercial Markets and Agency Markets report these same written premiums on the "booked at inception" method. Corporate and Other results reflect the difference between these two methods.

- Costs associated with certain long-term compensation plans and other corporate costs not allocated to the SBUs.

- For presentation in this MD&A, domestic property and casualty operations' investment income was allocated based on planned ordinary investment income returns by investment category allocated to the business units. Investments are allocated as follows: fixed income equal to liabilities net of insurance assets (reinsurance, premiums receivable, etc.) and a combination of fixed income, equity and nontraditional investments supporting allocated statutory policyholders' surplus. For internal reporting purposes, the Company allocates expected long-term returns on invested assets, including realized investment gains. The difference between the allocated net investment income and actual net investment income is included in Corporate and Other.

- Federal and foreign income taxes represent the difference between the consolidated projected income tax expense and the amounts recognized by the Personal, Commercial, and Agency Markets and International business units. In 2007, the Company changed its allocation methodology to allocate federal taxes at an initial expected tax rate (30%) to the domestic operations, while International reflects the actual tax expense of each country including changes in the international valuation allowance. The difference between the initial rate and the actual rate allocated to the SBUs is included in Corporate and Other. In 2006, domestic operations included in the business units reflect income tax at the 35% marginal U.S. Federal tax rate, while International reflects the actual tax expense of each country including changes in the international valuation allowance.

- Income (loss) related to limited partnership and limited liability company investments.

- Realized gains (losses) from the domestic property-casualty investment portfolio.

- Fee and other revenues include revenues from the Company's wholly owned subsidiary, Liberty Energy, and lease and other income on investment properties. Liberty Energy generates revenue from the production and sale of oil and gas.

Corporate and Other net written premium by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Internal Reinsurance	$57	$21	171.4%	$219	$81	170.4%
Individual life	61	76	(19.7)	205	580	(64.7)
Workers compensation[1]	56	68	(17.6)	(79)	(102)	22.5
Total net written premium	$174	$165	5.5%	$345	$559	(38.3%)

1 Booked as billed adjustment.

Net written premium for the three and nine months ended September 30, 2007 was $174 million and $345 million, respectively, an increase of $9 million and a decrease of $214 million versus the same periods in 2006. The changes in both periods primarily reflect an increase in internal reinsurance premium partially offset by a decrease in individual life business, primarily immediate annuity sales. Both periods also include the Company's workers compensation "booked as billed" adjustment.

Results of Operations – Corporate and Other

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$424	$608	(30.3%)	$1,297	$1,693	(23.4%)
PTOI before catastrophes and net incurred losses attributable to prior years	($5)	$53	NM	$42	$141	(70.2%)
Catastrophes[1]	-	(4)	(100.0)	-	(9)	(100.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(95)	-	NM	(95)	(3)	NM
- All other[3]	(117)	(49)	138.8	(360)	(134)	168.7
Pre-tax operating loss	(217)	-	NM	(413)	(5)	NM
Realized investment gains, net	30	241	(87.6)	144	286	(49.7)
Federal and foreign income tax benefit (expense)	76	(65)	NM	88	(50)	NM
Net (loss) income	($111)	$176	NM	($181)	$231	NM

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. hurricanes for assumed external reinsurance are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance reduction of zero and $3 million for the three and nine months ended September 30, 2007, respectively, and $1 million for the comparable periods of 2006.

3 Net of amortization of deferred gains on retroactive reinsurance of $4 million and $15 million for the three and nine months ended September 30, 2007, respectively, and $5 million and $16 million for the comparable periods of 2006.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2007 were $424 million and $1.297 billion, respectively, decreases of $184 million and $396 million from the same periods in 2006. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2007 was $123 million and $384 million, respectively, an increase of $26 million and a decrease of $277 million versus the same periods in 2006. The changes in both periods reflect lower sales of immediate annuities, partially offset by an increase in internal reinsurance earned premium.

Net investment income for the three and nine months ended September 30, 2007 was $230 million and $628 million, respectively, increases of $6 million and $38 million over the same periods in 2006. The increases in both periods reflect an increase in interest income due primarily to a higher invested asset base due to strong cash flow from operations and the proceeds received from the Company's August 2006 and March 2007 debt offerings. Both periods also reflect an increase in investment income related to limited partnerships, limited liability companies, and commercial mortgage loans due to the Company's increased investment in those asset classes consistent with its diversification strategy. These increases in net investment income, however, were constrained by lower yields on the fixed maturity portfolio, due primarily to the Company's increased investment in tax-exempt securities.

Net realized investment gains for the three and nine months ended September 30, 2007 were $30 million and $144 million, respectively, decreases of $211 million and $142 million from the same periods in 2006. The decreases in both periods reflect a $235 million gain on the sale of a restricted equity holding in the third quarter of 2006 with no comparably sized gain recurring in 2007. On a year-to-date basis, this decrease was partially offset by a $38 million increase in equity gains from foreign equities; a decrease in impairment losses, and a $32 million gain from the sale of a Company owned property.

Fee and other revenues for the three and nine months ended September 30, 2007 were $41 million and $141 million, respectively, decreases of $5 million and $15 million from the same periods in 2006. The decreases in both periods are principally due to a decline in the sale and production of oil and gas from the Liberty Energy subsidiary operation and lower revenue due to the sale of a Company owned operating property.

Claims, benefits and expenses for the three and nine months ended September 30, 2007 were $611 million and $1.566 billion, respectively, increases of $244 million and $154 million over the same periods in 2006. The increases in both periods reflect an increase in incurred losses attributable to prior years related to workers compensation, a $95 million increase in asbestos reserves related to the Company's completion of its biennial ground-up asbestos study in the third quarter, an increase in variable annuity reserves and higher interest expense as a result of the Company's March 2007 and August 2006 debt offerings. The increases in both periods also reflect higher variable incentive compensation and other corporate expenses. The increases in both periods are partially offset by a decrease in reserves related to Individual Life business, principally immediate annuities, and a decrease in adverse reserve development on assumed reinsurance lines.

Pre-tax operating loss for the three and nine months ended September 30, 2007 was $217 million and $413 million, respectively, increases of $217 million and $408 million over the same periods in 2006.

Federal and foreign income tax benefit for the three and nine months ended September 30, 2007 was $76 million and $88 million, respectively, increases of $141 million and $138 million over the same periods in 2006. See the Consolidated section for a discussion of taxes.

Net loss for the three and nine months ended September 30, 2007 was $111 million and $181 million, respectively, increases of $287 million and $412 million over the same periods in 2006.

INVESTMENTS

General

The Company's investment strategy seeks long-term returns through disciplined security selection, portfolio diversity and an integrated approach to risk management. The Company selects and monitors investments to balance the goals of safety, stability, liquidity, growth and after-tax total return with its need to comply with regulatory investment requirements. A relatively safe and stable income stream is achieved by maintaining a broadly based portfolio of investment grade bonds. These holdings are supplemented by investments in additional asset types with the objective of further enhancing the portfolio's diversification and expected returns. These additional asset types include commercial mortgages and other real estate financing investments, non-investment grade bonds, including syndicated bank loans, common and preferred stock, private equity and direct investments in energy ventures. Risk management is accomplished through asset liability management (including both interest rate risk and foreign currency risk), diversification, credit limits and a careful analytic review of each investment decision.

The Company's investment policy and strategy are reviewed and approved by the Investment Committee of its Board of Directors, which meets on a regular basis to review and consider investment activities, tactics and new investment classes. In addition, the Company has an experienced team of investment personnel responsible for managing and administering the investment portfolios of its domestic and foreign insurance operations.

Invested Assets

The following table summarizes the Company's invested assets by asset category as of September 30, 2007 and December 31, 2006:

$ in Millions	**As of September 30, 2007**		**As of December 31, 2006**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$45,447	86.3%	$41,102	87.0%
Equity securities, available for sale, at fair value	3,757	7.2	2,619	5.6
Trading securities, at fair value	16	-	22	-
Limited partnerships and limited liability companies	1,901	3.6	1,435	3.0
Commercial mortgage loans	559	1.1	322	0.7
Short-term investments	744	1.4	1,550	3.3
Other investments	224	0.4	211	0.4
Total invested assets	$52,648	100.0%	$47,261	100.0%

Total invested assets as of September 30, 2007 were $52.648 billion, an increase of $5.387 billion or 11.4% over December 31, 2006. This increase is primarily due to $4.166 billion in invested assets acquired with the Ohio Casualty purchase on August 24, 2007. In addition, strong cash flow from operations, continued growth in investment income, and a portion of the proceeds received from the Company's March 2007 junior subordinated notes offering contributed to the increase. This was partially offset by the liquidation of assets to fund the Ohio Casualty purchase.

Fixed maturities as of September 30, 2007 were $45.447 billion, an increase of $4.345 billion or 10.6% over December 31, 2006. The increase reflects net fixed maturities acquired from the Ohio Casualty purchase, and the aforementioned change in the amount of cash available to invest.

Equity securities, available for sale, as of September 30, 2007 were $3.757 billion ($3.068 billion common stock and $689 million preferred stock), an increase of $1.138 billion or 43.5% over December 31, 2006.

This increase was driven by the addition of Ohio Casualty equities ($460 million) and additional investments in common ($200 million) and preferred ($166 million) stock. Most of the remaining increase was attributable to market appreciation.

Limited partnerships and limited liability companies as of September 30, 2007 were $1.901 billion, an increase of $466 million or 32.5% over December 31, 2006. These investments consist of traditional private equity partnerships of $1.241 billion, real estate partnerships of $329 million, and other partnerships (primarily energy) of $331 million. The increase over December 31, 2006 was driven primarily by new investments in real estate and energy limited partnerships as the Company continues to diversify its private equity portfolio. The Company's investments in limited partnerships and limited liability companies are long-term in nature and highly illiquid. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Commercial mortgage loans as of September 30, 2007 were $559 million, an increase of $237 million or 73.6% over December 31, 2006. The increase reflects new investments in this asset class, which is consistent with the Company's diversification strategy.

Short term investments as of September 30, 2007 were $744 million, a decrease of $806 million or 52.0% from December 31, 2006. This decrease from December 31, 2006 was driven by other previously mentioned investment opportunities and liquidity requirements, including the acquisition of Ohio Casualty.

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 million, $392 million, $499 million, and $83 million, 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 million and various corporate and municipal securities at a cost and fair market value of $63 million.

As of September 30, 2007, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.0% of invested assets.

The following tables summarize the Company's fixed maturity portfolio by security type, credit quality and maturity as of September 30, 2007 and December 31, 2006:

$ in Millions	**As of September 30, 2007**		**As of December 31, 2006**	
Fixed Maturities by Security Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
U.S. Government and agency securities	$3,285	7.2%	$4,658	11.3%
Mortgage and asset-backed securities	13,248	29.2	12,267	29.8
U.S. state and municipal	9,492	20.9	6,612	16.1
Corporate and other	17,006	37.4	15,354	37.4
Foreign government securities	2,416	5.3	2,211	5.4
Total fixed maturities	$45,447	100.0%	$41,102	100.0%

The changes in asset allocation as of September 2007 compared to December 2006 are primarily driven by the Ohio Casualty acquisition. The decrease in U.S. Government and agency securities is primarily driven by the liquidation of securities to fund the Ohio Casualty purchase. This was offset by an increase in U.S. State and municipal and Corporate and Other securities due to the addition of Ohio Casualty invested assets. In addition, U.S. State and municipal continues to reflect the increased tactical allocation based on investment opportunities, tax status and the business environment.

The following table summarizes the Company's exposure to alt-A and sub-prime mortgage collateral as of September 30, 2007:

$ in Millions	As of September 30, 2007		
	Alt-A	**Sub-prime**	**Total**
Liberty Mutual Group (excluding Ohio Casualty)	$164	$19	$183
Ohio Casualty	46	84	130
Consolidated	$210	$103	$313

As of September 30, 2007, the Company's exposure to sub-prime ($103 million or 0.19% of invested assets) and alt-A mortgage collateral ($210 million or 0.40% of invested assets) is primarily AAA rated.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of September 30, 2007 and December 31, 2006:

$ in Millions	As of September 30, 2007		As of December 31, 2006	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$23,933	52.7%	$21,954	53.4%
AA+, AA, AA-	7,514	16.5	5,706	13.9
A+, A, A-	6,596	14.5	6,631	16.1
BBB+, BBB, BBB-	4,670	10.3	3,995	9.7
BB+, BB, BB-	1,369	3.0	1,699	4.1
B+, B, B-	1,168	2.6	1,047	2.6
CCC or lower	197	0.4	70	0.2
Total fixed maturities	$45,447	100.0%	$41,102	100.0%

For purposes of this disclosure, credit quality is primarily based upon Standard & Poor's ratings.

The Company's allocation to investment grade securities increased slightly to 94.0% at September 30, 2007 from 93.1% December 31, 2006. The improvement was driven primarily by the sale of non-investment grade securities and the acquisition of Ohio Casualty.

The Company had 6.0% of its fixed maturity securities invested in non-investment grade securities at September 30, 2007. The Company's holdings of below investment grade securities primarily consist of: (1) an actively managed diversified portfolio of high yield securities and loans within the domestic insurance portfolios; and (2) investments in emerging market sovereign debt primarily in support of the Company's international insurance companies.

The following table summarizes the Company's allocation of fixed maturities by maturity date as of September 30, 2007 and December 31, 2006:

$ in Millions	**As of September 30, 2007**		**As of December 31, 2006**	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,243	2.7%	$1,946	4.7%
Over 1 yr through 5 yrs	8,642	19.0	7,679	18.7
Over 5 yrs through 10 yrs	9,349	20.6	7,937	19.3
Over 10 years	12,965	28.5	11,273	27.5
Mortgage and asset-backed securities	13,248	29.2	12,267	29.8
Total fixed maturities	$45,447	100.0%	$41,102	100.0%

During the first nine months of 2007, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company made only minor adjustments to the average life of its investment portfolio. In addition, the fixed maturity asset portfolio assumed from the Ohio Casualty acquisition had a negligible impact on the average life of the existing portfolio.

Net Investment Income

The following table summarizes the Company's net investment income for the three and nine months ended September 30, 2007 and 2006:

$ in Millions	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Net Investment Income	**2007**	**2006**	**2007**	**2006**
Taxable interest income	$545	$538	$1,631	$1,546
Tax-exempt interest income	89	53	241	140
Dividends	18	18	60	42
Limited partnerships and limited liability companies[1]	127	82	277	211
Commercial mortgage loans[1]	7	-	18	-
Other investment income	2	-	5	5
Gross investment income	788	691	2,232	1,944
Investment expenses	(29)	(27)	(90)	(86)
Net investment income	$759	$664	$2,142	$1,858

[1] *Commercial mortgage loan income previously reported as limited liability income in 2006.*

Net investment income for the three and nine months ended September 30, 2007 was $759 million and $2.142 billion, respectively, increases of $95 million and $284 million over the same periods in 2006. The increases in both periods primarily reflect an increase in interest income due to higher invested assets driven by strong cash flow from operations and the proceeds received from the Company's August 2006 and March 2007 debt offerings. In addition, interest income increased slightly as a result of assets assumed from the acquisition of Ohio Casualty. Both periods also reflect an increase in investment income related to limited partnerships, limited liability companies, and commercial mortgage loans due to the Company's increased investment in those asset classes consistent with its diversification strategy. The increase in year-to-date dividend income also reflects the increased investment in equity securities. These increases in net investment income, however, were constrained by lower yields on the fixed maturity portfolio, due primarily to the Company's increased investment in tax-exempt securities.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and nine months ended September 30, 2007 and 2006:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended September 30, 2007:				
Fixed maturities	($14)	($14)	$	($28)
Common and preferred stock	16	-	-	16
Other	31	-	-	31
Total	$33	($14)	$-	$19
Three Months Ended September 30, 2006:				
Fixed maturities	($3)	($6)	$ -	($9)
Common and preferred stock	14	(2)	-	12
Other	243	(4)	-	239
Total	$254	($12)	$-	$242
Nine Months Ended September 30, 2007:				
Fixed maturities	$4	($14)	$-	($10)
Common and preferred stock	104	(2)	-	102
Other	67	(15)	-	52
Total	$175	($31)	$-	$144
Nine Months Ended September 30, 2006:				
Fixed maturities	$15	($36)	$-	($21)
Common and preferred stock	68	(4)	-	64
Other	272	(4)	-	268
Total	$355	($44)	$ -	$311

$ in Millions	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Components of Net Realized Investment Gains (Losses)	**2007**	**2006**	**2007**	**2006**
Fixed maturities:				
Gross realized gains	$28	$ 9	$82	$55
Gross realized losses	(56)	(18)	(92)	(76)
Equities:				
Gross realized gains	23	17	114	77
Gross realized losses	(7)	(5)	(12)	(13)
Other:				
Gross realized gains	35	244	71	274
Gross realized losses	(4)	(5)	(19)	(6)
Total net realized investment gains (losses)	$19	$242	$144	$311

Net realized investment gains for the three and nine months ended September 30, 2007 were $19 million and $144 million, respectively, decreases of $223 million and $167 million from the same periods in 2006.

The decreases in both periods are driven by a $235 million gain on the sale of a restricted equity holding in the third quarter of 2006 with no comparably sized gain recurring in 2007. On a year to date basis this decrease was partially offset by a $38 million increase in equity gains from foreign equities, a decrease in impairment losses, and a $32 million gain from the sale of a Company owned property.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment as of September 30, 2007:

$ in Millions	**Less Than 12 Months**		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($1)	$92	($29)	$1,378
Mortgage and asset-backed securities	(52)	4,305	(212)	4,863
U.S. state and municipal	(79)	4,510	(17)	180
Corporate and other	(193)	6,171	(280)	4,438
Foreign government securities	(42)	1,053	(10)	383
Equities	(57)	833	(6)	30
Total	($424)	$16,964	($554)	$11,272

Unrealized losses increased from $636 million as of December 31, 2006 to $978 million as of September 30, 2007 primarily due to an increase in interest rates. The Ohio Casualty assets assumed in the third quarter of 2007 had a minimal impact on unrealized gains and losses, as these assets were valued at fair value on the date of acquisition on August 24, 2007. Approximately 82.4% of the unrealized losses ($807 million) exist on holdings where the fair value as of September 30, 2007 was less than 10% below amortized cost. The Company monitors the difference between the amortized cost and estimated fair value of investments to ascertain whether declines in value are temporary in nature. The Company employs a systematic methodology utilizing a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in shareholders' equity. If the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to fair value and a realized loss is recorded. As a result of this review, the Company has concluded that the gross unrealized losses of fixed maturity securities as of September 30, 2007 are temporary.

The gross unrealized losses recorded on common equity securities and other investments at September 30, 2007 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. Therefore, these decreases are also viewed as temporary in accordance with the Company's policy with respect to recognizing impairments in the investment portfolio.

LIQUIDITY AND CAPITAL RESOURCES

General

The liquidity requirements of the insurance subsidiaries are met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims, claim adjustment expenses and operating expenses (underwriting and corporate benefit costs). There are certain cash outflows such as catastrophes and continued settlements of asbestos reserves that are unpredictable in nature and could create increased liquidity needs. The Company believes that the insurance subsidiaries' future business liquidity needs will be met from all the above sources.

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. For ongoing business, the Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of September 30, 2007 totaled $52.648 billion.

Short-term debt outstanding at September 30, 2007 and December 31, 2006 was as follows:

$ in Millions	**As of September 30, 2007**	**As of December 31, 2006**
Commercial paper	$-	$-
Revolving credit facilities	894	50
Current maturities of long-term debt	2	121
Total short-term debt	$896	$171

Long-term debt outstanding at September 30, 2007 and December 31, 2006 was as follows:

$ in Millions	**As of September 30, 2007**	**As of December 31, 2006**
6.75% Notes, due 2008	$15	$15
5.00% Prudential notes, due 2008	4	4
8.00% Prudential notes—series B due 2013	260	260
5.75% Senior notes, due 2014	500	500
7.30% Senior notes, due 2014[1]	200	-
6.70% Senior notes, due 2016	250	250
7.00% Junior subordinated notes due 2067[2]	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% Senior notes, due 2034	250	250
6.50% Senior notes, due 2035	500	500
7.50% Senior notes, due 2036	500	500
7.80% Junior subordinated notes due 2087[3]	700	-
7.697% Surplus notes, due 2097	500	500
7.10% – 7.86% Medium term notes, with various maturities	25	27
Subtotal	4,407	3,209
Unamortized discount[4]	(28)	(34)
Total long-term debt excluding current maturities	$4,379	$3,175

[1] Reflects debt issued by Ohio Casualty.
[2] 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).
[3] 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).
[4] Reflects purchase price adjustment of $8 million related to Ohio Casualty $200 million senior notes, due 2014.

The Company issues commercial paper through Liberty Mutual Group Inc. (“LMGI”). On June 25, 2007, LMGI increased its commercial paper program, guaranteed by LMIC, from $600 million to $1 billion. The program is backed by a $750 million five-year revolving credit facility. To date, no funds have been borrowed under the facility.

On June 15, 2007, LMIC and certain insurance affiliates entered into a $1.25 billion short-term revolving credit facility, guaranteed by LMIC, to facilitate the acquisition of Ohio Casualty. As of September 30, 2007, the Company had $830 million outstanding under the facility. The Company used the funds borrowed under the facility to facilitate the acquisition of Ohio Casualty by allowing for an optimal liquidation of investment assets. The final maturity of the facility is May 31, 2008.

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

Liberty Mutual Insurance Europe Limited entered into a $20 million revolving loan facility, which became effective September 9, 2006. The facility is available to provide working capital to the Company’s international operations. The revolving loan facility is guaranteed by LMIC. As of September 30, 2007, no borrowings were outstanding under the facility.

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.

The $725 million increase in short-term debt outstanding is due to $830 million in outstanding borrowings used to acquire Ohio Casualty and an increase of $14 million in outstanding borrowings under the Venezuelan credit facility. This increase was partially offset by the redemption of the Company’s 8.2% Surplus Notes on May 4, 2007 for $121 million.

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1 billion, consisting of $700 million Series A junior subordinated notes (the "Series A Notes") and $300 million 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). The $1,204 million increase in long-term debt outstanding is primarily the result of this offering. In addition, as a result of the Ohio Casualty acquisition, Ohio Casualty’s $200 million of 7.30% senior notes due 2014 are included as part of the Company’s long-term debt outstanding.

Consolidated interest expense for the nine months ended September 30, 2007 was $231 million, representing an increase of $80 million over the same period in 2006.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, the subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of September 30, 2007, the Company, through its downstream subsidiary LMGI, had $3.291 billion of debt outstanding.

The insurance subsidiaries' ability to pay dividends is restricted under applicable insurance laws and regulations. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Under the insurance laws of Wisconsin, the domiciliary state of Liberty Mutual Fire Insurance Company ("LMFIC") and Employers Insurance Company of Wausau ("EICOW"), an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC and EICOW could negatively affect LMGI's ability to pay principal and interest on the Notes, as could a redomestication, merger or consolidation of LMIC, LMFIC or EICOW to a different domiciliary state.

As of December 31, 2006, the authorized control level risk-based capital and 2007 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio [1]**			**Dividend Capacity[2]**
RBC Ratios and Dividend Capacity	**2006**	**2005**	**Change**	**2007**
LMIC [3]	554%	495%	59 points	$1,007
LMFIC	579%	596%	(17 points)	$69
EICOW [3]	395%	370%	25 points	$121

[1] Authorized control level risk-based capital as defined by the NAIC.
[2] Represents maximum allowable dividend without prior regulatory approval in the state of domicile.
[3] Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group. Effective January 1, 2007, the EICOW pooling percentage decreased from 16.0% to 10.0% and LMIC's pooling percentage increased accordingly.

LMGI also has access to funds at Liberty Corporate Services LLC ("Corporate Services"). Through its subsidiaries, Corporate Services collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the nine months ended September 30, 2007, Corporate Services recorded $225 million in pre-tax income.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $13.641 billion and $12.131 billion at September 30, 2007, and December 31, 2006, respectively. The increase in surplus reflects net income of $434 million (the sum of earnings from the Company's 49 domestic insurance companies and dividends from subsidiaries), capital contributions from the parent, LMGI, of $951 million, affiliated unrealized gains of $179 million, and unaffiliated unrealized gains of $206 million, partially offset by the redemption of surplus notes of $121 million and non-admitted goodwill of $222 million related to the Company's acquisition of Ohio Casualty. The balance of the increase in statutory surplus primarily reflects changes in deferred taxes, foreign exchange and non-admitted assets.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company 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:

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years;
- reinsurance recoverables and associated uncollectible reserves;
- impairments to the fair value of the investment portfolio;
- variable interest entities;
- deferred acquisition costs;
- valuation of goodwill; and
- deferred income tax valuation allowance.

While the Company believes the amounts included in the consolidated financial statements reflect best estimates and appropriate assumptions, these amounts could ultimately be materially different from the amounts currently provided for in the consolidated financial statements.

Certain reclassifications have been made to the 2006 tables to conform to the 2007 tables.

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 million 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 million, including approximately $85 million 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 million 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 may 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 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 Securitized 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 Securitized 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.

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.

As information develops that varies from past experience, provides additional data, or in some cases, augments data that previously was not considered sufficient for use in determining reserves, changes in the Company’s estimate of ultimate liabilities may be required. The effects of these changes are reflected in current operating results.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $42.758 billion and $38.606 billion at September 30, 2007 and December 31, 2006, respectively. The increase was primarily due to business growth less the on-going settlement of claims.

Property-casualty insurance unpaid claims and claim adjustment expenses represent the Company’s best estimate of amounts necessary to settle all outstanding claims, including claims that are incurred but not reported as of the reporting date. The Company’s reserve projections are based primarily on detailed analysis of the facts in each case, experience with similar cases and various historical development patterns. Consideration is given to such historical patterns as field reserving trends and claims settlement practices, loss payments, pending levels of unpaid claims and product mix, as well as court decisions, economic conditions and public attitudes. All of these factors can affect the estimation of reserves.

Establishing loss reserves, including loss reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigated cases, medical costs, and cost of repair materials and labor rates can all affect ultimate claim costs. In addition, the span of time between the incidence of a loss and the payment or settlement of the claim can be a critical part of reserving determinations and will cause more variability in the ultimate claim cost. Accordingly, “short-tail” claims, such as property damage claims, tend to be easier to estimate than "long-tail" claims, such as workers compensation or general liability claims.

As information develops that varies from past experience, provides additional data, or in some cases, augments data that previously was not considered sufficient for use in determining reserves, changes in the Company's estimate of ultimate liabilities may be required. The effects of these changes are reflected in current operating results.

Asbestos and Environmental

The Company's asbestos and environmental (A&E) reserves for unpaid claims and claim adjustment expenses were $1.263 billion and $1.386 billion at September 30, 2007 and December 31, 2006, respectively, net of reinsurance and including an allowance for doubtful accounts. The year-to-date decrease is due primarily to ongoing settlement activity of asbestos and environmental clams partially offset by an increase in asbestos reserves stemming from our biennial asbestos reserve study. Based on this study, the Company increased its asbestos reserves by $95 million.

In the third quarter of 2007, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. In addition, an internationally known actuarial consulting firm performed its own independent review of the Company's asbestos reserves and confirmed the reasonableness of the reserve increase.

As part of the internal review, potential exposures of large policyholders were individually evaluated using the company's proprietary stochastic model, which is consistent with the latest published actuarial paper on asbestos reserving. Among the factors reviewed in depth by the team specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. Small policyholders were evaluated using aggregate methods that utilized information developed from the large policyholders. Additionally, a provision of pure IBNR was established for the potential emergence of first-time filers of future asbestos claims.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of PruPac included $190 million and $130 million of gross and net A&E reserves, respectively. Any increase in A&E reserves related to PruPac is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial Inc. The Company had paid losses associated with these reserves of $45 million for the nine months ended September 30, 2007 and $61 million for the year ended December 31, 2006.

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties; the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding asbestos and environmental related claims could result in liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

Reinsurance Recoverables

The Company reported reinsurance recoverables of $15.625 billion and $15.564 billion at September 30, 2007 and December 31, 2006, respectively, net of allowance for doubtful accounts. The increase is primarily due to the acquisition of Ohio Casualty, offset by the ongoing settlement of 2005 hurricane claims and the continued payout of losses and expenses related to Nationwide's discontinued operations.

The reinsurance recoverables from Nationwide Indemnity Co. have been fully guaranteed by its parent, Nationwide Mutual Insurance Co., which has a financial strength rating of A+ from Standard & Poor's and A+ from A.M. Best. The reinsurance recoverables from state mandated involuntary pools and associations represent the Company's servicing carrier business. As a servicing carrier, the Company retains no direct underwriting risk but instead cedes 100% of the involuntary market premium and losses back to the pool. Payment of losses is shared by the pool participants in proportion to their pool participation. Credit risk with respect to this servicing carrier business is the composite of the cumulative creditworthiness of all participants in their respective pools.

As part of its reinsurance security oversight, the Company has established a Reinsurance Credit Committee ("RCC") that meets quarterly to monitor and review the credit quality of the existing reinsurance portfolio, discuss emerging trends in the reinsurance marketplace, and ensure that the current portfolio of reinsurance is in compliance with the committee's security standards. The RCC is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company's purchase and use of reinsurance.

Approximately 95% of the Company's reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at September 30, 2007. Collateral held against outstanding gross reinsurance recoverable balances was $5.186 billion and $4.802 billion at September 30, 2007 and December 31, 2006, respectively.

The remaining 5% of the Company's net reinsurance recoverable balance is well diversified. No single reinsurer rated B++ or below by A.M. Best accounts for more than 2% of statutory surplus as regards policyholders. In addition, the average net reinsurance recoverable balance from individual reinsurers rated below A- or not rated by A.M. Best was approximately $1 million as of September 30, 2007.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The Company evaluates and monitors the financial condition of its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. The Company reports its reinsurance recoverables net of an allowance for estimated uncollectible reinsurance recoverables. The allowance is based upon the Company's ongoing review of amounts outstanding, length of collection periods, changes in reinsurer credit standing and other relevant factors. Accordingly, the establishment of reinsurance recoverables and the related allowance for uncollectible reinsurance recoverables is also an inherently uncertain process involving estimates. Changes in these estimates could result in additional income statement charges.

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 million) 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 million and $839 million, 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 million and $86 million, respectively, as compared to $27 million and $80 million, 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 million and $45 million, respectively, as compared to $15 million and $45 million 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 billion and $2.258 billion 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 and Wausau 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, LMIC entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 million 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 million 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.

Impairment Losses on Investments

The total impairment losses on investments for the three and nine months ended September 30, 2007 were $14 million and $31 million, respectively, an increase of $2 million and a decrease of $13 million compared to the same periods in 2006. The impairments in the quarter were driven by the sale of securities for the funding of the Ohio Casualty purchase. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company's accounting policy for other-than-temporary impairment recognition requires other-than-temporary impairment charges to be recorded when it is determined that the Company is unlikely to recover its cost basis in an investment in the near-term. Factors considered in evaluating whether a decline in value is other-than-temporary include: (a) the length of time and extent to which the fair value has been below cost; (b) the financial condition and near-term prospects of the issuer; and (c) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

The Company employs a systematic methodology to evaluate declines in fair value below the book value for equity securities and other investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below carrying value is evaluated in a disciplined manner. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy. However, the Company reserves the flexibility to trade any investment as deemed appropriate based on changes in credit or other market factors in managing the invested assets positions of the Company.

Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, *"Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51"* ("FIN 46"). The Company's exposure to investment structures subject to analysis under FIN 46(R), relate primarily to investments in energy, private equity, and real estate limited partnerships that are accounted for under the equity method. The Company consolidates 2 VIEs in the energy investment sector in its 2007 and 2006 financial statements; the Company has been deemed to be the primary beneficiary. In addition, the Company has investments in 36 VIEs for which it is not the primary beneficiary at September 30, 2007. The Company's investments in VIEs were $340 million and $208 million at September 30, 2007 and December 31, 2006, respectively. The Company's maximum exposure to losses from VIEs is $665 million and $481 million as of September 30, 2007 and December

31, 2006, respectively, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Derivatives

The Company has a Derivative Use Policy, which has been approved by the Investment Committee. Pursuant to the policy, the Company may enter into derivative transactions. As of September 30, 2007, the Company had several embedded derivative instruments in its portfolio, warrants and two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of September 30, 2007, the value of these instruments was $4 million. The Company recognized approximately $5 million in net realized investment gains through September 30, 2007 driven by changes in fair value of derivative instruments, and proceeds from the disposition of a warrant.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were $1.979 billion and $1.662 billion as of September 30, 2007 and December 31, 2006, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses. Acquired in-force policy intangibles are costs associated with the acquisition of Ohio Casualty that equal the fair value of in-force insurance contracts at the date of acquisition.

Goodwill and Intangibles

Goodwill and intangible assets were $2.357 billion and $907 million at September 30, 2007 and December 31, 2006, respectively. The increase was primarily due to the acquisition of Ohio Casualty.

Deferred Income Taxes

The net deferred income tax asset was $1.354 billion and $1.490 billion as of September 30, 2007 and December 31, 2006, respectively, net of a valuation allowance of $109 million and $101 million, respectively. Management believes it is more likely than not that the Company’s net deferred income tax asset will be realized based on the Company’s ability and likelihood of generating future taxable income.

The income tax provision is calculated under the liability method. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax bases of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are unrealized capital gains and losses on certain investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs, employee benefits, net operating losses, and alternative minimum tax credits.

The IRS is currently reviewing the Company’s federal tax returns for the 1999 through 2005 tax years. Any adjustments that may 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.

About the Company

Boston-based Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of entities ("LMG" or the "Company"), is a diversified global insurer and sixth largest property and casualty insurer in the U.S. based on 2006 direct written premium. The Company also ranks 95th on the Fortune 500 list of largest corporations in the United States based on 2006 revenue. As of December 31, 2006, LMG had $85.498 billion in consolidated assets, $74.603 billion in consolidated liabilities, and $23.520 billion in annual consolidated revenue.

LMG, through its subsidiaries and affiliated companies, offers a wide range of property-casualty insurance products and services to individuals and businesses alike. In 2001 and 2002, the Company formed a mutual holding company structure, whereby the three principal mutual insurance companies, LMIC, LMFIC and EICOW, each became separate stock insurance companies under the ownership of Liberty Mutual Holding Company Inc.

Functionally, the Company conducts its business through four SBUs: Personal Markets, Commercial Markets, Agency Markets and International. Each business unit operates independently of the others and has dedicated sales, underwriting, claims, actuarial, financial and certain information technology resources. Management believes this structure allows each business unit to execute its business strategy and/or to make acquisitions without impacting or disrupting the operations of the Company's other business units.

LMG employs over 40,000 people in more than 900 offices throughout the world. For a full description of the Company's business operations, products and distribution channels, please visit Liberty Mutual's Investor Relations web site at www.libertymutual.com/investors.