

Liberty Mutual Holding Company Inc.

First Quarter 2016

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Revenues</b>		
Premiums earned	\$ 8,464	\$ 8,340
Net investment income	687	611
Fee and other revenues	250	279
Net realized (losses) gains	(39)	37
Total revenues	9,362	9,267
<b>Claims, Benefits and Expenses</b>		
Benefits, claims and claim adjustment expenses	5,731	5,792
Operating costs and expenses	1,587	1,617
Amortization of deferred policy acquisition costs	1,270	1,155
Interest expense	109	110
Interest credited to policyholders	67	64
Total claims, benefits and expenses	8,764	8,738
Loss on extinguishment of debt	(8)	-
Income from continuing operations before income tax expense and non-controlling interest	590	529
Income tax expense	187	139
Consolidated net income from continuing operations	403	390
Discontinued operations (net of income tax expense of \$0 and \$4 for the three months ended March 31, 2016 and 2015, respectively)	-	(118)
Consolidated net income	403	272
Less: Net income (loss) attributable to non-controlling interest	10	(4)
Net income attributable to Liberty Mutual Holding Company Inc.	\$ 393	\$ 276
<b>Net Realized (Losses) Gains</b>		
Other-than-temporary impairment losses:	<b>2016</b>	<b>2015</b>
Total other-than-temporary impairment losses	\$ (17)	\$ (24)
Change in portion of loss recognized in other comprehensive income	-	-
Other-than-temporary impairment losses	(17)	(24)
Other net realized (losses) gains	(22)	61
Net realized (losses) gains	\$ (39)	\$ 37

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Comprehensive Income

(dollars in millions)

(Unaudited)

	Three Months ended March 31,	
	2016	2015
Consolidated net income	\$ 403	\$ 272
Other comprehensive income (loss), net of taxes:		
Unrealized gains on securities	715	215
Reclassification adjustment for (losses) and gains included in consolidated net income	(10)	30
Foreign currency translation and other adjustments	203	(258)
Other comprehensive income (loss), net of taxes	908	(13)
Comprehensive income	\$ 1,311	\$ 259

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Total Equity

(dollars in millions)

(Unaudited)

	Three Months ended March 31,	
	2016	2015
Balance at beginning of the year	\$ 19,241	\$ 20,291
Consolidated net income	403	272
Other comprehensive income (loss), net of taxes	908	(13)
Total comprehensive income	1,311	259
Distributions from non-controlling interest	(53)	-
Balance at end of the period	<u>\$ 20,499</u>	<u>\$ 20,550</u>

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

	March 31, 2016	December 31, 2015
<b>Assets:</b>		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of \$62,426 and \$61,393)	\$ 65,081	\$ 62,794
Equity securities, available for sale, at fair value (cost of \$2,171 and \$2,571)	2,400	2,909
Short-term investments	251	272
Commercial mortgage loans	2,375	2,317
Other investments	5,730	5,691
Total investments	75,837	73,983
Cash and cash equivalents	4,424	4,227
Premium and other receivables	10,587	10,137
Reinsurance recoverables	13,759	13,575
Deferred income taxes	313	795
Deferred acquisition costs	3,245	3,164
Goodwill	4,851	4,758
Prepaid reinsurance premiums	1,195	1,098
Other assets	10,256	9,928
Total assets	\$ 124,467	\$ 121,665
<b>Liabilities:</b>		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	\$ 49,693	\$ 49,323
Life	9,582	9,262
Other policyholder funds and benefits payable	6,767	6,601
Unearned premiums	17,473	16,951
Funds held under reinsurance treaties	205	205
Short-term debt and current maturities of long-term debt	255	249
Long-term debt	6,925	6,940
Other liabilities	13,068	12,893
Total liabilities	103,968	102,424
<b>Equity:</b>		
Unassigned equity	21,057	20,664
Accumulated other comprehensive income	(627)	(1,521)
Total policyholders' equity	20,430	19,143
Non-controlling interest	69	98
Total equity	20,499	19,241
Total liabilities and equity	\$ 124,467	\$ 121,665

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Consolidated net income	\$ 403	\$ 272
Less - loss from Venezuela discontinued operations, net of tax expense	-	(118)
Income from operations excluding Venezuela discontinued operations	403	390
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	205	199
Realized losses (gains)	39	(37)
Undistributed private equity investment gains	(60)	(13)
Premium, other receivables, and reinsurance recoverables	(377)	(567)
Deferred acquisition costs	(104)	(83)
Liabilities for insurance reserves	503	675
Taxes payable, net of deferred	162	109
Other, net	(472)	(180)
Total adjustments	(104)	103
Net cash provided by operating activities - excluding Venezuela discontinued operations	299	493
Net cash provided by operating activities - Venezuela discontinued operations	-	235
Net cash provided by operating activities	299	728
<b>Cash flows from investing activities:</b>		
Purchases of investments	(3,861)	(4,604)
Sales and maturities of investments	3,663	3,957
Property and equipment purchased, net	(156)	(249)
Cash paid for acquisitions, net of cash on hand	(130)	-
Other investing activities	292	116
Net cash used in investing activities - excluding Venezuela discontinued operations	(192)	(780)
Net cash used in investing activities - Venezuela discontinued operations	-	(40)
Net cash used in investing activities	(192)	(820)
<b>Cash flows from financing activities:</b>		
Net activity in policyholder accounts	124	122
Debt financing, net	(16)	1
Net security lending activity and other financing activities	(30)	(58)
Net cash provided by financing activities - excluding Venezuela discontinued operations	78	65
Net cash provided by (used in) financing activities - Venezuela discontinued operations	-	-
Net cash provided by financing activities	78	65
Effect of exchange rate changes on cash - excluding Venezuela discontinued operations	12	(19)
Effect of exchange rate changes on cash - Venezuela discontinued operations	-	-
Effect of exchange rate changes on cash	12	(19)
Net increase (decrease) in cash and cash equivalents - excluding Venezuela discontinued operations	197	(241)
Net increase in cash and cash equivalents - Venezuela discontinued operations	-	195
Net increase (decrease) in cash and cash equivalents	197	(46)
Cash and cash equivalents, beginning of year - excluding Venezuela discontinued operations	4,227	4,003
Cash and cash equivalents, end of period - excluding Venezuela discontinued operations	\$ 4,424	\$ 3,762

See accompanying notes to the unaudited consolidated financial statements.

# Liberty Mutual Holding Company Inc.

## Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc., entities over which the Company exercises control including majority and wholly owned subsidiaries, and variable interest entities when the Company is deemed the primary beneficiary (collectively “LMHC” or the “Company”). The minority ownership of consolidated affiliates is represented in equity as non-controlling interest. All material intercompany transactions and balances have been eliminated. Certain reclassifications have been made to the 2015 consolidated financial statements to conform with the 2016 presentation.

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company’s principal estimates include (1) unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years, (2) reinsurance recoverables and associated uncollectible allowance, (3) fair value determination and other-than-temporary impairments of the investment portfolio and direct working interests in oil and gas properties, (4) recoverability of deferred acquisition costs, (5) valuation of goodwill and intangible assets, (6) deferred income tax valuation allowance, and (7) pension and postretirement benefit obligations. While the amounts included in the consolidated financial statements reflect management’s best estimates and assumptions, these amounts ultimately could vary.

#### Adoption of Accounting Standards

Effective January 1, 2016, the Company has adopted the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”) which amends the guidance for determining whether an entity is a variable interest entity (“VIE”). ASU 2015-02 eliminates the separate consolidation guidance for limited partnerships and with it, the presumption that a general partner should consolidate a limited partnership. In addition, ASU 2015-02 changes the guidance for determining if fee arrangements qualify as variable interests and the effect fee arrangements have on the determination of the primary beneficiary.

Effective January 1, 2016, the Company adopted ASU 2015-03, *Imputation of Interest* (Accounting Standards Codification (“ASC”) 835), which requires debt issuance costs to be presented as a deduction from the carrying amount of the related debt, consistent with treatment required for debt discounts. The Company has applied the guidance retrospectively and as a result has reclassified \$42 of unamortized debt issuance costs from other assets to long-term debt as of December 31, 2015.

#### Accounting Standards Not Yet Adopted

The Company will adopt the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”). ASU 2014-09 was issued to clarify the principles for recognizing revenue, however, insurance contracts and financial instrument transactions are not within the scope of this guidance. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers*, which deferred the effective date of ASU 2014-09 by one year. Accordingly, ASU 2014-09 is effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. For all other entities, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact the adoption of ASU 2014-09 is expected to have on the Company’s financial statements.

The Company will adopt the FASB issued ASU 2015-09, *Disclosures about Short-Duration Contracts* (“ASU 2015-09”). The amendments apply to all insurance entities that issue short-duration contracts as defined in ASC 944, *Financial Services – Insurance*. The disclosures required by ASU 2015-09 are aimed at providing the users of the financial statements with more transparent information about initial claim estimates and subsequent adjustments to those estimates, methodologies and judgments in estimating claims, and the timing, frequency and severity of claims. The new disclosures will require the accumulation and reporting of new and different groupings of data by insurers for U.S. GAAP reporting from what is currently captured for U.S. statutory and other reporting purposes. The amendments of ASU 2015-09 are effective for public business entities for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the amendments of ASU 2015-09 are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. The adoption of ASU 2015-09 is not expected to have an effect on the Company’s results of operations and financial position, but changes to the Company’s disclosures on loss reserves will be required.

The Company will adopt the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). ASU 2016-01 requires equity investments (excluding those accounted for under the equity method or those that result in consolidation) to be measured at fair value, with changes in fair value recognized in net income. ASU 2016-

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01 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. For all other entities, ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The adoption of ASU 2016-01 is expected to have a material impact on the Company's financial statements.

The Company will adopt the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02"). The amendments will require a lessee to recognize a right-of-use asset and a lease liability on the balance sheet for leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The amendments of ASU 2016-02 are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For all other entities, the amendments in this update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Company is currently evaluating the impact the adoption of ASU 2016-02 is expected to have on the Company's financial statements.

There are no other accounting standards not yet adopted by the Company that are expected to have a material impact on its financial position or results of operations.

**Accumulated Other Comprehensive Loss**

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

The components of accumulated other comprehensive loss excluding non-controlling interest, net of related deferred acquisition costs and taxes, are as follows:

	<b>March 31, 2016</b>	<b>December 31, 2015</b>
Unrealized gains on securities	\$1,524	\$819
Foreign currency translation & other adjustments	(662)	(825)
Pension liability funded status <sup>(1)</sup>	(1,489)	(1,515)
Accumulated other comprehensive loss	\$(627)	\$(1,521)

<sup>(1)</sup> Includes \$60 for the three months and year ended March 31, 2016 and December 31, 2015, respectively, due to the recognition of deferred taxes related to the Medicare Part D subsidy.

The following table presents the consolidated other comprehensive income (loss) reclassification adjustments for the three months ended March 31, 2016 and 2015, respectively.

	<b>Unrealized gains on securities</b>	<b>Change in pension and post retirement plans funded status</b>	<b>Foreign currency translation and other adjustments<sup>(1)</sup></b>	<b>Total</b>
<b>Three months ended March 31, 2016</b>				
Unrealized change arising during the period	\$1,042	\$ -	\$186	\$1,228
Less: Reclassification adjustments included in consolidated net income	(15)	(40)	-	(55)
Total other comprehensive income before income tax expense	1,057	40	186	1,283
Less: Income tax expense	352	14	9	375
Total other comprehensive income, net of income tax expense	\$705	\$26	\$177	\$908

<sup>(1)</sup> Includes \$14 of non-controlling interest.



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	Unrealized gains on securities	Change in pension and post retirement plans funded status	Foreign currency translation and other adjustments <sup>(1)</sup>	Total
<b>Three months ended March 31, 2015</b>				
Unrealized change arising during the period	\$431	\$ -	\$(323)	\$108
Less: Reclassification adjustments included in consolidated net income	45	(54)	-	(9)
Total other comprehensive income (loss), before income tax expense (benefit)	386	54	(323)	117
Less: Income tax expense (benefit)	141	19	(30)	130
Total other comprehensive income (loss), net of income tax expense (benefit)	\$245	\$35	\$(293)	\$(13)

<sup>(1)</sup> Includes \$1 of non-controlling interest.

**(2) ACQUISITIONS AND DISPOSITIONS**

**ACQUISITIONS**

**Compañía de Seguros Generales Penta Security S.A.**

On January 14, 2016, the Company completed the acquisition of Compañía de Seguros Generales Penta Security S.A., the fourth largest non-life insurer in Chile. Compañía de Seguros Generales Penta Security S.A. had approximately \$160 of net written premium in 2015.

**Hughes Insurance**

On July 1, 2015, the Company completed the acquisition of Hughes Insurance, an independent insurance broker in Northern Ireland. Hughes Insurance offers motor, van, household, small-to-medium-enterprise commercial insurance and travel insurance. Hughes Insurance has been reflected in the consolidated financial statements since the second quarter of 2014.

**DISPOSITIONS**

**Liberty Ubezpieczenia**

On December 18, 2015, the Company entered into an agreement to sell its Polish operations to a member of the AXA Group.

**Venezuela Operations**

Effective as of September 30, 2015, the Company determined to deconsolidate the Venezuelan subsidiaries and offer the Venezuelan operations for sale.

Since 2010 the Company's operations in Venezuela have been operating in a hyperinflationary economy with restrictive foreign exchange controls.

On February 10, 2015, the Venezuelan government published changes to its foreign exchange controls, which created a three-tiered system. The new exchange controls retained the CENCOEX, or "official" rate; however, the new exchange controls merged SICAD II into SICAD I, now referred to as SICAD. Additionally, the new exchange controls established the Marginal Foreign Exchange System ("SIMADI"), which is intended to be a free floating rate. As of September 30, 2015, the exchange rate of bolivars per U.S. dollar for CENCOEX, SICAD and SIMADI was 6.3, 13.5, and 198, respectively. The Company used the SICAD rate, consistent with promulgated guidance, to remeasure its Venezuelan operations' financial statements.

These three mechanisms became increasingly illiquid over time. The Company believes that significant uncertainty continues to exist regarding the foreign exchange mechanisms in Venezuela, including the nature of transactions that are eligible to flow through CENCOEX, SICAD or SIMADI, how any such mechanisms will operate in the future, as well as the availability of U.S. dollars under each mechanism.

The evolving conditions in Venezuela, including the increasingly restrictive exchange control regulations and other factors, significantly impact our control over the Venezuelan operations. As a result of these factors, which we believe to be other-than-temporary, we concluded that effective September 30, 2015, we do not meet the accounting criteria for control over the Venezuelan operations, and therefore have deconsolidated these operations in the accompanying financial statements. As a result of deconsolidating, the Company recognized an impairment charge of approximately \$690 which includes the write down of the investment in the previously consolidated Venezuelan operations to fair value and the write-off of related intercompany balances. The Company's Venezuelan operations are classified as discontinued operations in the consolidated financial statements. All prior periods were restated to reflect this change.

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(Unaudited)

The following table summarizes the amounts related to discontinued operations in the consolidated statements of income:

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
Revenues:		
Premiums earned	\$ -	\$530
Net investment income	-	26
Fee and other revenues	-	30
Net realized losses	-	(174)
Total revenues	<u>\$ -</u>	<u>\$412</u>
Claims, Benefits and Expenses		
Benefits, claims and claim adjustment expense	\$ -	\$337
Operating costs and expenses	-	106
Amortization of deferred policy acquisition costs	-	83
Total claims, benefits and expenses	<u>\$ -</u>	<u>\$526</u>
Loss before income tax expense	\$ -	\$(114)
Income tax expense	-	4
Net Loss on discontinued operations, net of tax	<u>\$ -</u>	<u>\$(118)</u>

**(3) INVESTMENTS**

The amortized cost, gross unrealized gains and losses and fair values of available for sale investments as of March 31, 2016 and December 31, 2015, are as follows:

<b>March 31, 2016</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. government and agency securities	\$3,180	\$181	\$(1)	\$3,360
Residential MBS <sup>(1)</sup>	7,096	247	(4)	7,339
Commercial MBS	1,630	47	(2)	1,675
Other MBS and ABS <sup>(2)</sup>	3,046	82	(13)	3,115
U.S. state and municipal	13,473	867	(14)	14,326
Corporate and other	29,661	1,450	(403)	30,708
Foreign government securities	4,340	234	(16)	4,558
Total fixed maturities	<u>62,426</u>	<u>3,108</u>	<u>(453)</u>	<u>65,081</u>
Common stock	1,793	360	(88)	2,065
Preferred stock	378	13	(56)	335
Total equity securities	<u>2,171</u>	<u>373</u>	<u>(144)</u>	<u>2,400</u>
Total securities available for sale	<u>\$64,597</u>	<u>\$3,481</u>	<u>\$(597)</u>	<u>\$67,481</u>

<sup>(1)</sup> Mortgage-backed securities ("MBS")

<sup>(2)</sup> Asset-backed securities ("ABS")

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(dollars in millions)

(Unaudited)

<b>December 31, 2015</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
U.S. government and agency securities	\$3,182	\$142	\$(12)	\$3,312
Residential MBS	7,224	185	(29)	7,380
Commercial MBS	1,592	20	(16)	1,596
Other MBS and ABS	3,051	57	(15)	3,093
U.S. state and municipal	13,553	666	(54)	14,165
Corporate and other	28,749	991	(694)	29,046
Foreign government securities	4,042	197	(37)	4,202
Total fixed maturities	61,393	2,258	(857)	62,794
Common stock	2,193	488	(110)	2,571
Preferred stock	378	14	(54)	338
Total equity securities	2,571	502	(164)	2,909
Total securities available for sale	<u>\$63,964</u>	<u>\$2,760</u>	<u>\$(1,021)</u>	<u>\$65,703</u>

Of the \$2,065 and \$2,571 of common stock as of March 31, 2016 and December 31, 2015, respectively, \$496 and \$483, respectively, related to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk.

The fair value of fixed maturities as of March 31, 2016 and December 31, 2015, by contractual maturity are as follows:

	<b>As of March 31, 2016</b>	<b>As of December 31, 2015</b>
Due to mature:		
One year or less	\$3,993	\$3,515
Over one year through five years	16,769	16,298
Over five years through ten years	17,814	17,255
Over ten years	14,376	13,657
MBS and ABS of government and corporate agencies	12,129	12,069
Total fixed maturities	<u>\$65,081</u>	<u>\$62,794</u>

Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Due to the potential for prepayment on MBS and ABS, they are not categorized by contractual maturity.

The following table summarizes the Company's gross realized gains and losses by asset type for the three months ended March 31, 2016 and 2015, respectively:

<i>Components of Net Realized (Losses) Gains</i>	<b>2016</b>	<b>2015</b>
Fixed maturities:		
Gross realized gains	\$33	\$35
Gross realized losses	(52)	(18)
Equities:		
Gross realized gains	109	51
Gross realized losses	(105)	(22)
Other:		
Gross realized gains	8	11
Gross realized losses	(32)	(20)
Total net realized (losses) gains	<u>\$(39)</u>	<u>\$37</u>

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The following table summarizes the gross unrealized losses and fair value of fixed income and equity securities by the length of time that individual securities have been in a continuous unrealized loss position as of March 31, 2016 and that are not deemed to be other-than-temporarily impaired:

<b>March 31, 2016</b>	<b>Less Than 12 Months</b>		<b>12 Months or Longer</b>	
	<b>Unrealized Losses</b>	<b>Fair Value of Investments with Unrealized Losses</b>	<b>Unrealized Losses</b>	<b>Fair Value of Investments with Unrealized Losses</b>
U.S. government and agency securities	\$ -	\$259	\$(1)	\$119
Residential MBS	(1)	305	(3)	273
Commercial MBS	(1)	67	(1)	161
Other MBS and ABS	(12)	758	(1)	59
U.S. state and municipal	(5)	340	(9)	328
Corporate and other	(221)	3,899	(182)	1,735
Foreign government securities	(7)	479	(9)	482
Total fixed maturities	(247)	6,107	(206)	3,157
Common stock	(75)	531	(13)	58
Preferred stock	(1)	3	(55)	253
Total equities	(76)	534	(68)	311
Total	\$(323)	\$6,641	\$(274)	\$3,468

Unrealized losses decreased from \$1,021 as of December 31, 2015 to \$597 as of March 31, 2016 primarily due to the declining treasury rates. Unrealized losses less than 12 months decreased from \$731 at December 31, 2015 to \$323 as of March 31, 2016. Unrealized losses 12 months or longer decreased from \$290 as of December 31, 2015 to \$274 as of March 31, 2016. Of the \$13 unrealized losses 12 months or longer on common stock, \$3 relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. As of March 31, 2016, there were 1,022 securities that were in an unrealized loss position for 12 months or longer. The Company monitors the difference between the amortized cost and estimated fair value of debt securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed maturity securities before they recover their fair value.

If the Company believes a decline in the value (including foreign exchange rates) of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be other-than-temporary, and the Company believes that it will not be able to collect all cash flows due on its fixed maturity securities, then the carrying value of the investment is written down to the expected cash flow amount and a realized loss is recorded as a credit impairment. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes, as the difference between expected cash flows and fair value. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of March 31, 2016 are temporary.

For equity securities, 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. The gross unrealized losses recorded on equity securities as of March 31, 2016 resulted primarily from decreases in quoted fair 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. The Company has concluded that the gross unrealized losses of equity securities as of March 31, 2016 are temporary.

The Company reviews fixed maturity securities, equity securities, and other investments for impairment on a quarterly basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to: (a) the extent of the decline in fair value below book value, (b) the duration of the decline, (c) significant adverse changes in the financial condition or near term prospects of the investment or issuer, (d) significant change in the business climate or credit ratings of the issuer, (e) general market conditions and volatility, (f) industry factors, and (g) the past impairment of the security holding or the issuer. For fixed maturity securities that the Company does not intend to sell or for which it is more likely than not that the Company would not be required to sell before an anticipated recovery in value, the Company separates impairments into credit loss and non-credit loss components. The determination of the credit loss component of the impairment charge is based on the Company's best estimate of the present value of the cash flows expected to be collected from the fixed

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(dollars in millions)

(Unaudited)

maturity security compared to its amortized cost and is reported as part of net realized gains. The non-credit component, the residual difference between the credit impairment component and the fair value, is recognized in other comprehensive income. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the fixed maturity security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration, (e) impact of foreign exchange rates on foreign currency denominated securities and (f) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all fixed maturity securities and certain preferred equity securities) or the Company does not have the intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in fair value.

#### ***Variable Interest Entities***

The Company invests in limited partnerships and other entities subject to VIE analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of March 31, 2016, the Company has determined that it is not the primary beneficiary of any VIEs.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323, *Investments-Equity Method and Joint Ventures*. These VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. The net carrying value of non-consolidated VIEs in which the Company has a variable interest was \$4,331 and \$1,719 as of March 31, 2016 and December 31, 2015, respectively, and the Company's maximum exposure to loss was \$7,272 and \$2,487 as of March 31, 2016 and December 31, 2015, respectively. The assets are included in other investments on the accompanying consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIEs. The increase in the maximum exposure to loss from December 31, 2015 to March 31, 2016 is primarily due to the adoption of ASU 2015-02. Please see footnote 1 for more information. There is no recourse provision to the general credit of the Company for any VIEs beyond the full amount of the Company's loss exposure.

#### **(4) REINSURANCE**

In the ordinary course of business, the Company assumes reinsurance and also cedes reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Company is also a member of various involuntary pools and associations and serves as a servicing carrier for residual market organizations. The Company remains contingently liable in the event reinsurers are unable to meet their obligations for paid and unpaid reinsurance recoverables and unearned premiums ceded under reinsurance agreements.

The Company reported reinsurance recoverables of \$13,759 and \$13,575 as of March 31, 2016 and December 31, 2015, respectively, net of allowance for doubtful accounts of \$136 and \$131, respectively. Included in these balances are \$540 and \$486 of paid recoverables and \$13,355 and \$13,220 of unpaid recoverables, respectively.

As part of its reinsurance security oversight, the Company has established a Credit Risk Committee ("the Committee") 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 Committee is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company's purchase and use of reinsurance.

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 charges to the accompanying consolidated statements of income.

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On July 17, 2014, Liberty Mutual Insurance Company (“LMIC”) entered into a reinsurance transaction with National Indemnity Company (“NICO”), a subsidiary of Berkshire Hathaway Inc., on a combined aggregate excess of loss agreement for substantially all of the Company’s U.S. workers compensation, asbestos and environmental liabilities (the “NICO Reinsurance Transaction”), attaching at \$12,522 of combined aggregate reserves, with an aggregate limit of \$6,500 and sublimits of \$3,100 for asbestos and environmental liabilities and \$4,507 for certain workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but effective as of January 1, 2014, the Company ceded \$3,320 of existing undiscounted liabilities under this retroactive reinsurance agreement. NICO will provide \$3,180 of additional aggregate adverse development cover. The Company paid NICO total consideration of \$3,046, and recorded a pre-tax loss of \$128. With respect to the ceded asbestos and environmental business, NICO has been given authority to handle claims, subject to the Company’s oversight and control. With respect to the ceded workers compensation business, the Company will continue to handle claims.

In general terms, the covered business includes post December 31, 2013 development on: (1) asbestos and environmental liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005; and (2) workers compensation liabilities arising out of policies on the books of the Company’s Commercial Insurance Strategic Business Unit as of December 31, 2013, as respects injuries or accidents occurring prior to January 1, 2014.

To the extent there is unfavorable development of losses covered by this reinsurance, additional reinsurance benefit is recognized in the consolidated statements of income until those benefits exceed the original loss on the transaction. Reinsurance benefits in excess of the original loss will be deferred and recognized over the claims paying period of the reinsured policies.

The following table displays the impact of the NICO Reinsurance Transaction on the consolidated statements of income and the remaining unrecognized reinsurance benefit:

	<b>Three Months Ended March 31, 2016</b>	<b>Twelve Months Ended December 31, 2015</b>
Change in unrecognized reinsurance benefit under NICO Reinsurance Transaction		
Unrecognized reinsurance benefit related to original transaction loss at the beginning of the period	\$59	\$43
Asbestos and environmental unfavorable loss development	-	5
Workers compensation unfavorable/(favorable) loss development	3	(21)
Total amounts ceded under NICO Reinsurance Transaction	3	(16)
Retroactive reinsurance (benefits)/reductions recognized into income	(3)	16
Pre-tax impact of unrecognized deferred retroactive reinsurance benefit	-	-
Unrecognized reinsurance benefit related to original transaction loss at the end of the period	\$56	\$59

Once the aggregate of workers compensation and asbestos and environmental development exceeds the original pre-tax loss of \$128, deferred gains will be recorded. Deferred gains are subsequently amortized into earnings over the period when underlying claims are settled.

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**(5) DEBT OUTSTANDING**

Debt outstanding as of March 31, 2016 and December 31, 2015 includes the following:

*Current maturities of long-term debt:*

	2016	2015
Short-term debt	\$6	\$ -
Current maturities of long-term debt	249	249
Total short-term debt and current maturities of long-term debt	\$255	\$249

*Long-term debt:*

	2016	2015
7.00% Junior Subordinated Notes, due 2067 <sup>(1)</sup>	\$300	\$300
5.00% Notes, due 2021	600	600
4.95% Notes, due 2022	750	750
4.25% Notes, due 2023	1,000	1,000
8.50% Surplus Notes, due 2025	140	140
7.875% Surplus Notes, due 2026	227	227
7.625% Notes, due 2028	3	3
3.91% - 4.25% Federal Home Loan Bank Borrowings due 2032	300	300
7.00% Notes, due 2034	231	231
6.50% Notes, due 2035	471	471
7.50% Notes, due 2036	19	19
7.80% Junior Subordinated Notes, due 2087 <sup>(2)</sup>	700	700
10.75% Junior Subordinated Notes, due 2088 <sup>(3)</sup>	177	193
6.50% Notes, due 2042	750	750
4.85% Notes, due 2044	1,050	1,050
7.697% Surplus Notes, due 2097	260	260
	6,978	6,994
Unamortized discount	(12)	(12)
Total long-term debt excluding unamortized debt issuance costs	6,966	6,982
Unamortized debt issuance costs	(41)	(42)
Total long-term debt	\$6,925	\$6,940

<sup>(1)</sup> The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.

<sup>(2)</sup> The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

<sup>(3)</sup> The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

***Debt Transactions and In-Force Credit Facilities***

During the three months ended March 31, 2016, the Company repurchased \$16 of the 10.75% Junior Subordinated notes due 2088 compared to no repurchases for the same period in 2015. Pre-tax losses of \$8 were recorded on these transactions for the three months ended March 31, 2016 and are included in loss on extinguishment of debt in the accompanying consolidated statements of income.

Effective December 21, 2015, LMIC renewed its \$1,000 repurchase agreement for a two-year period, which terminates December 21, 2017. To date, no funds have been borrowed under the facility.

Effective July 2, 2015, LMIC renewed its \$1,000 repurchase agreement for a two-year period, which terminates July 3, 2017 unless extended. To date, no funds have been borrowed under the facility.

The Company places commercial paper through a program issued by Liberty Mutual Group Inc. ("LMGI") and guaranteed by LMIC. On April 8, 2015, LMGI increased its commercial paper program from \$750 to \$1,000. As of March 31, 2016, there was no commercial paper outstanding.

On March 5, 2015, LMGI amended and restated its unsecured revolving credit facility from \$750 to \$1,000 with an expiration date of March 5, 2020. This facility backs the Company's commercial paper program. To date, no funds have been borrowed under the facility.

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LMIC, Peerless Insurance Company (“PIC”), Liberty Life Assurance Company of Boston (“LLAC”), Liberty Mutual Fire Insurance Company (“LMFIC”), and Employers Insurance Company of Wausau (“EICOW”) are members of the Federal Home Loan Bank. On March 21, 2012, LMFIC borrowed \$150 at a rate of 3.91% with a maturity date of March 22, 2032. On March 23, 2012 and April 2, 2012, LMIC borrowed \$127 at a rate of 4.24% with a maturity date of March 23, 2032 and \$23 at a rate of 4.25% with a maturity date of April 2, 2032, respectively. As of March 31, 2016, all of the outstanding Federal Home Loan Bank borrowings are fully collateralized.

On January 20, 2012, LMGI entered into two interest rate swap transactions having a notional amount of \$300 with respect to LMGI’s \$300 7.00% Junior Subordinated Notes due 2067. Pursuant to the terms of the swap agreements, commencing on March 15, 2017 and effective through March 15, 2037, LMGI has agreed with the counterparties to pay a fixed rate of interest on the notional amount and the counterparties have agreed to pay a floating rate of interest on the notional amount.

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

#### (6) ASBESTOS AND ENVIRONMENTAL

The Company’s asbestos and environmental reserves for unpaid claims and claim adjustment expenses, net of reinsurance before the NICO Reinsurance Transaction and including uncollectible reinsurance, were \$929 and \$952 as of March 31, 2016 and December 31, 2015, respectively.

In the third quarter of 2015, the Company completed a review of asbestos, environmental and miscellaneous toxic tort unpaid loss and ALAE claim liabilities. The review resulted in no change to reserves as they make a reasonable provision for all unpaid losses and loss adjustment expenses.

#### (7) INCOME TAXES

The income tax provision is calculated under the liability method of accounting. The Company recognizes deferred income tax assets and liabilities for the expected future tax effects attributable to temporary differences between the financial statement and tax return bases of assets and liabilities based on enacted tax rates and other provisions of the tax law. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized. Deferred tax positions are not established for adjustments arising from foreign operations whose earnings are considered to be permanently reinvested.

The Company’s effective tax rate on continuing operations differs from the U.S. Federal statutory rate of 35% principally due to tax-exempt investment income. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance as of December 31, 2015	\$249
Additions for tax positions in current year	1
Additions for tax positions of prior years	11
Reductions for tax positions of prior years	(4)
Translation	3
Balance as of March 31, 2016	<u>\$260</u>

Included in the tabular roll forward of unrecognized tax benefits are interest and penalties in the amount of \$34 and \$34 as of March 31, 2016 and December 31, 2015, respectively.

Included in the balance at March 31, 2016 is \$69 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. For the three months ended March 31, 2016 and 2015, the Company recognized \$1 and \$0 of interest and penalties, respectively. The Company had \$32 and \$31 of interest and penalties accrued as of March 31, 2016 and December 31, 2015, respectively.

The IRS has completed its review of the Company’s United States Federal income tax returns through the 2007 tax year and is currently reviewing income tax returns for the 2008 through 2011 tax years. Any adjustments that may result from the IRS examinations 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.



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The Company believes that the range of reasonably possible changes to the balance of unrecognized tax benefits could decrease by \$0 to \$200 within the next twelve months as a result of potential settlements with the IRS for prior years.

#### (8) BENEFIT PLANS

The net benefit costs for the three months ended March 31, 2016 and 2015 include the following components:

Three months ended March 31,	Pension Benefits		Supplemental Pension Benefits <sup>(1)</sup>		Postretirement Benefits	
	2016	2015	2016	2015	2016	2015
Components of net periodic benefit costs:						
Service costs	\$33	\$33	\$1	\$1	\$4	\$5
Interest costs	77	85	4	4	9	10
Expected return on plan assets	(115)	(107)	-	-	-	-
Amortization of unrecognized:						
Net loss	38	49	5	5	-	1
Prior service cost	(1)	(1)	-	-	(3)	(3)
<b>Net periodic benefit costs</b>	<b>\$32</b>	<b>\$59</b>	<b>\$10</b>	<b>\$10</b>	<b>\$10</b>	<b>\$13</b>

<sup>(1)</sup> The Company sponsors non-qualified supplemental pension plans to restore to selected highly compensated employees the pension benefits to which they would be entitled under the Company's U.S. tax qualified, defined benefit pension plan had it not been for limits imposed by the Internal Revenue Code. The supplemental plans are unfunded.

Effective December 31, 2015, the discount rate assumption used to determine the benefit obligations is based on the yield curve where the cash flows related to each of the benefit plans' liability stream is discounted using spot rates specifically applicable to the timing of the cash flows of each Plan. Effective January 1, 2016, service cost is calculated by discounting the future cash flows attributable to the current year of service using spot rates specifically applicable to the timing of the cash flows. Interest cost is determined by multiplying each benefit obligation cash flow by the spot rate applicable to that timing of the cash flow. The spot rate change, which is accounted for as a change in estimate, resulted in an immaterial reduction in interest cost and service cost for the period.

The Company has contributed \$101 to the qualified plans as of March 31, 2016 and expects to additionally contribute approximately \$704.

#### (9) FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses the market approach, which generally utilizes market transaction data for identical or similar instruments.

The hierarchy level assigned to each security in the Company's available for sale portfolio is based on the Company's assessment of the transparency and reliability of the inputs used in the valuation of each instrument at the measurement date. The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified based on the lowest level of input that is significant to the fair value measurement. The Company recognizes transfers between levels at the end of each reporting period. The three hierarchy levels are defined as follows:

- Level 1 — Valuations based on unadjusted quoted market prices in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2 — Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets or liabilities at the measurement date, quoted prices in markets that are not active, or other inputs that are observable, either directly or indirectly.
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement and involve management judgment. The unobservable inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the assets and liabilities.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace,

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and other characteristics particular to the financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3.

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance on the overall reasonableness and consistent application of valuation methodologies and inputs and compliance with accounting standards through the execution of various processes and controls designed to ensure that the Company's assets and liabilities are appropriately valued. For fair values received from third parties or internally estimated, the Company's processes are designed to determine that the valuation methodologies and inputs are appropriate and consistently applied, the assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities.

The Company used the following methods and assumptions in estimating the fair value of its financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy:

#### **Fixed Maturities**

At each valuation date, the Company uses various valuation techniques to estimate the fair value of its fixed maturities portfolio. The primary method for valuing the Company's securities is through independent third-party valuation service providers. For positions where valuations are not available from independent third-party valuation service providers, the Company utilizes broker quotes and internal pricing methods to determine fair values. The Company obtains a single non-binding price quote from a broker familiar with the security who, similar to the Company's valuation service providers, may consider transactions or activity in similar securities, as applicable, among other information. The brokers providing price quotes are generally from the brokerage divisions of leading financial institutions with market making, underwriting and distribution expertise regarding the security subject to valuation. The evaluation and prioritization of these valuation sources is systematic and predetermined resulting in a single quote or price for each financial instrument. The following describes the techniques generally used to determine the fair value of the Company's fixed maturities by asset class:

#### **U.S. Government and Agency Securities**

U.S. government and agency securities consist primarily of bonds issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. As the fair values of the Company's U.S. Treasury securities are based on active markets and unadjusted market prices, they are classified within Level 1. The fair value of U.S. government agency securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, reported trades, bids, offers and credit spreads. Accordingly, the fair value of U.S. government agency securities is primarily classified within Level 2.

#### **Mortgage-Backed Securities**

The Company's portfolio of residential and commercial MBS is originated by both agencies and non-agencies, the majority of which are pass-through securities issued by U.S. government agencies. The fair value of MBS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of MBS is primarily classified within Level 2.

#### **Asset-Backed Securities**

ABS include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, credit card receivables, and collateralized loan obligation securities originated by a variety of financial institutions. The fair value of ABS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of ABS is primarily classified within Level 2.

#### **Municipal Securities**

The Company's municipal portfolio is comprised of bonds issued by U.S. domiciled state and municipal entities. The fair value of municipal securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades and credit spreads. Accordingly, the fair value of municipal securities is primarily classified within Level 2.

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#### Corporate Debt and Other Securities

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair value of corporate and other securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of corporate and other securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

#### Foreign Government Securities

Foreign government securities include bonds issued or guaranteed by foreign governments. The fair value of foreign government securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades of identical or comparable securities and credit spreads. Accordingly, the fair value of foreign government securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

#### Equity Securities

Equity securities include common and preferred stocks. Common stocks with fair values based on quoted market prices in active markets are classified within Level 1. Common stocks with fair values determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active are classified within Level 2. The fair value of preferred stock is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active. Accordingly, the fair value of preferred stock is primarily classified within Level 2.

#### Short-Term Investments

The fair value of short-term investments is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of short-term investments is primarily classified within Level 2 of the fair value hierarchy.

#### Other Investments

Other investments include primarily foreign cash deposits and equity investments in privately held businesses. Cash deposits are primarily valued using quoted prices for similar instruments in active markets; these assets are categorized within Level 2 of the fair value hierarchy. Equity investments in privately held businesses are valued using internal management estimates; they are categorized within Level 3 of the hierarchy. Limited partnership and other equity method investments, which represent the remainder of the other investment balance on the accompanying consolidated balance sheet are not subject to these disclosures and therefore are excluded from the table in this note.

#### Separate Account Assets

Separate account assets, which primarily consist of other limited partnerships and equity securities, are measured based on the methodologies discussed above. The activity in separate account assets is offset by an equal amount for separate account liabilities, which results in a net zero impact for the Company. Separate account assets within Level 3 include other limited partnership interests. Other limited partnership interests are valued giving consideration to the value of the underlying holdings of the partnerships.

#### Other Assets and Other Liabilities

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

Additionally, other assets and other liabilities classified within Level 2 represent the Company's derivatives which can be exchange-traded or traded over-the-counter ("OTC"). OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. When models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of, and specific risks inherent in the instrument, as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be corroborated by observable market data by correlation or other means, and model selection does not involve significant management judgment.

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**Life Insurance Obligations**

Life insurance obligations include certain variable annuity contracts that provide guaranteed minimum income benefits. These benefits are accounted for as embedded derivatives and are bifurcated from the host contract and carried at fair value. The fair value of these embedded derivatives are computed on a recurring basis using assumptions predominately classified as Level 3 (significant unobservable) inputs. While some inputs are observable in the market, such as risk free rates, volatility and historical equity returns, the underlying future policyholder behavior inputs are highly unobservable. The significant policyholder behavior assumptions include lapse and the underlying annuitization rate.

The following tables summarize the Company's assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015:

	<b>As of March 31, 2016</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b><i>Assets, at Fair Value</i></b>				
U.S. government and agency securities	\$2,657	\$703	\$ -	\$3,360
Residential MBS	-	7,339	-	7,339
Commercial MBS	-	1,630	45	1,675
Other MBS and ABS	-	3,062	53	3,115
U.S. state and municipal	-	14,072	254	14,326
Corporate and other	-	30,440	268	30,708
Foreign government securities	-	4,558	-	4,558
Total fixed maturities, available for sale	2,657	61,804	620	65,081
Common stock	2,022	-	43	2,065
Preferred stock	-	331	4	335
Total equity securities, available for sale	2,022	331	47	2,400
Short-term investments	1	250	-	251
Other investments	-	60	479	539
Separate account assets	32	-	70	102
Other assets	7	18	31	56
Total assets	\$4,719	\$62,463	\$1,247	\$68,429
<b><i>Liabilities, at Fair Value</i></b>				
Life insurance obligations	\$ -	\$ -	\$(179)	\$(179)
Other liabilities	-	(64)	-	(64)
Total liabilities	\$ -	\$(64)	\$(179)	\$(243)

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<i>Assets, at Fair Value</i>	As of December 31, 2015			
	Level 1	Level 2	Level 3	Total
U.S. government and agency securities	\$2,627	\$685	\$ -	\$3,312
Residential MBS	-	7,379	1	7,380
Commercial MBS	-	1,521	75	1,596
Other MBS and ABS	-	3,013	80	3,093
U.S. state and municipal	-	13,921	244	14,165
Corporate and other	-	28,811	235	29,046
Foreign government securities	-	4,192	10	4,202
Total fixed maturities, available for sale	2,627	59,522	645	62,794
Common stock	2,529	-	42	2,571
Preferred stock	-	334	4	338
Total equity securities, available for sale	2,529	334	46	2,909
Short-term investments	1	271	-	272
Other investments	-	133	479	612
Separate account assets	38	-	64	102
Other assets	6	32	25	63
Total assets	\$5,201	\$60,292	\$1,259	\$66,752
<i>Liabilities, at Fair Value</i>				
Life insurance obligations	\$ -	\$ -	\$(154)	\$(154)
Other liabilities	-	(34)	-	(34)
Total liabilities	\$ -	\$(34)	\$(154)	\$(188)

The Company did not have significant transfers between Levels 1 and 2 for the three months ended March 31, 2016.

The following tables summarize the fair values of assets on a recurring basis classified as Level 3 within the fair value hierarchy:

	Balance January 1, 2016	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Purchases	Settlements	Sales and Maturities	Transfer in to Level 3	Transfer out of Level 3	Balance March 31, 2016
<i>Assets, at Fair Value</i>									
U.S. government and agency securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Residential MBS	1	-	-	-	-	-	-	(1)	-
Commercial MBS	75	-	1	-	-	-	1	(32)	45
Other MBS and ABS	80	-	(2)	-	-	(1)	-	(24)	53
U.S. state and municipal	244	-	6	67	-	(5)	-	(58)	254
Corporate and other	235	-	5	31	-	(3)	-	-	268
Foreign government securities	10	-	-	-	-	(1)	-	(9)	-
Total fixed maturities	645	-	10	98	-	(10)	1	(124)	620
Common stock	42	-	1	-	-	-	-	-	43
Preferred stock	4	-	-	-	-	-	-	-	4
Total equity securities	46	-	1	-	-	-	-	-	47
Short-term investments	-	-	-	-	-	-	-	-	-
Other investments	479	-	1	-	-	(1)	-	-	479
Separate account assets	64	-	-	-	-	-	6	-	70
Other assets	25	7	-	(1)	-	-	-	-	31
Total assets	\$1,259	\$7	\$12	\$97	\$ -	\$(11)	\$7	\$(124)	\$1,247
<i>Liabilities, at Fair Value</i>									
Life insurance obligations	\$(154)	\$(27)	\$ -	\$2	\$ -	\$ -	\$ -	\$ -	\$(179)
Total liabilities	\$(154)	\$(27)	\$ -	\$2	\$ -	\$ -	\$ -	\$ -	\$(179)

**Liberty Mutual Holding Company Inc.**

Notes to Consolidated Financial Statements

(dollars in millions)

(Unaudited)

	Balance January 1, 2015	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Purchases	Settlements	Sales and Maturities	Transfer in to Level 3	Transfer out of Level 3	Balance December 31, 2015
<b>Assets, at Fair Value</b>									
U.S. government and agency securities	\$22	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$(22)	\$ -
Residential MBS	1	-	1	156	-	-	-	(157)	1
Commercial MBS	84	-	2	52	-	(28)	-	(35)	75
Other MBS and ABS	70	-	(3)	100	-	(4)	-	(83)	80
U.S. state and municipal	176	-	(15)	180	-	(6)	47	(138)	244
Corporate and other	251	(4)	(6)	155	-	(156)	6	(11)	235
Foreign government securities	11	(1)	-	1	-	(1)	-	-	10
Total fixed maturities	615	(5)	(21)	644	-	(195)	53	(446)	645
Common stock	44	27	(4)	21	-	(36)	1	(11)	42
Preferred stock	2	-	-	2	-	-	-	-	4
Total equity securities	46	27	(4)	23	-	(36)	1	(11)	46
Short-term investments	1	-	-	-	-	(1)	-	-	-
Other investments	440	(1)	48	26	-	(34)	-	-	479
Separate account assets	60	6	-	-	-	(2)	-	-	64
Other assets	27	1	-	(3)	-	-	-	-	25
Total assets	<u>\$1,189</u>	<u>\$28</u>	<u>\$23</u>	<u>\$690</u>	<u>\$ -</u>	<u>\$(268)</u>	<u>\$54</u>	<u>\$(457)</u>	<u>\$1,259</u>
<b>Liabilities, at Fair Value</b>									
Life insurance obligations	\$(163)	\$(4)	\$ -	\$13	\$ -	\$ -	\$ -	\$ -	\$(154)
Total liabilities	<u>\$(163)</u>	<u>\$(4)</u>	<u>\$ -</u>	<u>\$13</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$(154)</u>

Transfers into and out of Level 3 were primarily due to changes in the observability of pricing inputs.

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held as of March 31, 2016.

For the three months ended March 31, 2016, there were no impairments recognized for items measured at fair value on a nonrecurring basis.

The Company has not applied ASC 820, *Fair Value Measurements and Disclosures*, to non-financial assets and liabilities.

#### **(10) COMMITMENTS AND CONTINGENT LIABILITIES**

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

As of March 31, 2016, the Company had unfunded commitments in traditional private equity partnerships, natural resources, real estate, and other of \$1,780, \$2,957 (\$2,950 of which is related to energy investments), \$828, and \$582, respectively.

As of March 31, 2016, the Company had commitments to purchase various residential MBS at a cost and fair value of \$119, and various corporate and municipal securities at a cost of \$249 and fair value of \$252.

#### **(11) SUBSEQUENT EVENTS**

On May 5, 2016, LMIC extended the termination date of its \$1,000 repurchase agreement from July 3, 2017 to July 3, 2018, unless extended.

On May 4, 2016, LMGI issued €750 million par value of Senior Notes due 2026 (the "2026 Notes"). Interest is payable annually at a fixed rate of 2.75%. The 2026 Notes mature on May 4, 2026.

Management has assessed material subsequent events through May 17, 2016, the date the financial statements were available to be issued.