Liberty
Mutual
INSURANCE

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

Quarter Ended March 31, 2016

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 Insurance group of entities (the "Company" or "LMHC"), for the three months ended March 31, 2016 and 2015. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's December 31, 2015 Audited Consolidated Financial Statements, March 31, 2016 Unaudited Consolidated Financial Statements and First Quarter 2016 Financial Supplement located on the Company's Investor Relations website at www.libertymutualgroup.com/investors. The Company's discussions related to net income are presented in conformity with U.S. generally accepted accounting principles ("GAAP") on an after-tax basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted. Further, the Company notes that it may make material information regarding the Company available to the public, from time to time, via the Company's Investor Relations website at www.libertymutualgroup.com/investors (or any successor site).

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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.

Some of the factors that could cause actual results to differ include, but are not limited to the following: the occurrence of catastrophic events (including terrorist acts, hurricanes, hail, tornados, tsunamis, earthquakes, floods, snowfall and winter conditions); inadequacy of loss reserves; adverse developments involving asbestos, environmental or toxic tort claims and litigation; adverse developments in the cost, availability or ability to collect reinsurance; disruptions to the Company’s relationships with its independent agents and brokers; financial disruption or a prolonged economic downturn; the performance of the Company’s investment portfolios; a rise in interest rates; risks inherent in the Company’s alternative investments in private limited partnerships (“LP”), limited liability companies (“LLC”), commercial mortgages and natural resource working interests; difficulty in valuing certain of the Company’s investments; subjectivity in the determination of the amount of impairments taken on the Company’s investments; unfavorable outcomes from litigation and other legal proceedings, including the effects of emerging claim and coverage issues and investigations by state and federal authorities; the Company’s exposure to credit risk in certain of its business operations; the Company’s inability to obtain price increases or maintain market share due to competition or otherwise; inadequacy of the Company’s pricing models; changes to insurance laws and regulations; changes in the amount of statutory capital that the Company must hold to maintain its financial strength and credit ratings; regulatory restrictions on the Company’s ability to change its methods of marketing and underwriting in certain areas; assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company’s claims-paying and financial strength ratings; the ability of the Company’s subsidiaries to pay dividends to the Company; inflation, including inflation in medical costs and automobile and home repair costs; the cyclicality of the property and casualty insurance industry; political, legal, operational and other risks faced by the Company’s international business; potentially high severity losses involving the Company’s surety products; loss or significant restriction on the Company’s ability to use credit scoring in the pricing and underwriting of personal lines policies; inadequacy of the Company’s controls to ensure compliance with legal and regulatory standards; changes in federal or state tax laws; risks arising out of the Company’s securities lending program; the Company’s utilization of information technology systems and its implementation of technology innovations; difficulties with technology or data security; insufficiency of the Company’s business continuity plan in the event of a disaster; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions; insufficiency of the Company’s enterprise risk management models and modeling techniques; and changing climate conditions. 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 website at www.libertymutualgroup.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 2016 Unaudited Consolidated Financial Statements.

Consolidated Results of Operations

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**% Change**
Net written premium ("NWP")	$8,772	$8,726	0.5%
Pre-tax operating income ("PTOI") before partnerships, LLC and other equity method income (loss)	614	545	12.7
Net operating income before partnership, LLC and other equity method income (loss)	405	403	0.5
Partnerships, LLC and other equity method income (loss)	23	(53)	NM
Net realized (losses) gains	(39)	37	NM
Consolidated net income from continuing operations	403	390	3.3
Discontinued operations, net of tax	-	(118)	(100.0)
Net income attributable to LMHC	$393	$276	42.4%
Cash flow provided by operations	$299	$493	(39.4%)

NM = Not Meaningful

	Three Months Ended March 31,		
	2016	**2015**	**Point Change**
Combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2]	90.2%	92.1%	(1.9)
Combined ratio	96.3%	97.1%	(0.8)

	As of March 31,	**As of December 31,**	
$ in Millions	**2016**	**2015**	**% Change**
Short-term debt	$255	$249	2.4%
Long-term debt	6,925	6,940	(0.2)
Total debt	$7,180	$7,189	(0.1%)
Unassigned equity	$21,057	$20,664	1.9%
Accumulated other comprehensive loss	(627)	(1,521)	(58.8)
Non-controlling interest	69	98	(29.6)
Total equity	$20,499	$19,241	6.5%

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. and Cyclone Winston. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years (including prior year losses related to natural catastrophes and prior year catastrophe reinstatement premium) including earned premium attributable to prior years.

Subsequent Events

On May 5, 2016, Liberty Mutual Insurance Company ("LMIC") extended the termination date of its $1 billion repurchase agreement from July 3, 2017 to July 3, 2018, unless extended.

On May 4, 2016, Liberty Mutual Group Inc. ("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.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated PTOI, PTOI before partnerships, LLC and other equity method income, and net operating income before partnerships, LLC and other equity method income as non-GAAP financial measures. PTOI is defined by the Company as pre-tax income excluding net realized gains, loss on extinguishment of debt, extraordinary items, discontinued operations, integration and other acquisition and realignment related costs and cumulative effects of changes in accounting principles. PTOI before partnerships, LLC and other equity method income is defined as PTOI excluding LP and LLC results recognized on the equity method and revenue and expenses from the production and sale of oil and gas. Net operating income is defined as net income excluding the after-tax impact of net realized gains and discontinued operations. PTOI before partnerships, LLC and other equity method income, PTOI, and net operating income before partnerships, LLC and other equity method income 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. Net realized gains and partnership, LLC and other equity method results are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results, and the timing and amount of integration and other acquisition and realignment related costs and the extinguishment of debt are not connected to the management of the insurance and underwriting aspects of the Company's business. Income taxes are significantly impacted by permanent differences. References to NWP 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"), and changes in estimated premium. In addition, the majority of workers compensation premium is adjusted to the "booked as billed" method through the Corporate and Other segment. The Company believes that NWP 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.

On February 17, 2016, the Company announced plans to combine its Personal Insurance and Liberty International strategic business units ("SBUs") to form a new SBU, Global Consumer Markets. This new SBU represents an opportunity to blend the complementary strengths of the two operations. The Company's local expertise in growth markets outside the U.S. coupled with strong and scalable U.S. personal lines capabilities puts it in a unique position to take maximum advantage of opportunities to grow its business globally. The former Personal Insurance and Liberty International SBUs are now operating segments of Global Consumer Markets and known as U.S. Consumer Markets and International Consumer Markets, respectively. All prior periods have been restated to reflect the new structure.

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

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

Effective September 30, 2015, the Company determined it was appropriate to deconsolidate the Venezuelan operations and recognized an impairment charge of $690 million. Concurrent with this decision, the Company has classified the Venezuelan operations and the related impairment charge as discontinued operations. Subsequent to deconsolidation, the Company accounts for its ongoing investment in the Venezuela operation on the cost basis. All prior periods have been adjusted to reflect this change.

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

On July 1, 2015, the Company completed the acquisition of Hughes Insurance, an independent insurance broker in Northern Ireland. Hughes Insurance controlled £60 million in gross written premium for the year ended March 31, 2014, making it the independent insurance broker in Northern Ireland. Hughes Insurance has been reflected in the Consolidated Financial Statements since the second quarter of 2014.

Venezuela

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 the 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 million 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. The prior period has been adjusted to reflect this change.

The Company’s three SBUs are as follows:

- Global Consumer Markets comprises two operating segments: U.S. Consumer Markets and International Consumer Markets.
    - U.S. Consumer Markets includes all domestic personal lines business. Products are distributed through multiple distribution channels, including captive representatives, independent agents and third-party producers.
    - International Consumer Markets sells property-casualty, health and life insurance products and services to individuals and businesses in two market segments: West, including Brazil, Colombia, Chile, Ecuador, Spain, Portugal, Ireland, and Poland; and East, including Thailand, Singapore, Hong Kong, Vietnam, Malaysia, India, China, Russia, and Turkey.

- Commercial Insurance offers a wide array of property-casualty, group benefits, and life insurance coverages through independent agents, brokers, benefit consultants, captive agents, and bank partners throughout the United States. Commercial Insurance is organized into the following four market segments: Business Insurance, National Insurance, Liberty Mutual Benefits, and Other Commercial Insurance.

- Global Specialty comprises a wide array of products and services offered through three market segments: Liberty Specialty Markets (“LSM”), Liberty International Underwriters (“LIU”), and Liberty Mutual Surety (“LM Surety”).

Overview – Consolidated

Consolidated NWP by significant line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Private passenger automobile	$3,082	$2,977	3.5%
Homeowners	1,338	1,301	2.8
Specialty insurance	559	644	(13.2)
Workers compensation – Voluntary	529	508	4.1
Workers compensation - Involuntary	24	28	(14.3)
Commercial multiple-peril	504	479	5.2
Global specialty reinsurance	498	520	(4.2)
Commercial automobile	439	410	7.1
Group disability and group life	396	351	12.8
General liability	369	360	2.5
Surety	201	215	(6.5)
Corporate reinsurance[1]	179	264	(32.2)
Commercial property	178	173	2.9
Global specialty inland marine	122	107	14.0
Individual life and A&H	106	150	(29.3)
Other[2]	248	239	3.8
Total NWP	$8,772	$8,726	0.5%

[1] NWP associated with internal reinsurance, net of corporate external placements.
[2] Primarily includes NWP from allied lines and domestic inland marine.

NWP for the three months ended March 31, 2016 was $8.772 billion, an increase of $46 million over the same period in 2015.

Significant changes by major line of business include:

- Private passenger automobile NWP increased $105 million over the same period in 2015. The increase reflects rate and model year increases, and to a lesser extent, growth in policies in-force in U.S. Consumer Markets, along with growth in International Consumer Markets primarily driven by Chile (acquired in January 2016). This was partially offset by the strengthening of the U.S. dollar and the exit from the personal insurance market in Great Britain.
- Homeowners NWP increased $37 million over the same period in 2015. The increase reflects rate and coverage increases as well as growth in homeowners policies in-force in U.S. Consumer Markets, partially offset by the strengthening of the U.S. dollar.
- Specialty insurance NWP decreased $85 million from the same period in 2015. The decrease reflects multi-year policies written in 2015, re-underwriting and pricing actions, competitive market conditions, and the strengthening of the U.S. dollar.
- Group disability and group life NWP increased $45 million over the same period in 2015. The increase reflects strong new business sales.
- Corporate reinsurance NWP decreased $85 million from the same period in 2015. The decrease was primarily driven by lower assumed premium due to program changes, lower subject premiums, and lower prices, partially offset by lower external reinsurance costs.
- Individual life and A&H NWP decreased $44 million from the same period in 2015. The decrease was primarily driven by lower life-contingent structured settlement sales.

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

Consolidated NWP by SBU was as follows:

	Three Months Ended March 31,		
$ in Millions	2016	2015	Change
Global Consumer Markets	$4,905	$4,746	3.4%
U.S. Consumer Markets	4,124	3,904	5.6
International Consumer Markets	781	842	(7.2)
Commercial Insurance	2,294	2,204	4.1
Global Specialty	1,380	1,486	(7.1)
Corporate and Other	193	290	(33.4)
Total NWP	$8,772	$8,726	0.5%
Foreign exchange effect on NWP change			(1.5)
NWP change excluding foreign exchange[1]			2.0%

[1] Determined by assuming constant foreign exchange rates between periods.

Major drivers of NWP growth were as follows:

	Three Months Ended March 31,			
$ in Millions	2016	2015	$ Change	Points Attribution
Total NWP	$8,772	$8,726	$46	0.5
Components of growth:				
Domestic personal automobile	2,604	2,436	168	1.9
Domestic homeowners	1,294	1,251	43	0.5
International consumer markets (ex foreign exchange)[1]	881	842	39	0.4
Specialty insurance (ex foreign exchange)[1]	572	644	(72)	(0.8)
Domestic workers compensation	527	509	18	0.2
Global specialty reinsurance (ex foreign exchange)[1]	510	520	(10)	(0.1)
Domestic group disability and group life	351	300	51	0.6
Surety	201	215	(14)	(0.2)
Corporate reinsurance (ex foreign exchange)[1,2]	180	264	(84)	(1.0)
Global specialty inland marine (ex foreign exchange)[1]	125	107	18	0.2
Domestic individual life and A&H	81	119	(38)	(0.4)
Foreign exchange[1]	(128)	-	(128)	(1.5)
Other commercial lines	1,574	1,519	55	0.7
Total NWP	$8,772	$8,726	$46	0.5

[1] Determined by assuming constant foreign exchange rates between periods

[2] NWP associated with internal reinsurance net of corporate external placements.

Consolidated NWP by geographic distribution channels was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
U.S.	$7,176	$6,973	2.9%
International[1]	1,596	1,753	(9.0)
Total NWP	$8,772	$8,726	0.5%

[1] Excludes domestically written business in Global Specialty's LIU market segment.

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

Results of Operations – Consolidated

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Net operating income before partnerships, LLC and other equity method income (loss)	$405	$403	0.5%
Partnerships, LLC and other equity method income (loss), net of tax	18	(34)	NM
Net realized (losses) gains, net of tax	(25)	25	NM
Loss on extinguishment of debt, net of tax	(5)	-	NM
Discontinued operations, net of tax	-	(118)	(100.0)
Net income attributable to LMHC	$393	$276	42.4%

NM = Not Meaningful

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$9,362	$9,267	1.0%
PTOI before catastrophes, net incurred losses attributable to prior years, and partnerships, LLC and other equity method income (loss)	$1,109	$938	18.2%
Catastrophes[1]	(550)	(496)	10.9
Net incurred losses attributable to prior years:			
- Asbestos & environmental[2]	-	(1)	(100.0)
- All other[3,4]	55	104	(47.1)
PTOI before partnerships, LLC and other equity method income (loss)	614	545	12.7
Partnerships, LLC and other equity method income (loss) [5]	23	(53)	NM
PTOI	637	492	29.5
Net realized (losses) gains	(39)	37	NM
Loss on extinguishment of debt	(8)	-	NM
Pre-tax income	590	529	11.5
Income tax expense	187	139	34.5
Consolidated net income from continuing operations	403	390	3.3
Discontinued operations, net of tax	-	(118)	(100.0)
Consolidated net income	403	272	48.2
Less: Net income (loss) attributable to non-controlling interest	10	(4)	NM
Net income attributable to LMHC	$393	$276	42.4%
Cash flow provided by operations	$299	$493	(39.4%)

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. and Cyclone Winston. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Gross of the NICO Reinsurance Transaction, which is described further in "Reinsurance Recoverables".

[3] 2015 includes a one-time benefit of $91 million due to a reduction in the estimated prior years' liability for state assessments related to workers compensation.

[4] Net of earned premium and reinstatement premium attributable to prior years of $1 million and $3 million for the three months ended March 31, 2016 and 2015, respectively.

[5] Partnerships, LLC and other equity method income (loss) includes LP, LLC and other equity method income (loss) within net investment income in the accompanying Consolidated Statements of Income and revenue and expenses from the production and sale of oil and gas.

NM = Not Meaningful

PTOI for the three months ended March 31, 2016 was $637 million, an increase of $145 million over the same period in 2015. The increase reflects partnerships, LLC, and other equity method income versus losses in the prior year primarily due to lower valuation losses in the energy and metals and mining sectors in 2016, as well as impairments recorded on two equity method investments in the metals and mining sector in 2015 that did not recur. The increase also reflects profit margin on earned premium growth in U.S. Consumer Markets, improved current accident year losses across all casualty lines of business in Commercial Insurance and favorable net incurred losses attributable to prior years versus unfavorable development in 2015 in Corporate and International Consumer Markets. The increase was partially offset by increases in catastrophe losses, higher expenses related to advertising and employee related costs, and a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur.

Revenues for the three months ended March 31, 2016 were $9.362 billion, an increase of $95 million over the same period in 2015. The major components of revenues are net premium earned, net investment income, net realized (losses) gains, and fee and other revenues.

Net premium earned for the three months ended March 31, 2016 was $8.464 billion, an increase of $124 million over the same period in 2015. The increase primarily reflects the premium earned associated with the changes in NWP previously discussed and NWP growth during the last nine months of 2015, partially offset by foreign exchange losses due to strengthening of the U.S. dollar.

Net investment income for the three months ended March 31, 2016 was $687 million, an increase of $76 million over the same period in 2015. The increase was primarily a result of lower valuation losses in the energy and metals and mining sectors in 2016 as compared to the prior year. Additionally, there were impairments recorded on two equity method investments in the metals and mining sector in 2015 that did not recur.

Net realized losses for the three months ended March 31, 2016 were $39 million versus gains of $37 million in the same period in 2015. The increase in net realized losses relates to derivative losses recognized in 2016 as compared to derivative gains in 2015 and losses on sales of fixed maturity securities with underlying investments in the energy sector in 2016.

Fee and other revenues for the three months ended March 31, 2016 were $250 million, a decrease of $29 million from the same period in 2015. The decrease primarily reflects lower oil and gas revenues and lower commission revenue from servicing carrier operations, partially offset by higher fees associated with life and group disability business and higher third-party administrator fee income.

Claims, benefits and expenses for the three months ended March 31, 2016 were $8.764 billion, an increase of $26 million over the same period in 2015. The increase was driven by higher catastrophe losses, higher expenses related to advertising and employee related costs, and a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur. These increases were partially offset by lower expenses related to Liberty Energy, a decrease in current accident year losses across all casualty lines of business in Commercial Insurance, favorable incurred losses attributable to prior years versus unfavorable development in 2015 in Corporate and International Consumer Markets and the strengthening of the U.S. dollar.

Income tax expense on continuing operations for the three months ended March 31, 2016 was $187 million, an increase of $48 million over the same period in 2015. The Company's effective tax rate on continuing operations for the three months ended March 31, 2016 was 32% compared 26% for the same period in 2015. The increase in the effective tax rate on continuing operations from 2015 to 2016 is primarily due to larger pre-tax income, revisions to prior year estimates and lower foreign tax benefits. 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.

Consolidated net income from continuing operations for the three months ended March 31, 2016 was $403 million, an increase of $13 million over the same period in 2015.

Net operating income before partnerships, LLC and other equity method income (loss) for the three months ended March 31, 2016 was $405 million, an increase of $2 million over the same period in 2015.

Discontinued operations, net of tax for the three months ended March 31, 2016 were zero compared to ($118) million for the same period in 2015. The prior year reflects the Venezuelan operations.

Net income attributable to LMHC for the three months ended March 31, 2016 was $393 million, an increase of $117 million over the same period in 2015.

Cash flow provided by operations for the three months ended March 31, 2016 was $299 million, a decrease of $194 million from the same period in 2015. The decrease reflects higher loss payments in U.S. Consumer Markets and lower premium collections in International Consumer Markets and Global Specialty.

	Three Months Ended March 31,		
CONSOLIDATED	**2016**	**2015**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	59.5%	60.9%	(1.4)
Underwriting expense ratio	30.7	31.1	(0.4)
Dividend ratio	-	0.1	(0.1)
Subtotal	90.2	92.1	(1.9)
Catastrophes[1]	6.9	6.3	0.6
Net incurred losses attributable to prior years			
- Asbestos & environmental	-	-	-
- All other[2,3]	(0.8)	(1.3)	0.5
Total combined ratio[4]	96.3%	97.1%	(0.8)

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. and Cyclone Winston. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] 2015 includes a one-time benefit of $91 million due to a reduction in the estimated prior years' liability for state assessments related to workers compensation.

[3] Net of earned premium and reinstatement premium attributable to prior years.

[4] The combined 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 ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense less managed care income to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less third-party administration income and fee income (primarily related to the Company's involuntary market servicing carrier operations) and 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 and certain other run off.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2016 was 90.2%, an improvement of 1.9 points over the same period in 2015. The decrease in claims and claim adjustment expense ratio was primarily driven by a decrease in frequency of current accident year non-catastrophe auto physical damage losses in U.S. Consumer Markets and a decrease in current accident year losses across all casualty lines of business in Commercial Insurance. The decrease in the underwriting expense ratio was primarily driven by lower employee pension expenses, a reduction in legal reserves, lower commission expenses primarily due to a shift in distribution in Brazil and favorable taxes, licenses, and fees as a result of a shift in business mix in Colombia, partially offset with higher expenses related to advertising and employee related costs.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three months ended March 31, 2016 was 96.3%, an improvement of 0.8 points over the same period in 2015. The period reflects the changes in the combined ratio previously discussed and favorable net incurred losses attributable to prior years versus unfavorable development in 2015 in Corporate and International Consumer Markets, partially offset by higher current year catastrophe losses and a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur.

GLOBAL CONSUMER MARKETS

Overview – Global Consumer Markets

Effective February 17, 2016, the Company announced plans to combine its Personal Insurance and Liberty International SBUs to form a new SBU, Global Consumer Markets. This new SBU, represents an opportunity to blend the complementary strengths of the two operations. The Company's local expertise in growth markets outside the U.S. coupled with strong and scalable U.S. personal lines capabilities puts it in a unique position to take maximum advantage of opportunities to grow its business globally. The former Personal Insurance and Liberty International SBUs are now operating segments of Global Consumer Markets and known as U.S. Consumer Markets and International Consumer Markets, respectively. All prior periods have been restated to reflect the new structure.

Global Consumer Markets NWP by segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
U.S. Consumer Markets	$4,124	$3,904	5.6%
International Consumer Markets	781	842	(7.2)
Total NWP	$4,905	$4,746	3.4%

Results of Operations – Global Consumer Markets

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$5,291	$5,098	3.8%
PTOI before catastrophes and net incurred losses attributable to prior years	$734	$664	10.5%
Catastrophes[1]	(463)	(408)	13.5
Net incurred losses attributable to prior years	11	9	22.2
PTOI	$282	$265	6.4%

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

	Three Months Ended March 31,		
			Change
GLOBAL CONSUMER MARKETS	**2016**	**2015**	**(Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	61.0%	61.7%	(0.7)
Underwriting expense ratio	28.0	28.4	(0.4)
Subtotal	89.0	90.1	(1.1)
Catastrophes[1]	9.3	8.5	0.8
Net incurred losses attributable to prior years	(0.2)	(0.2)	-
Total combined ratio	98.1%	98.4%	(0.3)

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

Management's discussion and analysis for Global Consumer Markets will be discussed at the segment level in the following U.S. Consumer Markets and International Consumer Market sections, respectively.

U.S. CONSUMER MARKETS

Overview – U.S. Consumer Markets

U.S. Consumer Markets sells automobile, homeowners and other types of property and casualty insurance coverage to individuals in the United States. U.S. Consumer Markets' products are distributed through approximately 2,200 licensed captive sales representatives, approximately 600 licensed telesales counselors, independent agents, third-party producers and the Internet. U.S. Consumer Markets has more than 20,000 sponsored affinity groups (including employers, professional and alumni associations, credit unions, and other partnerships) which is a significant source of new business.

U.S. Consumer Markets NWP by line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Private passenger automobile	$2,604	$2,436	6.9%
Homeowners and other	1,520	1,468	3.5
Total NWP	$4,124	$3,904	5.6%

NWP for the three months ended March 31, 2016 was $4.124 billion, an increase of $220 million over the same period in 2015.

Private passenger automobile NWP for the three months ended March 31, 2016 was $2.604 billion, an increase of $168 million over the same period in 2015. The growth reflects a 6.6% increase in average written premiums (resulting from rate and model year increases) and, to a lesser extent, growth in policies in-force of 1.2% as compared to March 31, 2015 (resulting from improved in-force retention and strong new business production).

Homeowners and other NWP for the three months ended March 31, 2016 was $1.520 billion, an increase of $52 million over the same period in 2015. The growth reflects a 3.3% increase in homeowners average written premiums (resulting from rate and coverage changes) and growth in homeowners policies in-force of 1.0% as compared to March 31, 2015 (resulting from strong new business production).

Results of Operations – U.S. Consumer Markets

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$4,364	$4,133	5.6%
PTOI before catastrophes and net incurred losses attributable to prior years	$741	$677	9.5%
Catastrophes[1]	(463)	(408)	13.5
Net incurred losses attributable to prior years	(5)	13	NM
PTOI	$273	$282	(3.2%)

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
NM = Not Meaningful

PTOI for the three months ended March 31, 2016 was $273 million, a decrease of $9 million from the same period in 2015. The decrease was driven by higher current accident year catastrophe losses due primarily to hail storms in Texas and higher expenses driven by advertising. These items were partially offset by profit margin on growth in earned premium and a decrease in frequency of current accident year non-catastrophe auto physical damage losses.

Revenues for the three months ended March 31, 2016 were $4.364 billion, an increase of $231 million over the same period in 2015. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2016 was $4.175 billion, an increase of $223 million over the same period in 2015. The increase reflects the premium earned associated with the changes in NWP previously discussed and NWP growth during the last nine months of 2015.

Net investment income for the three months ended March 31, 2016 was $157 million, an increase of $6 million over the same period in 2015. The increase was driven by a higher invested asset base, partially offset by a lower investment yield.

Claims, benefits and expenses for the three months ended March 31, 2016 were $4.091 billion, an increase of $240 million over the same period in 2015. The increase reflects higher current accident year catastrophe losses due primarily to hail storms in Texas and higher expenses driven by advertising. These items were partially offset by a decrease in frequency of current accident year non-catastrophe auto physical damage losses.

	Three Months Ended March 31,		
U.S. CONSUMER MARKETS	**2016**	**2015**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	59.9%	60.8%	(0.9)
Underwriting expense ratio	25.5	25.3	0.2
Subtotal	85.4	86.1	(0.7)
Catastrophes[1]	11.1	10.3	0.8
Net incurred losses attributable to prior years	0.1	(0.3)	0.4
Total combined ratio	96.6%	96.1%	0.5

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The U.S. Consumer Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2016 was 85.4%, a decrease of 0.7 points from the same period in 2015. The decrease in the claims and claim adjustment expense ratio primarily reflects favorable loss experience in the auto physical damage line of business driven by a decrease in frequency. The increase in the underwriting expense ratio was driven by higher advertising expenses.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three months ended March 31, 2016 was 96.6%, an increase of 0.5 points over the same period in 2015. The increase was driven by higher catastrophe losses and favorable development of prior accident year losses in 2015 that did not recur, partially offset by the favorable changes in the claims and claim adjustment expense ratio previously discussed.

INTERNATIONAL CONSUMER MARKETS

Overview –International Consumer Markets

International Consumer Markets sells property-casualty, health and life insurance products and services to individuals and businesses in two market segments.

International Consumer Markets was realigned effective in the first quarter of 2016. The realignment will better position International Consumer Markets for continued growth and improved profitability in an increasingly competitive global marketplace. The two market segments that comprise International Consumer Markets are West, including Brazil, Colombia, Chile, Ecuador, Spain, Portugal, Ireland, and Poland; and East, including Thailand, Singapore, Hong Kong, Vietnam, Malaysia, India, China, Russia, and Turkey. Other includes internal reinsurance. All periods have been restated to reflect this change. Private passenger automobile insurance is the single largest line of business.

On June 25, 2015, the Company announced its plans to withdraw from the personal motor insurance market in Great Britain and make significant changes to its operations in Ireland. On July 23, 2015, the Company sold its Great Britain personal motor book of business to Chaucer Insurance Services Ltd. The Company will now focus on the Republic of Ireland market and transferring the customer management of its Northern Ireland policies on renewal to Hughes Insurance Services Limited ("Hughes"). Costs associated with this restructuring are included in the Consolidated Financial Statements.

Effective September 30, 2015, the Company determined it was appropriate to deconsolidate the Venezuelan operations. Concurrent with this decision, the Company has classified the Venezuelan operations and the related impairment charge as discontinued operations. For further detail, see the Consolidated Results of Operations section. All prior periods have been adjusted to reflect this change.

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

On January 14, 2016, the Company completed the acquisition of Compañia de Seguros Generales Penta Security S.A. ("Penta"), the fourth largest non-life insurer in Chile.

International Consumer Markets NWP by market segment was as follows:

	Three Months Ended March 31,			
$ in Millions	**2016**	**2015**	**Change**	**Change ex. foreign exchange**[1]
West	$564	$638	(11.6%)	1.4%
East	198	185	7.0	16.5
Other	19	19	-	-
Total NWP	$781	$842	(7.2%)	4.6%

[1] Determined by assuming constant foreign exchange rates between periods.

International Consumer Markets NWP by line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Private passenger automobile	$478	$541	(11.6%)
Life and health	70	82	(14.6)
Commercial automobile	62	60	3.3
Homeowners	44	50	(12.0)
Commercial property	5	(5)	NM
Other[1]	122	114	7.0
Total NWP	$781	$842	(7.2%)

[1] Premium related to other personal and commercial lines including personal accident, bonds, workers compensation, small and medium enterprise and marine and cargo lines of business.
NM = Not Meaningful

NWP for the three months ended March 31, 2016 was $781 million, a decrease of $61 million from the same period in 2015. The decrease reflects the strengthening of the U.S. dollar against all currencies, primarily in Brazil and Colombia, a decrease in Ireland due to Hughes shifting to a broker business and the exit from the personal insurance market in Great Britain, partially offset by the acquisition of Penta in Chile in January 2016 and strong organic growth in Asia.

Results of Operations – International Consumer Markets

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$927	$965	(3.9%)
West and Other[1] pre-tax operating loss before catastrophes and net incurred losses attributable to prior years	($6)	($12)	(50.0%)
East[2] pre-tax operating loss before catastrophes and net incurred losses attributable to prior years	(1)	(1)	-
Catastrophes	-	-	-
Net incurred losses attributable to prior years	16	(4)	NM
Pre-tax operating income (loss)	$9	($17)	NM

[1] West operations include Brazil, Colombia, Chile, Ecuador, Spain, Portugal, Ireland, and Poland. Other includes internal reinsurance and home office revenue and expenses.
[2] East operations include Thailand, Singapore, Hong Kong, Vietnam, Malaysia, India, China, Russia, and Turkey.
NM = Not Meaningful

PTOI for the three months ended March 31, 2016 was $9 million, versus a pre-tax operating loss of $17 million in the same period in 2015. The increase was primarily due to favorable net incurred losses attributable to prior years in Singapore, Malaysia, and Hong Kong, a shift in the business mix driving favorable performance in Colombia, and improved earnings in Ireland due to re-underwriting initiatives taken in 2015, partially offset by the strengthening of the U.S. dollar and increased auto losses in Brazil and Chile.

Revenues for the three months ended March 31, 2016 were $927 million, a decrease of $38 million from the same period in 2015. The primary components of revenues are net premium earned, net investment income and net realized investment gains.

Net premium earned for the three months ended March 31, 2016 was $838 million, a decrease of $41 million from the same period in 2015. The decrease was primarily driven by the strengthening of the U.S. dollar against all currencies, partially offset by premiums earned associated with the organic growth in NWP as previously discussed, NWP growth during the last nine months of 2015 and the acquisition of Penta in Chile in January 2016.

Net investment income for the three months ended March 31, 2016 was $65 million, an increase of $2 million over the same period in 2015. The increase was primarily driven by an increased asset base due to the Penta acquisition.

Net realized investment gains for the three months ended March 31, 2016 were zero, compared to $3 million in the same period in 2015. Beginning in 2016, all investment related realized gains (losses) are being recognized in the Corporate and Other section.

Claims, benefits and expenses for the three months ended March 31, 2016 were $918 million, a decrease of $61 million from the same period in 2015. The decrease was primarily driven by the strengthening of the U.S. dollar, favorable incurred losses attributable to prior years in Singapore, Malaysia, and Hong Kong and lower policyholder benefits in Spain, partially offset by the acquisition of Penta in Chile in January 2016.

	Three Months Ended March 31,		
INTERNATIONAL CONSUMER MARKETS	**2016**	**2015**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	66.7%	66.1%	0.6
Underwriting expense ratio	40.8	42.5	(1.7)
Subtotal	107.5	108.6	(1.1)
Catastrophes	-	-	-
Net incurred losses attributable to prior years	(1.9)	0.5	(2.4)
Total combined ratio	105.6%	109.1%	(3.5)

The International Consumer Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2016 was 107.5%, a decrease of 1.1 points from the same period in 2015. The increase in the claims and claim adjustment expense ratio was primarily due to increased auto losses in Brazil, Colombia and Chile. The decrease in the underwriting expense ratio was driven by lower commission expenses primarily due to a shift in distribution in Brazil and lower taxes, licenses, and fees as a result of a shift in business mix in Colombia.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three months ended March 31, 2016 was 105.6%, a decrease of 3.5 points from the same period in 2015. The total combined ratio reflects the change in the combined ratio previously discussed, as well as favorable net incurred losses attributable to prior years in Singapore, Malaysia, and Hong Kong.

COMMERCIAL INSURANCE

Overview – Commercial Insurance

Commercial Insurance offers a wide array of property-casualty, group benefits, and life insurance coverages through independent agents, brokers, benefit consultants, captive agents, and bank partners throughout the United States. Commercial Insurance is organized into the following four market segments: Business Insurance; National Insurance; Liberty Mutual Benefits; and Other Commercial Insurance. Business Insurance serves small and middle market customers through a regional operating model that combines local underwriting, market knowledge and service with the scale advantages of a national company. National Insurance provides commercial lines products and services, including third-party administration, to large businesses. Liberty Mutual Benefits provides short and long-term disability, accident, health and group life insurance to mid-sized and large businesses, as well as life and annuity products to individuals in the United States. Other Commercial Insurance primarily consists of internal reinsurance and assumed business from state-based workers compensation involuntary market pools. The Company is also a servicing carrier for state-based workers compensation involuntary market pools.

Commercial Insurance NWP by market segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Business Insurance	$1,285	$1,233	4.2%
National Insurance	536	510	5.1
Liberty Mutual Benefits	432	419	3.1
Other Commercial Insurance	41	42	(2.4)
Total NWP	$2,294	$2,204	4.1%

Commercial Insurance NWP by line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Commercial multiple-peril	$504	$479	5.2%
Workers compensation - Voluntary	489	459	6.5
Workers compensation - Involuntary	24	28	(14.3)
Commercial automobile	377	350	7.7
Group disability and group life	351	300	17.0
General liability	295	291	1.4
Commercial property	173	178	(2.8)
Individual life and A&H	81	119	(31.9)
Total NWP	$2,294	$2,204	4.1%

NWP for the three months ended March 31, 2016 was $2.294 billion, an increase of $90 million over the same period in 2015. The increase was driven by higher group disability and group life premium due to new business sales as well as increased new business, rate and retention across most casualty lines. These increases were partially offset by lower life-contingent structured settlement sales and a decrease in property premium due to continued competitive market pressures.

Results of Operations – Commercial Insurance

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$2,770	$2,759	0.4%
PTOI before catastrophes and net incurred losses attributable to prior years	$383	$305	25.6%
Catastrophes[1]	(82)	(93)	(11.8)
Net incurred losses attributable to prior years[2,3]	6	92	(93.5)
PTOI	$307	$304	1.0%

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] 2015 includes a one-time benefit of $91 million due to a reduction in the estimated prior years' liability for state assessments related to workers compensation.

[3] Net of earned premium and reinstatement premium attributable to prior years of ($4) million and $1 million for the three months ended March 31, 2016 and 2015, respectively.

PTOI for the three months ended March 31, 2016 was $307 million, an increase of $3 million over the same period in 2015. The increase reflects lower catastrophe losses, better group disability and group life claim experience and improved current accident year losses across all casualty lines of business as earned rate exceeded loss cost trends and the overall quality of the casualty lines improved due to continued underwriting efforts. These increases were offset by a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur and higher employee related costs.

Revenues for the three months ended March 31, 2016 were $2.770 billion, an increase $11 million over the same period in 2015. The major components of revenues are net premium earned, net investment income, net realized losses, and fee and other revenues.

Net premium earned for the three months ended March 31, 2016 was $2.241 billion, a decrease of $4 million from the same period in 2015. The decrease reflects lower property and casualty earned premium, primarily in workers compensation and commercial property, as a result of declining NWP over the prior twelve months. This decrease was partially offset by growth in Liberty Mutual Benefits.

Net investment income for the three months ended March 31, 2016 was $386 million, an increase of $2 million over the same period in 2015. The increase was driven by higher invested assets in Liberty Mutual Benefits, partially offset by a lower invested asset base in the property and casualty market segments.

Net realized losses for the three months ended March 31, 2016 were zero versus $6 million in the same period in 2015. The decrease was primarily driven by technology impairments in 2015 that did not recur.

Fee and other revenues for the three months ended March 31, 2016 were $143 million, an increase of $7 million over the same period in 2015. The increase reflects higher fees associated with life and group disability and higher third-party administrator fee income, partially offset by lower commission revenue from servicing carrier operations.

Claims, benefits and expenses for the three months ended March 31, 2016 were $2.463 billion, an increase of $2 million over the same period in 2015. The increase reflects a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur, higher employee related costs and business growth in Liberty Mutual Benefits. These increases were offset by improved current accident year losses across all casualty lines of business and lower catastrophe losses.

	Three Months Ended March 31,		
			Change
COMMERCIAL INSURANCE	**2016**	**2015**	**(Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	57.1%	61.7%	(4.6)
Underwriting expense ratio	35.5	34.2	1.3
Dividend ratio	0.1	0.1	-
Subtotal	92.7	96.0	(3.3)
Catastrophes[1]	4.5	5.1	(0.6)
Net incurred losses attributable to prior years[2,3]	(0.4)	(5.0)	4.6
Total combined ratio	96.8%	96.1%	0.7

[1] Catastrophes include all current accident year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] 2015 includes a one-time benefit of $91 million due to a reduction in the estimated prior years' liability for state assessments related to workers compensation.

[3] Net of earned premium and reinstatement premium attributable to prior years.

The Commercial Insurance combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2016 was 92.7%, a decrease of 3.3 points from the same period in 2015. The decrease reflects improved current accident year losses across all casualty lines of business as earned rate exceeded loss cost trends and the overall quality of the casualty lines improved due to continued underwriting efforts. The decrease was partially offset by an increase in the underwriting expense ratio driven by higher employee related costs and lower property and casualty earned premium.

Including the impact of catastrophes and net incurred losses attributable to prior years the total combined ratio for the three months ended March 31, 2016 was 96.8%, an increase of 0.7 points over the same period in 2015. The increase was impacted by a reduction in the estimated prior years' liability for state assessments related to workers compensation in 2015 that did not recur, partially offset by lower catastrophe losses and the combined ratio decrease previously discussed.

GLOBAL SPECIALTY

Overview – Global Specialty

Global Specialty comprises a wide array of products and services offered through three market segments: LSM, LIU, and LM Surety. LSM provides a wide range of product capabilities and capacity for specialty markets worldwide and is organized into three business segments: Specialty, Commercial and Reinsurance. LIU sells inland marine and specialty commercial insurance worldwide through offices in Asia, Australia, the Middle East, North America and Latin America. LM Surety is a leading provider of global contract and commercial surety bonds to businesses of all sizes. Other primarily consists of internal reinsurance.

Global Specialty NWP by market segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
LSM	$871	$946	(7.9%)
LIU	272	292	(6.8)
LM Surety	196	210	(6.7)
Other	41	38	7.9
Total NWP	$1,380	$1,486	(7.1%)
Foreign exchange effect on growth			(1.8)
NWP growth excluding foreign exchange[1]			(5.3%)

[1] Determined by assuming constant foreign exchange rates between periods.

Global Specialty's major product lines are as follows:

(1) Specialty insurance: includes marine, energy, construction, aviation, property, casualty, excess casualty, directors and officers, errors and omissions, environmental impairment liability, commercial automobile, railroad, trade credit, excess and surplus property, crisis management, contingent lines and other;
(2) Reinsurance: includes worldwide multi-line marine, property, casualty and specialty reinsurance;
(3) Surety: includes contract and commercial surety bonds;
(4) Inland marine: handset protection coverage for lost or damaged wireless devices.

Global Specialty NWP by line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Specialty insurance	$559	$644	(13.2%)
Reinsurance	498	520	(4.2)
Surety	201	215	(6.5)
Inland marine	122	107	14.0
Total NWP	$1,380	$1,486	(7.1%)

NWP for the three months ended March 31, 2016 was $1.380 billion, a decrease of $106 million from the same period in 2015. The decrease reflects multi-year policies written in 2015, re-underwriting and pricing actions for selective products in specialty insurance, competitive market conditions across most lines, large non-recurring bonds within surety in 2015 and foreign exchange impact due to the strengthening of the U.S. dollar. The decrease was partially offset by inland marine business growth.

Results of Operations – Global Specialty

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$1,251	$1,310	(4.5%)
PTOI before catastrophes and net incurred losses attributable to prior years	$176	$182	(3.3%)
Catastrophes [1]	(15)	(4)	NM
Net incurred losses attributable to prior years [2]	17	15	13.3
PTOI	$178	$193	(7.8%)

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. and Cyclone Winston. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Net of earned premium and reinstatement premium attributable to prior years of $5 million and $2 million for the three months ended March 31, 2016 and 2015, respectively.

NM = Not Meaningful

PTOI for the three months ended March 31, 2016 was $178 million, a decrease of $15 million from the same period in 2015. The decrease reflects higher catastrophe losses as well as the impact of lower earned premium primarily within LSM.

Revenues for the three months ended March 31, 2016 were $1.251 billion, a decrease of $59 million from the same period in 2015. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2016 was $1.162 billion, a decrease of $56 million from the same period in 2015. The decrease reflects reductions in NWP, premium estimates from prior years and the foreign exchange impact due to the strengthening of the U.S. dollar, partially offset by growth within inland marine.

Net investment income for the three months ended March 31, 2016 was $84 million, which is consistent with the same period in 2015.

Claims, benefits and expenses for the three months ended March 31, 2016 were $1.073 billion, a decrease of $40 million from the same period in 2015. The decrease reflects favorable current accident year losses primarily within LSM and LIU U.S. due to a decrease in exposures, partially offset by higher catastrophe losses.

	Three Months Ended March 31,		
GLOBAL SPECIALTY	**2016**	**2015**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years			
Claims and claim adjustment expense ratio	56.6%	57.5%	(0.9)
Underwriting expense ratio	34.4	33.5	0.9
Dividend ratio	0.2	0.2	-
Subtotal	91.2	91.2	-
Catastrophes [1]	1.3	0.3	1.0
Net incurred losses attributable to prior years[2]	(1.4)	(1.2)	(0.2)
Total combined ratio	91.1%	90.3%	0.8

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. and Cyclone Winston. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Net of earned premium and reinstatement premium attributable to prior years.

The Global Specialty combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2016 was 91.2%, which is consistent with 2015. The decrease in the claims and claim adjustment expense ratio reflects favorable current accident year losses primarily within LIU U.S. due to actuarial reserving adjustments recorded in 2015. The increase in the underwriting expense ratio was primarily due to the impact of lower earned premium within LSM and LIU U.S. Though no impact to the combined ratio, the year was further impacted by the increased weighting of inland marine relative to the total SBU, which operates at a higher claims and claim adjustment expense ratio, offset by lower underwriting expenses.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three months ended March 31, 2016 was 91.1%, an increase of 0.8 points over the same period in 2015. The increase in the period primarily reflects higher catastrophe losses.

CORPORATE AND OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Certain internal discontinued operations, which comprises: the run-off of certain Commercial Insurance business, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation and certain distribution channels related to Prudential Property and Casualty Insurance Company, Prudential General Insurance Company and Prudential Commercial Insurance Company (together, "PruPac") and Liberty Re annuity business.

- Cessions related to certain retroactive reinsurance agreements, including the NICO Reinsurance Transaction, which is described further in "Reinsurance Recoverables."

- Effective January 1, 2015, Corporate and Commercial Insurance entered into a new agreement including certain pre-2014 voluntary and involuntary workers compensation claims. The covered business materially aligns with the workers compensation business covered by the retroactive reinsurance agreement defined as the NICO Reinsurance Transaction, which is described further in "Reinsurance Recoverables."

- Interest expense on the Company's outstanding debt.

- Certain risks of its SBUs that the Company reinsures as part of its risk management program and risks on USCM homeowners business covered by an externally ceded homeowners quota share reinsurance treaty.

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

- The Company discounts the long-term indemnity portion of its settled unpaid workers compensation claims at risk-free discount rates. Commercial Insurance reports its discount based on statutory discount rates. Corporate and Other results reflect the difference between the statutory and risk-free rate.

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

- For presentation in this MD&A, property and casualty operations' investment income is allocated to the business units based on planned ordinary investment income returns by investment category. The difference between allocated net investment income and actual net investment income is included in Corporate and Other.

- Income related to LP, LLC and other equity method investments.

- Fee and other revenues include revenues from certain wholly owned non-insurance subsidiaries, primarily Liberty Energy. Liberty Energy generates revenue from the production and sale of oil and gas and related LP, LLC and other equity method investments.

Corporate and Other NWP by line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Reinsurance, net	$179	$264	(32.2%)
Workers compensation - Voluntary[1]	13	21	(38.1)
Other	1	5	(80.0)
Total NWP	$193	$290	(33.4%)

[1] Booked as billed adjustment.

NWP for the three months ended March 31, 2016 was $193 million, a decrease of $97 million from the same period in 2015. The period was primarily impacted by lower assumed NWP due to program changes, lower subject premiums, and lower prices, partially offset by lower external reinsurance costs.

Results of Operations – Corporate and Other

	Three Months Ended March 31,		
$ in Millions	**2016**	**2015**	**Change**
Revenues	$50	$100	(50.0%)
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years, and partnerships, LLC and other equity method income (loss)	($184)	($213)	(13.6%)
Catastrophes[1]	10	9	11.1
Net incurred losses attributable to prior years:			
- Asbestos & environmental[2]	-	(1)	100.0
- All other[3]	21	(12)	NM
Pre-tax operating loss before partnerships, LLC and other equity method income (loss)	(153)	(217)	(29.5)
Partnerships, LLC and other equity method income (loss) [4]	23	(53)	NM
Pre-tax operating loss	($130)	($270)	51.9%

[1] 2016 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. 2015 catastrophes include all current accident year catastrophe losses for severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Gross of the NICO Reinsurance Transaction, which is described further in “Reinsurance Recoverables”.

[3] Net of earned premium attributable to prior years of zero for the three months ended March 31, 2016 and 2015.

[4] Partnerships, LLC and other equity method income (loss) includes LP, LLC and other equity method (loss) income within net investment income in the accompanying Consolidated Statements of Income and revenue and expenses from the production and sale of oil and gas.

NM = Not Meaningful

Pre-tax operating loss for the three months ended March 31, 2016 was $130 million, a decrease of $140 million from the same period in 2015. The change in the period reflects partnerships, LLC, and other equity method income versus losses in the prior year, lower employee pension expenses, a reduction in legal reserves, and favorable net incurred losses attributable to prior years versus unfavorable development in 2015, partially offset by higher net investment losses excluding partnerships, LLC, and other equity method investments.

Revenues for the three months ended March 31, 2016 were $50 million, a decrease of $50 million from the same period in 2015. The major components of revenues are net premium earned, net investment income (driven by LP, LLC and other equity method investments), net realized (losses) gains, and fee and other revenues.

Net premium earned for the three months ended March 31, 2016 was $48 million, an increase of $2 million over the same period in 2015. The period was impacted by the continued softening of the external reinsurance market resulting in favorable terms.

Net investment loss for the three months ended March 31, 2016 was $5 million, a decrease of $66 million from the same period in 2015. The decrease was primarily driven by partnerships, LLC and other equity method income as a result of lower valuation losses in the energy and metals and mining sectors in 2016, as well as impairments recorded on two equity method investments in the metals and mining sector in 2015 that did not recur. These favorable results were partially offset by a lower asset base reflected in Corporate.

Net realized losses for the three months ended March 31, 2016 were $39 million versus gains of $36 million in the same period in 2015. The increase in net realized losses relates to derivative losses recognized in 2016 as compared to derivative gains in 2015 and losses on sales of fixed maturity securities with underlying investments in the energy sector in 2016.

Fee and other revenues for the three months ended March 31, 2016 were $46 million, a decrease of $43 million from the same period in 2015. The decrease was primarily driven by lower oil and gas revenues as a result of lower prices and production.

Claims, benefits and expenses for the three months ended March 31, 2016 were $219 million, a decrease of $115 million from the same period in 2015. The decrease reflects lower expenses related to Liberty Energy as a result of lower production, lower employee pension expenses, a reduction in legal reserves, and favorable net incurred losses attributable to prior years versus unfavorable development in 2015.

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 leveraged loans, common and preferred stock, private equity and direct investments in natural resource ventures. Risk management is accomplished through asset liability management (including both interest rate risk and foreign currency risk), diversification, credit limits and a careful analytical 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 predominantly uses a subsidiary investment advisor for managing and administering the investment portfolios of its domestic and foreign insurance operations.

Invested Assets (including cash and cash equivalents)

The following table summarizes the Company's invested assets by asset category as of March 31, 2016 and December 31, 2015:

$ in Millions	**As of March 31, 2016**		**As of December 31, 2015**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$65,081	81.1%	$62,794	80.3%
Equity securities, available for sale, at fair value	2,400	3.0	2,909	3.7
LP, LLC and other equity method investments	5,132	6.4	5,023	6.4
Commercial mortgage loans	2,375	3.0	2,317	3.0
Short-term investments	251	0.3	272	0.3
Other investments	598	0.7	668	0.9
Cash and cash equivalents	4,424	5.5	4,227	5.4
Total invested assets	$80,261	100.0%	$78,210	100.0%

Total invested assets as of March 31, 2016 were $80.261 billion, an increase of $2.051 billion or 2.6% over December 31, 2015. The increase reflects the favorable impact of declining treasury rates and the weakening U.S. dollar.

Fixed maturities as of March 31, 2016 were $65.081 billion, an increase of $2.287 billion or 3.6% over December 31, 2015. The increase reflects the favorable impact of declining treasury rates, the weakening U.S. dollar, and purchases of fixed maturities driven by the reinvestment of proceeds generated by sales of equity securities. As of March 31, 2016, included in fixed maturities are commitments to purchase various residential mortgage-backed securities at a cost and fair value of $119 million, and various corporate and municipal securities at a cost of $249 million and fair value of $252 million.

Equity securities as of March 31, 2016 were $2.400 billion ($2.065 billion common stock and $335 million preferred stock) versus $2.909 billion as of December 31, 2015 ($2.571 billion common stock and $338 million preferred stock), a decrease of $509 million or 17.5% from December 31, 2015. Of the $2.065 billion of common stock at March 31, 2016, $496 million relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The decrease in total equity securities was primarily due to sales.

LP, LLC and other equity method investments as of March 31, 2016 were $5.132 billion, an increase of $109 million or 2.2% over December 31, 2015. The increase primarily reflects net contributions and valuation changes. These investments consist of traditional private equity partnerships of $2.837 billion, natural resources partnerships of $585 million ($385 million related to energy investments), real estate partnerships of $637 million, other partnerships of $807 million, and other equity method investments of $267 million ($265 million of which is related to natural resources). The Company's investments in LP, LLC and other equity method investments are long-term in nature. 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 March 31, 2016 were $2.375 billion (net of $9 million of loan loss reserves or 0.4% of the outstanding loan portfolio), an increase of $58 million or 2.5% over December 31, 2015. The increase primarily reflects $105 million in funding and a decrease of $2 million to the loan loss reserve, partially offset by $49 million in principal reductions. The entire commercial loan portfolio is U.S.-based. The number of loans in the portfolio increased from 4,763 at December 31, 2015 to 4,778 at March 31, 2016.

Other investments as of March 31, 2016 were $598 million, a decrease of $70 million or 10.5% from December 31, 2015. The decrease was primarily related to reduced Additional Securities Limited ("ASL") deposit balances in the Company's international operations.

Cash and cash equivalents as of March 31, 2016 were $4.424 billion, an increase of $197 million or 4.7% over December 31, 2015. The increase was primarily related to increases in cash from investment proceeds and securities lending.

Regarding fair value measurements, as of March 31, 2016, excluding other assets, the Company reflected $4.680 billion (6.8%) as level 1 (quoted prices in active markets) primarily consisting of U.S. Treasuries and common equity securities. The majority of the Company's invested assets are reported as level 2 (quoted prices from other observable inputs). As of March 31, 2016, the Company reported $62.445 billion (91.5%) as level 2, consisting primarily of fixed maturity securities. Finally, the Company reported $1.146 billion (1.7%) as level 3 (unobservable inputs), primarily consisting of international and privately held securities for which a market price is not readily observable.

As of March 31, 2016, the Company had unfunded commitments in traditional private equity partnerships, natural resources, real estate, and other of $1.780 billion, $2.957 billion (primarily energy investments), $828 million, and $582 million, respectively. Unfunded energy investment commitments as of March 31, 2016 were $2.950 billion, of which, $1.299 billion and $1.651 billion are related to natural resources partnerships and direct investments in oil and gas wells, respectively. Included in the $1.299 billion natural resource partnerships unfunded commitments was a $600 million estimate related to a commitment made by the Company to invest in the successor fund of an existing private equity energy fund in an amount not to exceed the lesser of (i) 40% of the capital commitment of such fund and (ii) $600 million, which obligation attaches only if such fund has raised commitments of at least $1 billion, including the Company's commitment, by August 1, 2020 and the contractual obligations with the fund manager have not been previously terminated. These conditions have currently not been met. The majority of direct investment energy commitments are subject to contractual price floors. If certain price targets are not met, the Company is not required to fund these investments until pricing improves. Due to current market conditions, energy prices would need to increase significantly in order for these commitments to become callable.

As of March 31, 2016, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 0.7% of invested assets. As of March 31, 2016, investments in the energy sector accounted for $2.954 billion or 3.7% of total invested assets. These investments consist of investment grade bonds of $2.110 billion, bonds that were rated below investment grade of $312 million, publicly traded equity securities of $145 million, and natural resources partnerships and other equity method investments of $387 million. In addition, the Company has direct investments in oil and gas wells of $1.490 billion which are included in other assets on the Consolidated Balance Sheets.

The following tables summarize the Company's available for sale portfolio by security type as of March 31, 2016 and December 31, 2015:

$ in Millions **March 31, 2016**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government and agency securities	$3,180	$181	($1)	$3,360
Residential MBS [1]	7,096	247	(4)	7,339
Commercial MBS	1,630	47	(2)	1,675
Other MBS and ABS [2]	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	62,426	3,108	(453)	65,081
Common stock	1,793	360	(88)	2,065
Preferred stock	378	13	(56)	335
Total equity securities	2,171	373	(144)	2,400
Total securities available for sale	$64,597	$3,481	($597)	$67,481

[1] Mortgage-backed securities ("MBS")
[2] Asset-backed securities ("ABS")

$ in Millions **December 31, 2015**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
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	$63,964	$2,760	($1,021)	$65,703

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of March 31, 2016:

$ in Millions	**As of March 31, 2016**							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality[1]	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$2,093	$-	$-	$-	$-	$-	$2,093	17.3%
GNMA residential mortgage	2,914	2	-	-	-	-	2,916	24.0
FNMA residential mortgage	2,138	-	-	-	-	-	2,138	17.6
FHLMC residential mortgage	2,029	-	-	-	-	-	2,029	16.7
Non-agency residential mortgage	26	6	-	3	14	207	256	2.2
Commercial MBS	1,577	69	8	21	-	-	1,675	13.8
Non-mortgage ABS	590	-	61	361	3	7	1,022	8.4
Total	$11,367	$77	$69	$385	$17	$214	$12,129	100.0%
% of Total	93.7%	0.6%	0.6%	3.2%	0.1%	1.8%	100.0%	

[1] For purposes of this disclosure, credit quality is primarily based upon average credit ratings.

Approximately 76% of the Company's mortgage and asset-backed fixed maturity portfolio is explicitly backed by the U.S. government (SBA and GNMA) or by government-sponsored entities (FNMA and FHLMC). Approximately 94% of the holdings are rated AAA. The commercial mortgage-backed securities portfolio is well diversified and of high quality with approximately 94% rated AAA.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of March 31, 2016 and December 31, 2015:

$ in Millions	**As of March 31, 2016**		**As of December 31, 2015**	
Fixed Maturities by Credit Quality[1]	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
AAA	$19,713	30.3%	$19,777	31.5%
AA+, AA, AA-	11,769	18.1	11,459	18.2
A+, A, A-	15,680	24.1	14,620	23.3
BBB+, BBB, BBB-	13,607	20.9	13,474	21.5
Total investment grade	60,769	93.4	59,330	94.5
BB+, BB, BB-	2,243	3.4	1,585	2.5
B+, B, B-	1,633	2.5	1,448	2.3
CCC or lower	436	0.7	431	0.7
Total below-investment grade	4,312	6.6	3,464	5.5
Total fixed maturities	$65,081	100.0%	$62,794	100.0%

[1] For purposes of this disclosure, credit quality is primarily based upon average credit ratings.

The Company's allocation to investment grade (fixed maturities with an average credit rating of BBB- or higher) securities was approximately 93.4% at March 31, 2016, slightly lower than December 31, 2015. The Company's allocation to below-investment grade (fixed maturities with an average credit rating below BBB-) securities was approximately 6.6% at March 31, 2016, slightly higher than December 31, 2015, primarily driven by credit downgrades in 2016. The Company's holdings of below investment grade securities primarily consist of an actively managed diversified portfolio of high yield securities and leveraged loans within the domestic insurance portfolios and investments in emerging market sovereign and corporate debt primarily in support of the Company's international insurance operations. Overall, the average credit quality rating stands at A+ as of March 31, 2016.

The following table summarizes available for sale fixed maturity securities by contractual maturity at March 31, 2016 and December 31, 2015. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid with or without call or prepayment penalties. Due to the potential for prepayment on MBS and ABS, they are not categorized by contractual maturity.

$ in Millions	**As of March 31, 2016**		**As of December 31, 2015**	
Fixed Maturities by Maturity Date	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
One year or less	$3,993	6.1%	$3,515	5.6%
Over one year through five years	16,769	25.8	16,298	26.0
Over five years through ten years	17,814	27.4	17,255	27.5
Over ten years	14,376	22.1	13,657	21.7
MBS and ABS	12,129	18.6	12,069	19.2
Total fixed maturities	$65,081	100.0%	$62,794	100.0%

During 2016, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company has made only minor adjustments to the average duration of its investment portfolio.

Net Investment Income

The following table summarizes the Company's net investment income for the three months ended March 31, 2016, and 2015:

$ in Millions	**Three Months Ended March 31,**	**Three Months Ended March 31,**
Net Investment Income	**2016**	**2015**
Taxable interest income	$527	$523
Tax-exempt interest income	83	100
Dividends	11	14
LP, LLC and other equity method income (loss)	73	(17)
Commercial mortgage loans	28	26
Other investment income	6	5
Gross investment income	728	651
Investment expenses[2]	(41)	(40)
Net investment income	$687	$611

[1] Fees paid to external managers are included within the components of gross investment income.

Net investment income for the three months ended March 31, 2016 was $687 million, an increase of $76 million over the same period in 2015. The increase was primarily a result of lower valuation losses in the energy and metals and mining sectors in 2016 as compared to the prior year. Additionally, there were impairments recorded on two equity method investments in the metals and mining sector in 2015 that did not recur.

Net Realized Gains (Losses)

The following tables summarize the Company's net realized gains (losses) for the three months ended March 31, 2016 and 2015:

$ in Millions **Net Realized Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Three Months Ended March 31, 2016:				
Fixed maturities	($12)	($7)	$-	($19)
Equities	14	(10)	-	4
Other	-	-	(24)	(24)
Total	$2	($17)	($24)	($39)
Three Months Ended March 31, 2015:				
Fixed maturities	$27	($10)	$-	$17
Equities	35	(6)	-	29
Other	(8)	(8)	7	(9)
Total	$54	($24)	$7	$37

$ in Millions	**Three Months Ended March 31,**	**Three Months Ended March 31,**
Components of Net Realized (Losses) Gains	**2016**	**2015**
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	($39)	$37

Net realized losses for the three months ended March 31, 2016 were $39 million, versus gains of $37 million in the same period of 2015. The increase in net realized losses relates to derivative losses recognized in 2016 as compared to derivative gains in 2015 and losses on sales of fixed maturity securities with underlying investments in the energy sector in 2016. In addition, 2016 reflects gross equity gains and losses realized from sales to reduce overall exposure, but the net impact of this effort is minimal.

The following table summarizes the Company's 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:

$ in Millions	Less Than 12 Months		12 Months or Longer	
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	$-	$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 equity securities	(76)	534	(68)	311
Total securities available for sale	($323)	$6,641	($274)	$3,468

Unrealized losses decreased from $1.021 billion as of December 31, 2015 to $597 million as of March 31, 2016 primarily due to the declining treasury rates. Unrealized losses less than 12 months decreased from $731 million at December 31, 2015 to $323 million as of March 31, 2016. Unrealized losses 12 months or longer decreased from $290 million as of December 31, 2015 to $274 million as of March 31, 2016. Of the $13 million of unrealized losses 12 months or longer on common stock, $3 million 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 rate changes) 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 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 at 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.

LIQUIDITY AND CAPITAL RESOURCES

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 while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. 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 March 31, 2016 (including cash and cash equivalents) totaled $80.261 billion.

Debt outstanding as of March 31, 2016 and December 31, 2015 was as follows:

Short-term debt and current maturities of long-term debt:

$ in Millions	**As of March 31, 2016**	**As of December 31, 2015**
Short-term debt	$ 6	$ -
Current maturities of long-term debt[1]	249	249
Total short-term debt and current maturities of long-term debt	$ 255	$ 249

[1] Includes $249 million of 6.70% Notes due 8/15/2016.

Long-term debt:

$ in Millions	**As of March 31, 2016**	**As of December 31, 2015**
7.00% Junior Subordinated notes, due 2067[1]	$ 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[2]	700	700
10.75% Junior Subordinated notes, due 2088[3]	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
Subtotal	6,978	6,994
Unamortized discount	(12)	(12)
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

[1] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.
[2] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.
[3] The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

As part of its overall capital strategy, the Company previously announced that it may issue, repurchase or exchange debt depending on market conditions. Debt repurchases may be executed through open market or other appropriate transactions. The Company continues to evaluate market conditions and may periodically effect transactions in its debt, subject to applicable limitations.

Debt Transactions and In-force Credit Facilities

During the three months ended March 31, 2016, the Company repurchased $16 million of the 10.75% Junior Subordinated notes due 2088 compared to no repurchases for the same period in 2015. Pre-tax losses of $8 million 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 billion 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 billion repurchase agreement for a two-year period, which terminates July 3, 2017 unless extended. To date, no funds have been borrowed under the facility.

On April 8, 2015, LMGI increased its commercial paper program from $750 million to $1 billion. There was no commercial paper outstanding at March 31, 2016.

On March 5, 2015, LMGI amended and restated its unsecured revolving credit facility from $750 million to $1 billion with an expiration date of March 5, 2020. This facility backs the Company’s commercial paper program that is guaranteed by LMIC. To date, no funds have been borrowed under the facility.

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 million 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 million at a rate of 4.24% with a maturity date of March 23, 2032 and $23 million 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 million with respect to LMGI’s $300 million 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.

Interest Expense

Consolidated interest expense for the three months ended March 31, 2016 was $109 million, a decrease of $1 million from prior year.

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 March 31, 2016, the Company, through its downstream subsidiary LMGI, had $6.297 billion of debt outstanding, excluding discount and issuance costs.

The insurance subsidiaries' ability to pay dividends on preferred or common stock is restricted under applicable insurance laws and regulations and may be paid only from unassigned surplus. 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 policyholders, following such dividend, is reasonable in relation to its outstanding liabilities, is adequate to meet its financial needs, and does not exceed the insurer's unassigned surplus. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Insurance subsidiaries owned directly by LMGI are LMIC, Liberty Mutual Personal Insurance Company ("LMPICO"), LMFIC and EICOW. Under the insurance laws of Massachusetts, the domiciliary state of LMIC and LMPICO, 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 LMFIC and 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 its debt, as could a redomestication or merger of LMIC, LMPICO, LMFIC or EICOW to a different domiciliary state.

The authorized control level risk-based capital (as of December 31, 2015) and 2016 available dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio[1]**		**Dividend Capacity[2]**	**Dividends Paid[3]**
RBC Ratios and Dividend Capacity	**2015**	**2014**	**2016**	**2016**
LMIC	497%	514%	$1,531	$16
LMFIC	518%	485%	$139	$4
EICOW	512%	467%	$151	-

[1] Authorized control level risk-based capital as defined by the NAIC.

[2] Represents the estimated maximum allowable dividend without prior regulatory approval in the state of domicile.

[3] Dividends paid represent amounts paid during the three months ended March 31, 2016. Available dividend capacity as of March 31, 2016 is calculated as 2016 dividend capacity less dividends paid for the preceding 12 months. Dividends paid April 1, 2015 through March 31, 2016 for LMIC, LMFIC and EICOW were $65 million, $15 million and zero, respectively.

LMGI also has access to the following sources of funding:

- A management services agreement with LMIC pursuant to which LMGI is entitled to collect certain costs plus a management fee for services rendered by LMGI employees.
- Investment management agreements with affiliated entities pursuant to which an LMGI subsidiary investment advisor is entitled to recover annual expenses for investment management services performed by its employees.
- Liberty Corporate Services LLC ("LCS"), which through its subsidiaries collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three months ended March 31, 2016, LCS recorded $69 million in pre-tax income.
- Approximately $80 million of annual dividends related to non-redeemable perpetual preferred stock issuances by LMIC and LMFIC.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S affiliates, including international branches, was $18.825 billion and $18.687 billion as of March 31, 2016 and December 31, 2015, respectively. The increase in surplus primarily reflects net income of $321 million (the sum of earnings from the Company’s 56 domestic property-casualty insurance companies and dividends from subsidiaries), partially offset by affiliated unrealized losses of $96 million, unaffiliated unrealized losses of $77 million, and a reduction to other changes in surplus of $10 million. Other changes in surplus is primarily driven by non-admitted assets, net deferred income tax and dividends to stockholders, partially offset by foreign exchange.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

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 accompanying Consolidated Financial Statements reflect management's best estimates and assumptions, these amounts ultimately could vary.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $49.693 billion and $49.323 billion as of March 31, 2016 and December 31, 2015, respectively.

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 litigation, medical costs, the costs of repair materials, and labor rates can all affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement can be. 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, net of reinsurance before National Indemnity Company ("NICO") and including uncollectible reinsurance, were $929 million and $952 million 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 claims and claim adjustment expenses.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to NICO and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company acquired PruPac in 2003 and any increase in A&E reserves is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial, Inc.

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 A&E related claims could result in a 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 $13.759 billion and $13.575 billion at March 31, 2016 and December 31, 2015, respectively, net of allowance for doubtful accounts of $136 million and $131 million, respectively. Included in these balances are $540 million and $486 million of paid recoverables and $13.355 billion and $13.220 billion of unpaid recoverables (including retroactive reinsurance), respectively.

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 Consolidated Statements of Income.

Ceded transactions that transfer risk but are retroactive are included in reinsurance recoverables. The excess of estimated liabilities for claims and claim costs over the consideration paid net of experience adjustments is established as a deferred credit at inception. The deferred amounts are subsequently amortized using the effective interest method over the expected settlement period. The periodic amortization is reflected in the accompanying Consolidated Statements of Income through benefits, claims and claim adjustment expenses. In transactions where the consideration paid exceeds the estimated liabilities for claims and claim costs a loss is recognized. If the adverse development net of experience adjustments exceeds the original loss, deferred gains are recorded. The deferred gains are subsequently recognized into earnings over the expected settlement period of the reserves.

On July 17, 2014, the Company entered into a reinsurance transaction with NICO, a subsidiary of Berkshire Hathaway Inc., on a combined aggregate excess of loss agreement (the "NICO Reinsurance Transaction") for substantially all of the Company's U.S. workers compensation (pre-2014 accident year) and A&E liabilities, attaching at approximately $12.5 billion of combined aggregate reserves, with an aggregate limit of $6.5 billion and sublimits of $3.1 billion for A&E liabilities and approximately $4.5 billion for certain large dollar deductible workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but effective as of January 1, 2014, the Company ceded approximately $3.3 billion of existing liabilities under this retroactive reinsurance agreement. NICO will provide approximately $3.2 billion of additional aggregate adverse development cover. The Company paid NICO total consideration of approximately $3.0 billion. In general terms, the covered business includes post December 31, 2013 development on: (1) A&E liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005 including unallocated loss adjustment costs; and (2) workers compensation liabilities arising out of policies on the books of the Company's Commercial Insurance SBU as of December 31, 2013, as respects injuries or accidents occurring prior to January 1, 2014. With respect to the ceded A&E 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.

The NICO Reinsurance Transaction is accounted for as retroactive reinsurance in the Company's GAAP Consolidated Financial Statements. To the extent there is unfavorable development of losses covered by this reinsurance, an 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 (amounts in millions):

Change in unrecognized benefit under NICO Reinsurance Transaction	**Three Months Ended March 31, 2016**	**Twelve Months Ended December 31, 2015**
Unrecognized reinsurance benefit related to original transaction loss at the beginning of the period	$59	$43
A&E 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 A&E development exceeds the original pre-tax loss of $128 million, deferred gains will be recorded. Deferred gains are subsequently amortized into earnings over the period when underlying claims are settled.

Fair Value Determination

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, 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.

Impairment Losses on Investments

If the Company believes a decline in the value (including foreign exchange rate changes) 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 flow and fair value.

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 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.

The Company is required to review its oil and gas properties when facts and circumstances indicate that net book values may not be recoverable. In performing a quarterly review, an undiscounted cash flow test is performed at the lowest level for which identifiable cash flows are independent of cash flows from other assets. If the sum of the undiscounted future net cash flows is less than the net book value of the property, an impairment loss is recognized for the excess, if any, of the property's net book value over its estimated fair value.

Variable Interest Entities

The Company invests in limited partnerships and other entities subject to Variable Interest Entity ("VIE") analysis under the VIE subsections of Accounting Standards Codification ("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 was 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*. The 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 billion and $1.719 billion as of March 31, 2016 and December 31, 2015, respectively and the Company's maximum exposure to loss was $7.272 billion and $2.487 billion as of March 31, 2016 and December 31, 2015, respectively. The assets are included in other investments in the accompanying consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. The increase in the maximum exposure to loss from December 31, 2015 to March 31, 2016 is primarily related to an increase in the number of investments considered VIEs due to the adoption of Accounting Standards Update 2015-02, Consolidation Topic 810, *Amendments to the Consolidation Analysis*. There is no recourse provision to the general credit of the Company for any VIE beyond the full amount of the Company's loss exposure.

Deferred Acquisition Costs

Total deferred acquisition costs were $3.245 billion and $3.164 billion as of March 31, 2016 and December 31, 2015, respectively. Deferred acquisition costs are costs that are directly related to the acquisition or renewal of insurance contracts. All other acquisition related costs, including market research, training, administration, unsuccessful acquisition or renewal efforts, and product development, are charged to expense as incurred. 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 and underwriting expenses.

Goodwill

Goodwill assets were $4.851 billion and $4.758 billion as of March 31, 2016, and December 31, 2015, respectively. Goodwill is tested for impairment at least annually using either a qualitative or a quantitative process. Election of the approach can be made at the reporting unit level. The reporting unit has the option to skip the qualitative test and move directly to completion of the quantitative process. The Company's SBUs are deemed reporting units.

The qualitative approach can be used to evaluate if there are any indicators of impairment. Through this process, the reporting unit must determine if there is indication that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill. If it is determined that there is an indication of potential impairment, the reporting unit must complete the quantitative process. The quantitative approach is a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount is not recoverable from the discounted cash flows using a “market” rate and is measured as the difference between the carrying amount and the implied fair value. Other changes in the carrying amount of goodwill are primarily caused by foreign currency translation adjustments and acquisitions.

There were no goodwill impairments recognized as of March 31, 2016 and December 31, 2015, respectively.

Deferred Income Taxes

The net deferred tax asset was $313 million and $795 million as of March 31, 2016 and December 31, 2015, net of a valuation allowance of $111 million and $106 million, respectively. The net decrease in the Company’s net deferred income tax asset is primarily due to changes in net unrealized gains and losses on investments and the utilization of net operating losses. The increase in the valuation allowance is primarily due to currency translation adjustments. Management believes it is more likely than not that the Company’s net deferred income tax asset will be realized based upon the Company’s ability and the likelihood of generating future taxable income.

The income tax provision is calculated under the liability method. Deferred income tax assets and liabilities are recorded based upon 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 net unrealized capital gains and losses on investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs, employee benefits, net operating losses, intangibles, and fixed assets.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (amounts in millions):

Balance at December 31, 2015	$249
Additions based on tax positions related to current year	1
Additions for tax positions of prior years	11
Reductions for tax positions of prior years	(4)
Translation	3
Balance at March 31, 2016	$260

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

Included in the balance at March 31, 2016, is $69 million 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 million of interest and penalties. The Company had $32 million and $31 million 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.

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

Pension and Postretirement Benefit Obligations

The Company sponsors non-contributory defined benefit pension plans (the "Plans") covering substantially all U.S. and Canadian employees. The benefits and eligibility are based on age, years of service, and the employee's final average compensation, as more fully described in the Plans. Some foreign subsidiaries also sponsor defined benefit pension plans. In 2014, the Company added a new cash balance benefit formula for all eligible U.S. employees and froze credited service under the plan's final average pay formula.

The Company sponsors non-qualified supplemental pension plans for selected highly compensated employees to restore the pension benefits they would be entitled to 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.

The Company also provides certain postretirement healthcare and life insurance benefits covering substantially all U.S. and Canadian employees. In 2014, the Company's U.S. postretirement medical and dental cost sharing arrangement changed to a defined contribution model with an annual dollar contribution amount based on age and years of eligible credited service. Life insurance benefits are based on a participant's final compensation subject to the plan maximum. The postretirement plan is unfunded.

On an annual basis, the Company reviews the discount rate assumption used to determine the benefit obligations and the composition of various yield curves to ensure that the assumed discount rate reflects the Company's best estimate of the rate of return inherent in a portfolio of high-quality debt instruments that would provide the cash flows necessary to settle the Company's projected benefit payments. The discount rate assumption used to determine the benefit obligations was based on a yield curve approach where the cash flows related to the benefit plans' liability stream were discounted at an interest rate specifically applicable to the timing of the cash flows. Prior to December 31, 2015, the process calculated the present value of these cash flows and determined the weighted average discount rate that produced the same present value of the future cash flows. The single effective discount rate was also used to determine the Service cost and Interest cost components of net periodic benefit cost. 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, had no material impact in the first quarter of 2016.

In choosing the expected long-term rate of return on plan assets, the Company's Retirement Board considers the historical returns of equity and fixed income markets in conjunction with current economic and financial market conditions.

About the Company

Boston-based LMHC, the parent corporation of the Liberty Mutual Insurance group of entities, is a diversified global insurer and fifth largest property and casualty insurer in the U.S. based on 2015 direct written premium. The Company also ranks 78th on the Fortune 100 list of largest corporations in the U.S. based on 2014 revenue. As of December 31, 2015, LMHC had $121.665 billion in consolidated assets[1], $102.424 billion in consolidated liabilities[1], and $37.617 billion in annual consolidated revenue.

LMHC, 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 LMHC.

Functionally, the Company conducts substantially all of its business through the SBUs, with each operating independently of the others with 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.

LMHC employs more than 50,000 people in over 800 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.libertymutualgroup.com/investors.

[1] Reflects the 2016 adoption of the Financial Accounting Standards Board issued Accounting Standards Update 2015-03, *Imputation of Interest* (ASC 835).