Liberty Mutual Holding Company Inc.

Second Quarter 2010

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Revenues				
Premiums earned	$ 7,025	$ 6,959	$ 14,124	$ 13,841
Net investment income	737	697	1,547	1,034
Fee and other revenues	193	201	379	382
Net realized investment gains (losses)	111	(27)	206	(21)
Total revenues	8,066	7,830	16,256	15,236
Claims, Benefits and Expenses				
Benefits, claims and claim adjustment expenses	5,357	5,044	10,589	10,078
Insurance operating costs and expenses	1,060	1,077	2,179	2,131
Amortization of deferred policy acquisition costs	1,187	1,160	2,379	2,284
Interest expense	114	123	230	245
Interest credited to policyholders	49	55	97	99
Total claims, benefits and expenses	7,767	7,459	15,474	14,837
Income before income tax expense	299	371	782	399
Income tax expense	79	103	247	109
Net income	$ 220	$ 268	$ 535	$ 290

Net Realized Investment Gains (Losses)				
Other-than-temporary impairment losses:	**2010**	**2009**	**2010**	**2009**
Total other-than-temporary impairment losses	$ -	$ (57)	$ (15)	$ (203)
Change in portion of loss recognized in other comprehensive income	-	(5)	-	28
Other-than-temporary impairment losses	-	(62)	(15)	(175)
Other net realized investment gains	111	35	221	154
Net realized investment gains (losses)	$ 111	$ (27)	$ 206	$ (21)

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

	June 30, 2010	December 31, 2009
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of $53,955 and $54,789)	$ 56,587	$ 56,439
Equity securities, available for sale, at fair value (cost of $1,073 and $1,077)	1,117	1,188
Short-term investments	425	575
Mortgage loans	1,140	1,121
Other investments	2,775	2,619
Total investments	62,044	61,942
Cash and cash equivalents	5,126	4,847
Premium and other receivables (net of allowance of $131 and $121)	7,952	7,629
Reinsurance recoverables (net of allowance of $434 and $434)	15,135	14,749
Deferred income taxes (net of valuation allowance of $163 and $160)	1,168	1,691
Deferred acquisition costs	2,663	2,636
Goodwill	4,713	4,748
Prepaid reinsurance premiums	1,564	1,317
Separate account assets	3,725	3,557
Other assets	6,608	6,359
Total assets	$ 110,698	$ 109,475
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	$ 48,517	$ 48,355
Life	6,521	6,586
Other policyholder funds and benefits payable	3,462	3,300
Unearned premiums	13,645	13,224
Funds held under reinsurance treaties	1,819	1,819
Short-term and current maturities of long-term debt	1	305
Long-term debt	5,635	5,635
Separate account liabilities	3,725	3,557
Other liabilities	12,116	12,180
Total liabilities	95,441	94,961
Policyholders' equity:		
Unassigned equity	14,549	14,014
Accumulated other comprehensive income	708	500
Total policyholders' equity	15,257	14,514
Total liabilities and policyholders' equity	$ 110,698	$ 109,475

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Balance at beginning of the period	$ 14,514	$ 10,403
Net income	535	290
Other comprehensive income, net of taxes:		
Unrealized gains on securities	353	1,266
Foreign currency translation and other adjustments	(145)	117
Total other comprehensive income, net of taxes	208	1,383
Total comprehensive income	743	1,673
Balance at end of the period	$ 15,257	$ 12,076

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Cash flows from operating activities:		
Net income	$ 535	$ 290
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	199	166
Realized investment (gains) losses	(206)	21
Undistributed private equity investment (gains) losses	(76)	401
Premium, other receivables, and reinsurance recoverables	(1,088)	(420)
Deferred policy acquisition costs	(117)	(70)
Liabilities for insurance reserves	1,603	185
Taxes payable, net of deferred	235	(118)
Other, net	(40)	533
Total adjustments	510	698
Net cash provided by operating activities	1,045	988
Cash flows from investing activities:		
Purchases of investments	(9,630)	(9,244)
Sales and maturities of investments	9,876	7,420
Property and equipment purchased, net	(222)	(157)
Other investing activities	(117)	967
Net cash used in investing activities	(93)	(1,014)
Cash flows from financing activities:		
Net activity in policyholder accounts	88	34
Debt financing, net	(302)	(24)
Net security lending activity and other financing actitivites	(242)	388
Net cash (used in) provided by financing activities	(456)	398
Effect of exchange rate changes on cash	(217)	16
Net increase in cash and cash equivalents	279	388
Cash and cash equivalents, beginning of period	4,847	5,848
Cash and cash equivalents, end of period	$ 5,126	$ 6,236

See accompanying notes to the unaudited consolidated financial statements.

(dollars in millions)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2009 unaudited consolidated interim financial statements to conform with the 2010 presentation. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company's principal estimates include (1) unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years; (2) reinsurance recoverables and associated uncollectible reserves; (3) impairments to the fair value of the investment portfolio; (4) deferred acquisition costs; (5) valuation of goodwill and intangible assets; and (6) deferred income tax valuation allowance. While management believes that the amounts included in the consolidated financial statements reflect their best estimates and assumptions, these amounts ultimately could be materially different from the amounts currently provided for in the consolidated financial statements.

Adoption of New Accounting Standards
Effective January 1, 2009, the Company adopted new guidance for accounting for other-than-temporary impairments, as codified in FASB Accounting Standards Codification ("ASC") 320, *Investments – Debt and Equity Securities*. This guidance amends the accounting for other-than-temporary impairment of debt securities, requires the establishment of a policy for determining when "credit losses" exist, and provides direction on determining the amount of impairment to be recognized in the statement of income. The adoption of the new guidance resulted in an increase of $28 (net of tax) to policyholders' unassigned equity and a corresponding decrease to accumulated comprehensive income.

None of the other accounting standards adopted by the Company through the second quarter of 2010 had a material impact on the Company.

Future Adoption of New Accounting Standards
None of the accounting standards issued through the second quarter of 2010 will have a material impact on the Company.

Changes in Reporting Entity
On May 10, 2010, the Company's subsidiary, Liberty Mutual Agency Corporation ("LMAC"), filed a Registration Statement on Form S-1 with the Securities and Exchange Commission (the "SEC") with the intent to form a public company comprising substantially all of its Agency Markets Strategic Business Unit and to sell up to 20% of its interest in LMAC through an initial public offering. The Company intends to maintain a significant interest in LMAC going forward. The registration requires the review of the SEC, which the Company expects to be completed by the third quarter of 2010.

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

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

	June 30, 2010	December 31, 2009
Unrealized gains on securities	$ 1,440	$ 1,115
Foreign currency translation & other adjustments	110	269
Accumulated pension liability adjustments	(842)	(856)
Cumulative effect of accounting change	-	(28)
Accumulated other comprehensive income	$ 708	$ 500

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation
On September 22, 2008, the Company, through its subsidiaries, acquired all outstanding shares of common stock of Safeco Corporation for a total purchase price of $6,244. Goodwill and intangible assets (excluding acquired in-force policy intangibles) recognized from the transaction was $3,603. The results of operations of Safeco Corporation are included in the Company's financial statements subsequent to September 22, 2008.

(dollars in millions)

Integration Activities
As part of the Safeco Corporation acquisition, management has received board authorization to implement certain integration efforts, principally employee and contract terminations. Changes to the restructuring reserves for the six months ended June 30, 2010 are as follows:

	2010
Balance as of December 31, 2009	$30
Payments applied against liability	(7)
Balance as of June 30, 2010	$23

(3) INVESTMENTS

The following table summarizes the Company's available for sale portfolio by security type as of June 30, 2010 and December 31, 2009:

June 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,552	$224	($1)	$ 2,775
Mortgage and asset-backed securities:				
Residential	9,533	564	(69)	10,028
Commercial	2,408	96	(4)	2,500
Other mortgage and ABS securities	1,800	112	(11)	1,901
U.S. state and municipal	13,166	738	(50)	13,854
Corporate and other	20,979	1,237	(250)	21,966
Foreign government securities	3,517	122	(76)	3,563
Total fixed maturities	53,955	3,093	(461)	56,587
Common stock	521	168	(36)	653
Preferred stock	552	28	(116)	464
Total equity securities	1,073	196	(152)	1,117
Total securities available for sale	$55,028	$3,289	($613)	$57,704

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,324	$147	($6)	$2,465
Mortgage and asset-backed securities:				
Residential	10,725	376	(112)	10,989
Commercial	2,163	39	(42)	2,160
Other mortgage and ABS securities	1,849	74	(21)	1,902
U.S. state and municipal	14,910	700	(100)	15,510
Corporate and other	19,134	891	(342)	19,683
Foreign government securities	3,684	128	(82)	3,730
Total fixed maturities	54,789	2,355	(705)	56,439
Common stock	525	195	(32)	688
Preferred stock	552	32	(84)	500
Total equity securities	1,077	227	(116)	1,188
Total securities available for sale	$55,866	$2,582	($821)	$57,627

Of the $653 and $688 of common stock as of June 30, 2010 and December 31, 2009, respectively, $243 and $275, respectively, relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The decrease in total equity securities available for sale primarily reflects the general market decline.

(dollars in millions)

The following table summarizes the Company's allocation of fixed maturities by maturity date as of June 30, 2010 and December 31, 2009:

	As of June 30, 2010	As of December 31, 2009
Fixed Maturities by Maturity Date	**Fair Value**	**Fair Value**
1 year or less	$ 2,466	$ 2,556
Over 1 year through 5 years	14,203	12,678
Over 5 years through 10 years	12,013	10,633
Over 10 years	13,476	15,521
Mortgage and asset-backed securities	14,429	15,051
Total fixed maturities	$56,587	$56,439

During the first half of 2010, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company continued to shorten the average duration of its investment portfolio.

The following table summarizes the Company's gross realized gains and losses by asset type for the three and six months ended June 30, 2010 and 2009, respectively:

	Three Months Ended June 30,		Six Months Ended June 30,	
Components of Net Realized Investment Gains (Losses)	**2010**	**2009**	**2010**	**2009**
Fixed maturities:				
Gross realized gains	$123	$31	$227	$55
Gross realized losses	(7)	(61)	(21)	(184)
Equities:				
Gross realized gains	4	13	12	108
Gross realized losses	(2)	(12)	(2)	(62)
Other:				
Gross realized gains	-	4	8	70
Gross realized losses	(7)	(2)	(18)	(8)
Total net realized investment gains (losses)	$111	($27)	$206	($21)

(dollars in millions)

The following table summarizes the Company's unrealized losses and fair value by security type and by duration that individual securities have been in an unrealized loss position as of June 30, 2010, that are not deemed to be other-than-temporarily impaired:

	Less Than 12 Months		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($1)	$32	$-	$-
Mortgage and asset-backed securities:				
Residential	(3)	64	(66)	445
Commercial	(1)	42	(3)	102
Other mortgage and ABS securities	(3)	17	(8)	46
U.S. state and municipal	(4)	189	(46)	527
Corporate and other	(62)	2,373	(188)	1,686
Foreign government securities	(33)	569	(43)	234
Total fixed maturities	(107)	3,286	(354)	3,040
Common stock	(11)	84	(25)	96
Preferred stock	(3)	78	(113)	217
Total equities	(14)	162	(138)	313
Total	($121)	$3,448	($492)	$3,353

Unrealized losses decreased from $821 as of December 31, 2009 to $613 as of June 30, 2010 primarily due to a decrease in credit spreads. Unrealized losses less than 12 months decreased from $147 at December 31, 2009 to $121 as of June 30, 2010, a decrease of $26. Unrealized losses greater than 12 months decreased from $674 as of December 31, 2009 to $492 as of June 30, 2010 and accounted for $182 of the overall decrease in unrealized losses. 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 income securities before they recover their fair value.

If the Company believes a decline in the value 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 it will not be able to collect all cash flows due on its fixed income 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. As a result of the Company's quarterly other-than-temporary impairment review, total impairment losses for the three and six months ended June 30, 2010 were less than $1 and $15 respectively, decreases of $62 and $160 from the same periods in 2009.

For the three and six months ended June 30, 2010, the Company recorded less than $1 and $7, respectively, of fixed maturity impairment losses. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of June 30, 2010 are temporary.

For equity securities, if the decline is believed to be other-than-temporary, the carrying value of the investment is written down to fair value and a realized loss is recorded. The gross unrealized losses recorded on equity securities as of June 30, 2010 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. As of June 30, 2010, the Company has concluded that the gross unrealized losses of equity securities are temporary.

The Company reviews fixed income, public equity securities and private equity and private equity co-investment securities 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 income securities where the Company does not expect to recover the entire amortized cost basis of the security, the Company will evaluate whether the other-than-temporary is a credit or a non-credit impairment. 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 debt 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) 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 debt securities and certain preferred equity securities) or the Company's intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in market value.

Subsequent to June 30, 2010, the Company has not recognized any additional material other-than-temporary impairments.

Variable Interest Entities

The Company invests in energy, private equity and real estate limited partnerships, and other entities subject to variable interest entity (VIE) analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of December 31, 2009, the Company determined that it was the primary beneficiary of two VIEs in the energy investment sector, and as such, these VIEs were consolidated in the Company's 2009 financial statements. The carrying value of assets and liabilities and the Company's maximum exposure to loss of the consolidated VIEs were immaterial to the Company. These entities were deconsolidated in 2010 upon adoption of the revised guidance in ASC 810 when the Company determined that it did not have a controlling financial interest in the 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. For these VIEs, the Company absorbs a portion, but not majority, of this variability. The carrying value of assets was $88 and $87 as of June 30, 2010 and December 31, 2009, and the Company's maximum exposure to loss was $100 and $99 as of June 30, 2010 and December 31, 2009, respectively, for unconsolidated VIEs in which the Company has a significant variable interest. The assets are included in other investments on the consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. 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.

Derivatives

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each domestic insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. As of June 30, 2010, the Company had no material derivative agreements in place. In August 2008, the Company, as part of its risk management program and diversification strategy, entered into two equity swap agreements with a total notional amount of $335. These contracts matured in January 2009, resulting in realized gains of $25 for the six months ended June 30, 2009.

(4) REINSURANCE

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195) that are amortized into income using the effective interest method over the estimated settlement periods. As of June 30, 2010, and December 31, 2009, deferred gains related to these reinsurance arrangements were $567 and $592, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three and six months ended June 30, 2010 was $30 and $59, respectively, as compared to $29 and $58 for the three and six months ended June 30, 2009, respectively. Deferred gain amortization for the three and six months ended June 30, 2010 was $17 and $34, respectively, as compared to $17 and $33 for the three and six months ended June 30, 2009, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $1,991 and $2,019 as of June 30, 2010 and December 31, 2009, respectively.

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

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

(dollars in millions)

(5) DEBT OUTSTANDING

Debt outstanding as of June 30, 2010 and December 31, 2009, includes the following:

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

	June 30, 2010	December 31, 2009
Commercial paper	$ -	$ -
Revolving credit facilities	-	4
Current maturities of long-term debt	1	301
Total short-term and current maturities of long-term debt	$ 1	$ 305

Long-term debt excluding current maturities:	June 30, 2010	December 31, 2009
7.25% Notes, due 2012	$ 204	$ 204
8.00% Notes, due 2013	260	260
7.86% Medium Term Notes, due 2013	25	25
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014	200	200
5.588% Mortgage Loan due 2015	49	49
6.70% Notes, due 2016	249	249
7.00% Subordinated Notes, due 2067[1]	300	300
8.50% Surplus Notes, due 2025	140	140
7.875% Surplus Notes, due 2026	227	227
7.625% Notes, due 2028	3	3
7.00% Notes, due 2034	231	231
6.50% Notes, due 2035	471	471
7.50% Notes, due 2036	440	440
7.80% Subordinated Notes, due 2087[2]	700	700
10.75% Subordinated Notes, due 2088[3]	1,250	1,250
7.697% Surplus Notes, due 2097	435	435
	5,684	5,684
Unamortized discount	(49)	(49)
Total long-term debt excluding current maturities	$5,635	$5,635

[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.

Short-term Debt and Current Maturities of Long-term Debt

On May 12, 2010, LMAC entered into a $200 unsecured revolving credit facility for general corporate purposes with a syndicate of lenders led by Bank of America, N.A. that terminates three years following the date the facility first becomes available. LMAC has the ability to trigger the availability of the facility and establish the specific terms of the consolidated tangible net worth financial covenant based on then-current financials (after giving effect to certain reorganization transactions) at any time before December 31, 2010.

On May 11, 2010, Peerless Insurance Company ("PIC") became a member of the Federal Home Loan Bank of Boston. This membership provides the Company with access to a secured asset-based borrowing with loan maturities of up to 20 years. To date, no funds have been borrowed.

On March 26, 2010, Liberty Mutual Insurance Company ("LMIC") entered into a $750 three-year committed repurchase agreement for general corporate purposes. To date, LMIC has not used the repurchase agreement. In connection with the new repurchase agreement, LMIC terminated its existing $750 364-day committed repurchase agreement.

On March 26, 2010, PIC entered into a $250 three-year committed repurchase agreement. The repurchase agreement is guaranteed by LMIC. To date, PIC has not used the repurchase agreement.

On December 14, 2009, Liberty Mutual Group Inc. ("LMGI") entered into a three-year $400 unsecured revolving credit facility which terminates on December 14, 2012. To date, no funds have been borrowed under the facility. In connection with the new facility, LMGI terminated its $250 three-year unsecured revolving credit facility and its two revolving credit facilities totaling $750.

The Company places commercial paper through a program issued by LMGI and guaranteed by LMIC. Effective December 14, 2009, the $1,000 commercial paper program was reduced to $400 and is backed by the three-year $400 unsecured revolving credit facility. As of June 30, 2010, no commercial paper borrowings were outstanding.

On March 11, 2009, LMIC became a member of the Federal Home Loan Bank of Boston. This membership provides the Company with access to a secured asset-based borrowing with loan maturities of up to 20 years. To date, no funds have been borrowed.

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a $20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of June 30, 2010, no borrowings were outstanding under the facility.

Long-term Debt

On December 10, 2009, Berkeley/St. James Real Estate LLC, a wholly-owned affiliate of the Company, entered into a five-year $50 mortgage loan secured by the Company's headquarters located at 175 Berkeley Street and 30 St. James Avenue, Boston Massachusetts. The mortgage loan has limited recourse to Berkeley/St. James Real Estate LLC in certain instances and LMGI guarantees those limited recourse obligations.

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

Capital lease obligations as of June 30, 2010 and December 31, 2009, were $102 and $105, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. In 2008, the Company entered into an arrangement to sell and leaseback certain furniture and equipment. The weighted average interest rate on the lease is 4.88%. The transactions are accounted for as capital leases.

(6) ASBESTOS AND ENVIRONMENTAL

The Company's asbestos and environmental reserves for unpaid claims and claim adjustment expenses, net of reinsurance and including uncollectible reinsurance, were $1,277 and $1,580 as of June 30, 2010 and December 31, 2009, respectively. The decrease is primarily due to a payment on a large settlement during the period.

In the third quarter of 2009, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal review, potential exposures of certain policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with published actuarial papers on asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. The remaining policyholders (those with less potential exposure) were evaluated using aggregate methods that utilized information and experience specific to these insureds. The study resulted in an increase to reserves of $383. The previous comprehensive study was completed in 2007. Between comprehensive studies, the Company monitors asbestos activity to determine whether or not any adjustment to reserves is warranted. The Company completed its annual study on the environmental claims liability, resulting in immaterial adjustments to held reserves.

(7) INCOME TAXES

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

The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-exempt investment income, foreign taxes and the elimination of the tax benefit associated with Medicare Part D subsidies.

(dollars in millions)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at December 31, 2009	$221
Additions based on tax positions related to current year	7
Additions for tax positions of prior years	14
Settlements	(1)
Balance at June 30, 2010	$241

Included in the tabular roll forward of unrecognized tax benefits is interest in the amount of $88 and $85 as of June 30, 2010 and December 31, 2009, respectively.

Included in the balance as of June 30, 2010 is $139 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 six months ended June 30, 2010 and 2009, respectively, the Company recognized approximately $3 and $12 of interest and penalties, respectively. The Company had approximately $85 and $82 of interest and penalties accrued as of June 30, 2010 and December 31, 2009, respectively.

(8) FAIR VALUE MEASUREMENT

The Company's estimates of fair value are based on the framework established in ASC 820, *Fair Value Measurements and Disclosures*. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses the market approach incorporating prices and other relevant information generated by market transactions involving identical or comparable securities. The Company also considers the impact of a significant decrease in trading volume and level of activity for an asset when compared with normal activity to identify transactions that are not orderly. The majority of the fair value estimates for the Company's investment portfolio are obtained from third party pricing services.

The level assigned to each security is based on the Company's assessment of the transparency of the inputs used in the valuation of each asset type at the measurement date. Valuations categorized as Level 1 reflect quoted prices for identical assets in active markets. Securities classified as Level 2 utilize observable inputs including interest rates, yield curves, prepayment speeds, and default rates to estimate fair value. Holdings classified as Level 3 utilize unobservable inputs and incorporate management's assumptions and judgments in estimating fair value. Securities are classified based on the lowest level of input that is significant to the fair value measurement. Transfers between levels are recognized at the end of each reporting period. The hierarchy requires the use of market observable information when available for assessing fair value. The following tables summarize the Company's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, respectively, along with a brief description of the valuation technique for each type of asset and liability:

(dollars in millions)

	As of June 30, 2010			
Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. government and agency securities	$ 1,719	$ 1,038	$ 18	$ 2,775
Mortgage and asset-backed securities:				
Residential	-	9,989	39	10,028
Commercial	-	2,472	28	2,500
Other mortgage and asset-backed securities	-	1,867	34	1,901
U.S. state and municipal	-	13,843	11	13,854
Corporate and other	-	21,273	693	21,966
Foreign government securities	-	3,558	5	3,563
Total fixed maturities, available for sale	1,719	54,040	828	56,587
Common stock	587	3	63	653
Preferred stock	-	461	3	464
Total equity securities, available for sale	587	464	66	1,117
Short-term investments	109	289	27	425
Other investments	-	68	57	125
Separate account assets	1,695	1,831	199	3,725
Other assets	4	70	24	98
Total assets	$ 4,114	$ 56,762	$ 1,201	$ 62,077
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$ (162)	$ (162)
Total liabilities	$ -	$ -	$ (162)	$ (162)

	As of December 31, 2009			
Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. government and agency securities	$ 1,504	$ 917	$ 44	$ 2,465
Mortgage and asset-backed securities:				
Residential	-	10,983	6	10,989
Commercial	-	2,145	15	2,160
Other mortgage and asset-backed securities	-	1,849	53	1,902
U.S. state and municipal	-	15,489	21	15,510
Corporate and other	-	18,835	848	19,683
Foreign government securities	-	3,723	7	3,730
Total fixed maturities, available for sale	1,504	53,941	994	56,439
Common stock	630	44	14	688
Preferred stock	-	497	3	500
Total equity securities, available for sale	630	541	17	1,188
Short-term investments	147	369	59	575
Other investments	-	62	64	126
Separate account assets	1,628	1,742	187	3,557
Other assets	15	75	19	109
Total assets	$ 3,924	$ 56,730	$ 1,340	$ 61,994
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$ (143)	$ (143)
Total liabilities	$ -	$ -	$ (143)	$ (143)

The Company did not have significant transfers between Levels 1 and 2 for the six months ended June 30, 2010.

Fixed maturities and short-term securities are recorded at fair value in the Company's financial statements. U.S. government securities are valued based on unadjusted market prices and are classified as Level 1. The fair values of securities issued by U.S. government agencies, mortgage and asset-backed securities, securities issued by state and municipal governments, corporate bonds, and securities issued by foreign governments are estimated utilizing models that incorporate observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, option adjusted spreads, two sided markets, benchmark securities, bids, offers, and published market research reference data such as market indicators and economic events. The majority of the Company's fixed income portfolio is classified as Level 2. The fair value of fixed maturity securities that are not provided by the pricing services are estimated by management using various matrix pricing techniques and are classified as Level 3.

Equity securities include public and private common and preferred stock. Public common stocks with fair values based on quoted market prices in active markets are classified as Level 1. Public common stocks in markets that are less active and public preferred stock have been classified as Level 2. Equity securities that are not actively traded on an exchange are valued using models that incorporate observable inputs such as reported trades, broker/dealer quotes, benchmark securities, bids, offers, and published market research reference data such as market indicators and economic events. Private common stock, private preferred stock, and other equities securities that are not valued by the pricing services are estimated by management using various matrix pricing techniques and are classified as Level 3.

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

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

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

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

(dollars in millions)

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

	Balance January 1, 2010	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer in and/or out of Level 3	Balance June 30, 2010
U.S. government and agency securities	$ 44	$ -	$ 2	$ (15)	$ (13)	$ 18
Mortgage and asset-backed securities:						
Residential	6	-	34	(1)	-	39
Commercial	15	-	21	(2)	(6)	28
Other mortgage and asset backed securities	53	(4)	6	(2)	(19)	34
U.S. state and municipal	21	-	-	(2)	(8)	11
Corporate and other	848	-	101	(286)	30	693
Foreign government securities	7	(2)	-	-	-	5
Total fixed maturities	994	(6)	164	(308)	(16)	828
Common stock	14	1	6	2	40	63
Preferred stock	3	1	1	(2)	-	3
Total equity securities	17	2	7	-	40	66
Short-term investments	59	(2)	1	(31)	-	27
Other investments	64	-	4	(11)	-	57
Separate account assets	187	4	5	(10)	13	199
Other assets	19	3	-	2	-	24
Total assets	$ 1,340	$ 1	$ 181	$ (358)	$ 37	$ 1,201
Life insurance obligations	$ (143)	$ (27)	$ -	$ 8	$ -	$ (162)
Total liabilities	$ (143)	$ (27)	$ -	$ 8	$ -	$ (162)

	Balance January 1, 2009	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer in and/ or out of Level 3	Balance December 31, 2009
U.S. government and agency securities	$ 31	$ -	$ 1	$ (3)	$ 15	$ 44
Mortgage and asset-backed securities:						
Residential	4	-	-	-	2	6
Commercial	18	-	2	(1)	(4)	15
Other mortgage and asset backed securities	44	1	-	(9)	17	53
U.S. state and municipal	9	-	1	(1)	12	21
Corporate and other	781	9	81	72	(95)	848
Foreign government securities	10	-	1	(3)	(1)	7
Total fixed maturities	897	10	86	55	(54)	994
Common stock	110	(5)	8	(16)	(83)	14
Preferred stock	-	-	-	3	-	3
Total equity securities	110	(5)	8	(13)	(83)	17
Short-term investments	73	-	-	(14)	-	59
Other investments	62	(2)	4	(1)	1	64
Separate account assets	188	(1)	5	(3)	(2)	187
Other assets	27	(12)	-	4	-	19
Total assets	$ 1,357	$ (10)	$ 103	$ 28	$ (138)	$ 1,340
Life insurance obligations	$ (223)	$ -	$ 36	$ 44	$ -	$ (143)
Total liabilities	$ (223)	$ -	$ 36	$ 44	$ -	$ (143)

(dollars in millions)

For fixed maturities and equity securities, transfers into Level 3 were $101 and transfers out of Level 3 were ($77) during the six months ended June 30, 2010. These transfers were primarily due to re-evaluation of the observability of pricing inputs.

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held as of June 30, 2010.

For the six months ended June 30, 2010, there were no impairments recognized for items measured at fair value on a nonrecurring basis.

The Company has not applied ASC 820 to non-financial assets and liabilities.

(9) BENEFIT PLANS

The net benefit costs for the three months ended June 30, 2010 and 2009, include the following components:

Three months ended June 30,	**Pension Benefits**		**Supplemental Pension Benefits ***		**Postretirement Benefits**	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Components of net periodic benefit costs:						
Service costs	$ 50	$ 48	$ 3	$ 3	$ 7	$ 7
Interest costs	74	68	5	5	12	12
Expected return on plan assets	(67)	(61)	-	-	-	-
Settlement charge	1	-	-	-	-	-
Amortization of unrecognized:						
Net loss	12	14	3	3	1	1
Prior service cost	1	1	-	-	(1)	-
Net transition (assets)/obligation	(1)	(1)	-	-	2	2
Net periodic benefit costs	$ 70	$ 69	$ 11	$ 11	$ 21	$ 22

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

The net benefit costs for the six months ended June 30, 2010, and 2009, include the following components:

Six months ended June 30,	**Pension Benefits**		**Supplemental * Pension Benefits**		**Postretirement Benefits**	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Components of net periodic benefit costs:						
Service costs	$ 98	$ 99	$ 5	$ 6	$ 14	$ 14
Interest costs	145	135	10	10	24	24
Expected return on plan assets	(131)	(123)	-	-	-	-
Settlement charge	1	-	-	-	-	-
Amortization of unrecognized:						
Net loss	24	27	5	5	1	1
Prior service cost	3	3	1	1	(1)	(1)
Net transition (assets)/obligation	(3)	(3)	-	-	4	4
Net periodic benefit costs	$ 137	$ 138	$ 21	$ 22	$ 42	$ 42

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

The Company has contributed $202 to the qualified plans as of June 30, 2010 and expects to additionally contribute approximately $39.

(10) COMMITMENTS AND CONTINGENT LIABILITIES

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

As of June 30, 2010, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of $1,059, $537, and $1,137, respectively. As of June 30, 2010, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair value of $21 and various corporate and municipal securities at a cost and fair value of $41.

(11) SUBSEQUENT EVENTS

Management has assessed and concluded that there were no material subsequent events through August 5, 2010, the date of the second quarter 2010 earnings release.