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

Quarter Ended September 30, 2008

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

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three and nine months ended September 30, 2008 and 2007. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2007 Annual Report, Third Quarter 2008 Consolidated Financial Statements (unaudited) and Third Quarter 2008 Financial Supplement located on the Company's Investor Relations website at www.libertymutual.com/investors. The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

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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.

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

Some of the other factors that could cause actual results to differ include, but are not limited to, the following: the Company's inability to obtain price increases or maintain market share due to competition or otherwise; the performance of the Company's investment portfolio, which could suffer reduced returns or losses adversely affecting the Company's profitability, capitalization and liquidity; market conditions that may limit the Company's ability to replace maturing liabilities in a timely manner or that may make it difficult to value the Company's investments; developments in U.S. and global financial and capital markets, including changes in interest rates, rates of inflation, credit spreads, equity prices and foreign exchange rates; losses due to defaults of individual issuers and defaults of the collateral backing certain investments; weakening U.S. and global economic conditions, which could adversely affect the Company's ability to grow its business profitably; the potential effect of legislation and other governmental initiatives taken in response to the current financial crisis; insufficiency of, or changes in, loss reserves; the occurrence of catastrophic events, both natural and man-made, including terrorist acts, with a severity or frequency exceeding the Company's expectations; adverse changes in loss cost trends, including inflationary pressures in medical costs and automobile and home repair costs; developments relating to coverage and liability for mold claims; the effects of corporate bankruptcies on surety bond claims; adverse developments in the cost, availability and/or ability to collect reinsurance, which may be adversely affected by the current financial crisis; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the acquisition of Ohio Casualty Corporation and its subsidiaries, and the recent acquisition of Safeco Corporation and its subsidiaries, in accordance with its business strategy; the ability of the Company's subsidiaries to pay dividends to the Company; adverse results or other consequences from legal proceedings; the impact of regulatory investigations or reforms, including governmental actions regarding the compensation of brokers and agents and the purchase and sale of nontraditional products and related disclosures; unusual loss activity resulting from adverse weather conditions, including storms, hurricanes, hail, snowfall and winter conditions; repatriation of foreign earnings; judicial expansion of policy coverage and the impact of new theories of liability; the impact of legislative actions, including Federal and state legislation related to asbestos liability reform; larger than expected assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings, which could adversely affect its business volumes, adversely affect its ability to access the debt markets and increase its borrowing costs; the loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of Personal Lines policies; and amendments and changes to the risk-based capital requirements. The Company's forward-looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs. For a detailed

discussion of these and other cautionary statements, visit the Company's Investor Relations web site at www.libertymutual.com/investors. The Company undertakes no obligation to update these forward-looking statements.

EXECUTIVE SUMMARY

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

Three Months Ended September, 30 2008 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2008 were $6.871 billion, an increase of $282 million or 4.3% over the same period in 2007.
- Net written premium for the three months ended September 30, 2008 was $6.546 billion, an increase of $751 million or 13.0% over the same period in 2007.
- Pre-tax operating income for the three months ended September 30, 2008 was $159 million, a decrease of $363 million or 69.5% from the same period in 2007. Results in the period include $697 million of losses related to hurricanes Ike and Gustav ("September 2008 Hurricanes").
- Net income for the three months ended September 30, 2008 was $6 million, a decrease of $398 million or 98.5% from the same period in 2007. Results in the period include after-tax realized investment losses of $162 million.
- Cash flow from operations for the three months ended September 30, 2008 was $880 million, a decrease of $251 million or 22.2% from the same period in 2007.
- The combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2] for the three months ended September 30, 2008 was 94.9%, a decrease of 3.8 points over the same period in 2007. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the three months ended September 30, 2008 increased 4.4 points to 103.4%.

Nine Months Ended September 30, 2008 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2008 were $20.704 billion, an increase of $1.677 billion or 8.8% over the same period in 2007.
- Net written premium for the nine months ended September 30, 2008 was $19.081 billion, an increase of $2.122 billion or 12.5% over the same period in 2007.
- Pre-tax operating income for the nine months ended September 30, 2008 was $1.058 billion, a decrease of $337 million or 24.2% from the same period in 2007. Results in the period include $697 million of losses related to the September 2008 Hurricanes.

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[1] Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from the Texas Windstorm Insurance Association ("TWIA") and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. 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 (excluding prior year losses related to natural catastrophes and the events of September 11, 2001) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains.

- Net income for the nine months ended September 30, 2008 was $666 million, a decrease of $427 million or 39.1% from the same period in 2007. Results in the period include after-tax realized investment losses of $166 million.

- Cash flow from operations for the nine months ended September 30, 2008 was $2.572 billion, a decrease of $355 million or 12.1% from the same period in 2007.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2008 was 97.3%, a decrease of 0.8 points over the same period in 2007. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the nine months ended September 30, 2008 increased 1.9 points to 102.0%.

Financial Condition as of September 30, 2008

- Total assets were $105.517 billion as of September 30, 2008, an increase of $10.775 billion over December 31, 2007.

- Policyholders' equity was $10.808 billion as of September 30, 2008, a decrease of $1.558 billion from December 31, 2007. Included in policyholders' equity was $2.013 billion of after-tax unrealized investment losses.

Other 2008 3rd Quarter Highlights

Acquisitions and New Markets

- On September 22, 2008, the Company, through its subsidiaries, acquired all outstanding shares of common stock of Safeco Corporation ("Safeco"), for $68.25 per share in cash, at an aggregate purchase price of approximately $6.2 billion. The results of the operations of Safeco are included in the Company's financial statements subsequent to September 22, 2008. Following the acquisition, Safeco became part of the Company's Agency Markets SBU.

Rating Actions

- On September 23, 2008, Moody's Investors Service affirmed the debt and insurance financial strength ratings of Liberty Mutual Group Inc. ("LMGI") and its subsidiaries following LMGI's announcement that it completed the acquisition of Safeco. The outlook for all of LMG's long-term ratings remains negative.

- On September 25, 2008, Standard & Poor's Rating Service removed from CreditWatch and lowered its counterparty credit and financial strength ratings of the insurance companies that constitute LMGI to 'A-' from 'A' following the close of the Safeco acquisition on September 22, 2008. The outlook on all these companies is stable.

Credit Facilities

- On September 2, 2008, Liberty Mutual Insurance Company ("LMIC") entered into a $750 million, 364 day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

CONSOLIDATED RESULTS OF OPERATIONS

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

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

Overview – Consolidated

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Private passenger automobile	$2,015	$1,663	21.2%	$5,583	$4,701	18.8%
Workers compensation	1,148	1,139	0.8	3,764	3,743	0.6
Homeowners	638	573	11.3	1,646	1,469	12.0
Commercial multiple peril / Fire	511	449	13.8	1,459	1,253	16.4
International local businesses	403	286	40.9	1,236	965	28.1
Commercial automobile	340	322	5.6	1,021	885	15.4
General liability	277	239	15.9	896	705	27.1
LIU[1] reinsurance	233	296	(21.3)	766	877	(12.7)
LIU third party	223	148	50.7	553	411	34.5
LIU inland marine program	158	160	(1.3)	460	424	8.5
Group disability and life	140	116	20.7	417	349	19.5
Bond	111	84	32.1	293	228	28.5
LIU first party	67	80	(16.3)	200	227	(11.9)
Individual life	66	61	8.2	185	205	(9.8)
Assumed voluntary reinsurance	44	24	83.3	119	83	43.4
Other	172	155	11.0	483	434	11.3
Total net written premium[2]	$6,546	$5,795	13.0%	$19,081	$16,959	12.5%

1 Liberty International Underwriters (LIU).
2 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business in the above table.

Consolidated net written premium by SBU was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Personal Markets[1]	$1,643	$1,596	2.9%	$4,527	$4,433	2.1%
Commercial Markets	1,372	1,326	3.5	4,511	4,342	3.9
Agency Markets [2,3]	1,685	1,318	27.8	4,862	3,795	28.1
International	1,744	1,442	20.9	5,026	4,249	18.3
Corporate and Other[4]	102	113	(9.7)	155	140	10.7
Total net written premium (NWP)	$6,546	$5,795	13.0%	$19,081	$16,959	12.5%
Foreign exchange effect on growth			1.2			1.8
NWP growth excluding foreign exchange			11.8%			10.7%

1 Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.
2 Table includes the results of Safeco subsequent to September 22, 2008.
3 Table includes the results of Ohio Casualty subsequent to August 24, 2007.
4 Includes internal reinsurance.

Major drivers of net written premium growth were as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
$ in Millions	**2008**	**2007**	**$ Change**	**Pts. Attribution**	**2008**	**2007**	**$ Change**	**Pts. Attribution**
LMG NWP[1]	$6,546	$5,795	$751	13.0	$19,081	$16,959	2,122	12.5
Components of Growth:								
Ohio Casualty	$336	$113	$223	3.8	$1,039	$113	$926	5.4
Safeco	134	-	134	2.3	134	-	134	0.8
International local businesses (excluding foreign exchange)	1,009	772	237	4.1	2,891	2,372	519	3.0
International foreign exchange	71	-	71	1.2	299	-	299	1.8
Domestic personal auto	1,218	1,156	62	1.1	3,424	3,273	151	0.9
National Markets multi-year account	-	-	-	-	88	-	88	0.5
Group disability and life	140	116	24	0.4	417	349	68	0.4
Homeowners	579	561	18	0.3	1,522	1,457	65	0.4
Workers compensation booked as billed adjustment	59	56	3	0.1	(30)	(79)	49	0.3
Bond	83	78	5	0.1	234	222	12	0.1
Individual life	66	61	5	0.1	185	205	(20)	(0.1)
Other commercial lines[2]	2,851	2,882	(31)	(0.5)	8,878	9,047	(169)	(1.0)
Total LMG NWP	$6,546	$5,795	$751	13.0	$19,081	$16,959	$2,122	12.5

1 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business in the above table.
2 Excludes Ohio Casualty/Safeco premium, and includes LIU premium.
NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2008 was $6.546 billion and $19.081 billion, respectively, increases of $751 million and $2.122 billion over the same periods in 2007. Significant changes by major line of business include:

- Private passenger automobile net written premium, including internal reinsurance premium, increased $352 million and $882 million in the quarter and year-to-date, respectively. The

increases in both periods primarily reflect organic growth in all of International's local businesses in Latin America, and approximately $160 million and $375 million of premium in the quarter and year-to-date, respectively, related to acquisitions made, which include Ohio Casualty Corporation ("Ohio Casualty"), Brazilian insurer Indiana Seguros and Safeco. The increase in both periods also reflects stronger currencies versus the U.S. dollar (approximately $42 million and $158 million in the quarter and year-to-date, respectively) and strong customer retention and new business growth in both Personal Markets and Agency Markets. These increases were partially offset by lower average premium per policy in Personal Markets due primarily to mandatory rate decreases in Massachusetts, which became effective in April 2007.

- Workers compensation net written premium, including internal reinsurance premium, increased $9 million and $21 million in the quarter and year-to-date, respectively. Both periods were impacted by approximately $20 million and $82 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively. The increase year-to-date also reflects new business premium of $45 million related to a construction account with a multi-year exposure written in Commercial Markets' National Market segment. Partially offsetting the increases in both periods were rate decreases in both Agency Markets and Commercial Markets and lower retention in Commercial Markets due to a more competitive environment, a decrease in Summit's premium due to both mandated rate decreases in Florida and lower audit and retrospectively rated premium. Both periods also include an adjustment to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium.
- Homeowners net written premium, including internal reinsurance premium, increased $65 million and $177 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect approximately $47 million and $112 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively, and strong customer retention and new business growth, primarily in non-coastal areas, in both Personal Markets and Agency Markets. The increase in both periods also reflects the impact of rate increases in Personal Markets.
- Commercial multiple peril / fire, including internal reinsurance premium, increased $62 million and $206 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect approximately $66 million and $235 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively, improved retention in Commercial Markets and a reduction in the utilization of ceded reinsurance in Commercial Markets' Liberty Mutual Property segment as compared to 2007. These increases were offset by rate decreases in both Commercial Markets and Agency Markets due to a more competitive environment and lower retention in Agency Markets.
- International local businesses net written premium (excluding private passenger automobile), including internal reinsurance premium, increased $117 million and $271 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect organic growth in International's local businesses in Latin America, the acquisition of Brazilian insurer Indiana Seguros and stronger foreign currencies versus the U.S. dollar (approximately $25 million and $101 million in the quarter and year-to-date, respectively).
- Commercial automobile net written premium, including internal reinsurance premium, increased $18 million and $136 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect approximately $46 million and $175 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively, partially offset by modest rate decreases and lower retention in both Commercial Markets and Agency Markets due to a more competitive environment.
- General liability net written premium, including internal reinsurance premium, increased $38 million and $191 million in the quarter and year-to-date, respectively. The increases in both periods reflect approximately $16 million and $70 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively, partially offset by modest rate decreases due to a more competitive environment. Also impacting the year-to-date increase was new business premium of approximately $43 million related to a construction account with a multi-year exposure written in Commercial Markets' National Market segment.

- LIU reinsurance net written premium, including internal reinsurance premium, decreased $63 million and $111 million in the quarter and year-to-date, respectively. The decreases in both periods primarily reflects a reduction in aggregate exposure.
- LIU third party net written premium, including internal reinsurance premium, increased $75 million and $142 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect a decrease in ceded written premium due to a change in the structure of a reinsurance program, partially offset by a decline in rates as a result of a more competitive environment.
- LIU inland marine program net written premium decreased $2 million and increased $36 million in the quarter and year-to-date, respectively. The year to date increase reflects International's continued expansion of this program.
- Group disability and life net written premium increased $24 million and $68 million in the quarter and year-to-date, respectively, due primarily to the impact of broader market penetration.
- Bond net written premium, including internal reinsurance premium, increased $27 million and $65 million in the quarter and year-to-date respectively, primarily due to approximately $23 million and $54 million of premium related to the Ohio Casualty and Safeco acquisitions in the quarter and year-to-date, respectively.
- LIU first party net written premium, including internal reinsurance premium, decreased $13 million and $27 million in the quarter and year-to-date, respectively. The decreases in both periods are primarily due to increased ceded written premium.
- Individual life net written premium decreased $20 million year-to-date, primarily due to lower immediate annuity and structured settlement sales.

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

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

Results of Operations – Consolidated

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$6,871	$6,589	4.3%	$20,704	$19,027	8.8%
PTOI before catastrophes and net incurred losses attributable to prior years	$671	$543	23.6	$1,886	$1,695	11.3
Catastrophes[1]						
-September 2008 Hurricanes	(697)	-	NM	(697)	-	NM
-All other	(111)	(60)	85.0	(590)	(241)	144.8
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(1)	(95)	(98.9)	(5)	(96)	(94.8)
- All other[3]	297	134	121.6	464	37	NM
Pre-tax operating income	159	522	(69.5)	1,058	1,395	(24.2)
Realized investment (losses) gains, net	(249)	19	NM	(256)	144	NM
Federal and foreign income tax benefit (expense)	96	(137)	NM	(136)	(446)	(69.5)
Net income	$6	$404	(98.5%)	$666	$1,093	(39.1%)
Cash flow from operations	$880	$1,131	(22.2%)	$2,572	$2,927	(12.1%)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance of zero and $7 million for the three and nine months ended September 30, 2008, and zero and $3 million for the comparable periods of 2007.

3 Net of earned premium attributable to prior years of $14 million and $11 million for the three and nine months ended September 30, 2008, and $4 million and $39 million for the comparable periods of 2007. Net of amortization of deferred gains on retroactive reinsurance of $17 million and $53 million for the three and nine months ended September 30, 2008, and $21 and $69 million for the comparable periods of 2007.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2008 were $6.871 billion and $20.704 billion respectively, increases of $282 million and $1.677 billion over the same periods in 2007. The major components of revenues are net premium earned, net investment income, net realized investment gains, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2008 was $6.218 billion and $18.160 billion, respectively, increases of $622 million and $1.997 billion over the same periods in 2007. The increases primarily reflect approximately $389 million and $1.182 billion in the quarter and year-to-date, respectively, of premium related to the acquisitions of Ohio Casualty, Safeco and Brazilian insurer Indiana Seguros, approximately $91 million and $302 million of foreign exchange in the quarter and year-to-date, respectively, and higher earned premium associated with the changes in net written premium in 2007 and the first nine months of 2008.

Net investment income for the three and nine months ended September 30, 2008 was $705 million and $2.216 billion, respectively, representing a $54 million decrease and a $74 million increase versus the same periods in 2007. The decrease in net investment income for the quarter is primarily driven by a $117 million decrease in limited partnerships and limited liability companies income due to reduced valuations and IPO/takeover activities as compared to the same period in 2007, lower investment yields and a shift to tax-exempt securities. The year-to-date improvement reflects an increase in interest income, primarily due to a higher invested asset base resulting from the continued investment of cash flow from operations and cash proceeds received from the May 2008 debt issuance, respectively. In addition, interest income increased slightly as a result of net assets assumed from the acquisition of Safeco. Partially offsetting this

increase were lower investment yields, a shift to tax-exempt securities, and the decrease in limited partnerships and limited liability companies income.

Net realized investment losses for the three and nine months ended September 30, 2008 were $249 million and $256 million, respectively, compared to gains of $19 million and $144 million in the same periods in 2007, both periods reflect higher impairment losses on fixed maturity and equity investments related to securities subsequently sold to raise funds for the acquisition of Safeco and securities deemed to be other than temporarily impaired due to recent market conditions (primarily FNMA, FHLMC, Lehman, Wachovia and Washington Mutual). Partially offsetting these losses were $83 million and $116 million respectively, in net gains related to derivative contracts the Company used to partially hedge its equity exposure for the three and nine months ended September 30, 2008. In addition, the Company recognized a $106 million gain from the sale of an investment property.

Fee and other revenues for the three and nine months ended September 30, 2008 were $197 million and $584 million, respectively, a decrease of $18 million and an increase $6 million versus the same periods in 2007. The decrease in the quarter reflects a reclassification from earned premium to fee and other revenue in the third quarter of 2007 for contractholder charges and assessments related to SFAS 97 business within Spain and Portugal which did not recur in 2008. Also driving the decrease in the quarter was lower fee revenues from the Company's servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 were $6.961 billion and $19.902 billion, respectively, increases of $913 million and $2.414 billion over the same periods in 2007. The increases in both periods primarily reflect the acquisitions of Ohio Casualty, Brazilian insurer Indiana Seguros, and Safeco, organic business growth, in particular International's Latin America operations, higher catastrophe losses including the September 2008 Hurricanes, general cost increases including higher interest expense and an increase in non-catastrophe property losses in both Agency Markets and Commercial Markets. Partially offsetting these increases in both periods were decreases in incurred losses attributable to prior years, primarily related to general liability lines, and lower variable incentive compensation. Also offsetting the year-to-date increase in claims, benefits and expenses was favorable development in the workers compensation line of business in 2008 versus unfavorable development in the prior period.

	Three Months Ended September 30,			Nine Months Ended September 30,		
CONSOLIDATED	**2008**	**2007**	**Change (Points)**	**2008**	**2007**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	68.2%	70.3%	(2.1)	69.7%	69.9%	(0.2)
Underwriting expense ratio	26.5	28.1	(1.6)	27.3	27.9	(0.6)
Dividend ratio	0.2	0.3	(0.1)	0.3	0.3	-
Subtotal	94.9	98.7	(3.8)	97.3	98.1	(0.8)
Catastrophes[1]						
-September 2008 Hurricanes	11.6	-	11.6	4.0	-	4.0
-All other	1.9	1.1	0.8	3.4	1.6	1.8
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	1.7	(1.7)	0.1	0.6	(0.5)
- All other	(5.0)	(2.5)	(2.5)	(2.8)	(0.2)	(2.6)
Total combined ratio[2]	103.4%	99.0%	4.4	102.0%	100.1%	1.9

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

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

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2008 was 94.9% and 97.3% respectively, decreases of 3.8 points and 0.8 points over the same periods in 2007. The decreases in the quarter reflect a decline in loss activity within LIU's reinsurance business resulting from less severe loss events (excluding the September 2008 Hurricanes) in 2008 as compared to 2007 and a lower claims and claim adjustment expense ratio in Personal Markets mainly related to the auto liability line of business. In 2008, Personal Markets began recording an accident year loss ratio on its auto liability business at a level which was consistent with market trends for the period ending December 31, 2007. These decreases were partially offset by higher non-catastrophe property related losses in both Agency Markets and Commercial Markets, higher auto physical damage losses due to an increase in frequency in Agency Markets and a more competitive rate environment across all SBUs and lines of business. The year-to-date decrease in the claims and claim adjustment expense ratio was also partially offset by increased loss activity within LIU's first party business. The underwriting expense ratio in both periods decreased primarily as a result of lower variable incentive compensation.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2008 was 103.4% and 102.0% respectively, increases of 4.4 points and 1.9 points over the same periods in 2007. The increases in both periods primarily reflect the changes in the combined ratio components discussed previously and higher catastrophe losses due mainly to the 2008 Hurricanes, tornados and Midwestern storms. Partially offsetting the increases in both periods was the impact of favorable net incurred loss development attributable to prior

years primarily in general liability lines. Also offsetting the year-to-date increase in the combined ratio was modest favorable development in the workers compensation line of business in 2008 versus unfavorable development in the prior period.

PTOI for the three and nine months ended September 30, 2008 was $159 million and $1.058 billion, respectively, decreases of $363 million and $337 million versus the same periods in 2007.

Federal and foreign income tax (benefit) expense for the three and nine months ended September 30, 2008 was ($96) million and $136 million, respectively, decreases of $233 million and $310 million from the same periods in 2007. The Company's effective tax rate for the three and nine months ended September 30, 2008 was (107%) and 17%, respectively, compared to 25% and 29% for the same periods in 2007. The effective tax rate for the three months ended September 30, 2008, reflects a tax benefit of $96 million primarily driven by the operating loss for the period and the recognition of unbooked tax benefits under FASB Interpretation No. 48 resulting from a tax refund claim. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income, goodwill, foreign taxes and the aforementioned tax refund claim.

Net income for the three and nine months ended September 30, 2008 was $6 million and $666 million, respectively, decreases of $398 million and $427 million from the same periods in 2007.

Cash flow from operations for the three and nine months ended September 30, 2008 was $880 million and $2.572 billion, respectively, a decrease of $251 million and $355 million from the same periods in 2007. The decrease in the quarter reflects higher loss payments related to catastrophes and non-catastrophe property losses due to adverse weather conditions, lower premium collections in the Commercial Markets SBU, and general cost increases. The year-to-date decrease reflects higher loss payments related to catastrophes and non-catastrophe property losses due to adverse weather conditions, and general cost increases including higher advertising expenses.

PERSONAL MARKETS

Overview – Personal Markets

Personal Markets sells primarily automobile, homeowners and other types of property and casualty insurance coverage, as well as a wide range of life and annuity products, to individuals in the United States. Products are distributed through approximately 1,800 licensed captive sales representatives, approximately 500 licensed direct response sales counselors, third-party producers and the Internet. Personal Markets' largest source of new business is through its more than 11,400 sponsored affinity groups (such as employers, credit unions, professional associations and alumni associations). Personal Markets' coverages are primarily personal automobile and homeowners.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Private passenger automobile	$1,054	$1,024	2.9%	$2,955	$2,905	1.7%
Homeowners and other	523	511	2.3	1,387	1,323	4.8
Individual life[1]	66	61	8.2	185	205	(9.8)
Total net written premium	$1,643	$1,596	2.9%	$4,527	$4,433	2.1%

[1] Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

Net written premium for the three and nine months ended September 30, 2008 was $1.643 billion and $4.527 billion, respectively, increases of $47 million and $94 million over the same periods in 2007. The increases in both periods reflect new business growth, strong customer retention in both automobile and homeowners and rate increases on homeowners policies, partially offset by a decrease in sales of immediate annuity products. For individual life, the increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.

Private passenger automobile net written premium for the three and nine months ended September 30, 2008 was $1.054 billion and $2.955 billion, respectively, increases of $30 million and $50 million over the same periods in 2007. The increases in both periods reflect a 4.1% increase in voluntary policies in-force as compared to September 30, 2007 due to strong customer retention and new business growth, partially offset by lower average premium per policy due primarily to the effect of rate decreases in Massachusetts. The introduction of managed competition in 2008 provided the Company with the opportunity to significantly increase its presence in the Massachusetts automobile insurance market.

Homeowners and other net written premium for the three and nine months ended September 30, 2008 was $523 million and $1.387 billion, respectively, increases of $12 million and $64 million over the same periods in 2007. The increases in both periods reflect rate increases and a 4.7% increase in policies in-force (1.8 points related to renters policies) as compared to September 30, 2007 due to strong customer retention and new business growth, primarily in non-coastal areas.

Individual life net written premium for the three and nine months ended September 30, 2008 was $66 million and $185 million, respectively, an increase of $5 million and a decrease of $20 million versus the same periods in 2007. The increase in the quarter reflects higher structured settlement sales, while the decrease on a year-to-date basis reflects lower immediate annuity and structured settlement sales.

Results of Operations – Personal Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$1,679	$1,648	1.9%	$4,965	$4,851	2.4%
PTOI before catastrophes and net incurred losses attributable to prior years	$222	$236	(5.9)	$657	$615	6.8
Catastrophes[2]:						
-September 2008 Hurricanes	(268)	-	NM	(268)	-	NM
-All other	(52)	(42)	23.8	(307)	(170)	80.6
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	45	44	2.3	58	118	(50.8)
Pre-tax operating (loss) income	($53)	$238	NM	$140	$563	(75.1%)

1 Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

2 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2008 were $1.679 billion and $4.965 billion, respectively, increases of $31 million and $114 million over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2008 was $1.476 billion and $4.354 billion, respectively, increases of $32 million and $109 million over the same periods in 2007. The increases in both periods reflect the earned premium associated with the changes in net written premium for both the voluntary automobile and homeowners lines of business in 2007 and the first nine months of 2008, partially offset by a decrease in sales of immediate annuity products. The increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.

Net investment income for the three and nine months ended September 30, 2008 was $180 million and $530 million, respectively, increases of $5 million and $16 million over the same periods in 2007. The increases in both periods primarily reflect a higher invested asset base due to the continued investment of cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 was $1.742 billion and $4.844 billion, respectively, increases of $330 million and $558 million over the same periods in 2007. The increases in both periods primarily reflect higher catastrophe losses, business growth, general cost increases, and an increase in acquisition expenses mainly due to higher advertising costs as compared to the same periods in 2007, partially offset by lower profit sharing associated with the Prudential distribution channel. The higher catastrophe losses in both periods are mainly driven by the September 2008 Hurricanes. The remaining variance on a year-to-date basis reflects losses related to wind and hail storms in Midwestern and Southwestern states and a decrease in the amount of favorable prior year loss development on auto liability business as compared to the same period in 2007.

PERSONAL MARKETS	Three Months Ended September 30, 2008	2007	Change (Points)	Nine Months Ended September 30, 2008	2007	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	62.1%	64.6%	(2.5)	63.3%	66.2%	(2.9)
Underwriting expense ratio	27.0	24.3	2.7	26.5	24.8	1.7
Dividend ratio	-	-	-	-	-	-
Subtotal	89.1	88.9	0.2	89.8	91.0	(1.2)
Catastrophes[1]:						
-September 2008 Hurricanes	19.0	-	19.0	6.4	-	6.4
-All other	3.7	3.0	0.7	7.4	4.2	3.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.2)	(3.3)	0.1	(1.4)	(2.9)	1.5
Total combined ratio	108.6%	88.6%	20.0	102.2%	92.3%	9.9

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes.

The Personal Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2008 was 89.1% and 89.8%, respectively, an increase of 0.2 points and a decrease of 1.2 points versus the same periods in 2007. The decrease in the claims and claim adjustment expense ratio in both periods is mainly related to the auto liability line of business. In 2008, Personal Markets began recording an accident year loss ratio on its auto liability business at a level which was consistent with market trends for the year ending December 31, 2007. The higher underwriting expense ratio in both periods primarily reflects an increase in advertising expenditures (approximately 2.1 points and 1.3 points in the quarter and year-to-date, respectively) and higher personnel costs, partially offset by lower profit sharing associated with the Prudential distribution channel.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2008 was 108.6% and 102.2%, respectively, increases of 20.0 points and 9.9 points over the same periods in 2007. The increases in both periods reflect the changes in the combined ratio previously discussed, higher catastrophe losses related to the September 2008 Hurricanes in the quarter, losses related to Midwestern and Southwestern wind and hail storms and a year-to-date decrease in the amount of favorable net incurred loss development attributable to prior years on auto liability business as compared to the same period in 2007.

PTOI for the three and nine months ended September 30, 2008 was ($53) million and $140 million, respectively, decreases of $291 million and $423 million from the same periods in 2007.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets offers a wide array of commercial insurance and reinsurance coverages to U.S. employers and insurance companies, respectively. Products are distributed through a variety of distribution channels, including the Company's direct sales force, brokers and consultants. The Commercial Markets business unit is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base, product grouping or distribution channel to provide tailored products and services that specifically address customers' needs. The Commercial Markets coverages include workers' compensation, commercial automobile, general liability (including product liability), group disability and life, commercial multiple peril and fire, assumed voluntary reinsurance, and a variety of other coverages. The Company is also a servicing carrier for state based workers' compensation and commercial automobile involuntary market pools.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Business Market	$348	$371	(6.2%)	$1,182	$1,294	(8.7%)
Wausau Insurance	338	331	2.1	1,070	1,027	4.2
National Market	280	247	13.4	1,001	887	12.9
Group Market	140	116	20.7	417	349	19.5
Liberty Mutual Property	89	83	7.2	297	271	9.6
Other Markets	177	178	(0.6)	544	514	5.8
Total net written premium	$1,372	$1,326	3.5%	$4,511	$4,342	3.9%

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Workers compensation	$761	$744	2.3%	$2,569	$2,582	(0.5%)
General liability	148	147	0.7	522	471	10.8
Group disability and life	140	116	20.7	417	349	19.5
Commercial automobile	115	140	(17.9)	375	397	(5.5)
Commercial multiple peril / Fire	94	84	11.9	328	286	14.7
Assumed voluntary reinsurance	44	24	83.3	116	80	45.0
Other	70	71	(1.4)	184	177	4.0
Total net written premium	$1,372	$1,326	3.5%	$4,511	$4,342	3.9%

Net written premium for the three and nine months ended September 30, 2008 was $1.372 billion and $4.511 billion, respectively, increases of $46 million and $169 million over the same periods in 2007. The increases in both periods reflect an increase in group disability and assumed voluntary reinsurance business due to a broader penetration of those markets and higher commercial multiple peril/fire premium due to a reduction in the utilization of ceded reinsurance as compared to 2007. Year-to-date National Market's results also reflect new business premium of approximately $43 million in general liability, and $45 million in workers compensation, related to a construction account with a multi-year exposure. These increases in both periods were partially offset by a decrease in commercial automobile premium due to the non-renewal

of a large account and lower customer retention levels and rate decreases across most lines of business due to a more competitive market environment. Also impacting year-to-date results was a decrease in audit and retrospective workers compensation premium recorded in the Business Market segment.

Results of Operations – Commercial Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$1,757	$1,681	4.5%	$5,143	$4,959	3.7%
PTOI before catastrophes and net incurred losses attributable to prior years	103	143	(28.0)	335	382	(12.3)
Catastrophes[1]:						
-September 2008 Hurricanes	(156)	-	NM	(156)	-	NM
-All other	(12)	4	NM	(71)	(5)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	25	(27)	NM	47	(48)	NM
Pre-tax operating (loss) income	($40)	$120	NM	$155	$329	(52.9%)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of $22 million and $24 million for the three and nine months ended September 30, 2008, and $10 million and $31 million for the comparable period of 2007. Net of amortization of deferred gains on retroactive reinsurance of $12 million and $38 million for the three and nine months ended September 30, 2008, and $17 million and $54 million for the comparable period of 2007.

Revenue for the three and nine months ended September 30, 2008 was $1.757 billion and $5.143 billion, respectively, increases of $76 million and $184 million over the same periods in 2007. The major components of revenues are net premium earned, net investment income, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2008 was $1.471 billion and $4.292 billion, respectively, increases of $67 million and $157 million over the same periods in 2007. The increases reflect the earned premium associated with the changes in net written premium in 2007 and the first nine months of 2008.

Net investment income for the three and nine months ended September 30, 2008 was $210 million and $621 million, respectively, increases of $15 million and $48 million over the same periods in 2007. The increases primarily reflect a higher invested asset base due to the continued investment of cash flow from operations.

Fee and other revenues for the three and nine months ended September 30, 2008 was $76 million and $230 million, respectively, decreases of $6 million and $21 million from the same periods in 2007. The decreases primarily reflect lower fee revenues from the Company's servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 was $1.797 billion and $4.988 billion, respectively, increases of $236 million and $358 million over the same periods in 2007. The increases in both periods primarily reflect higher catastrophe related property losses, business growth and general cost increases. The year-to-date increase also reflects higher non-catastrophe related property losses. Partially offsetting these increases in both periods was a decrease in the amount of incurred losses attributable to prior years, primarily in the workers compensation line of business, and a reduction in premium taxes.

COMMERCIAL MARKETS	Three Months Ended September 30, 2008	2007	Change (Points)	Nine Months Ended September 30, 2008	2007	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	84.2%	79.4%	4.8	83.4%	80.7%	2.7
Underwriting expense ratio	20.2	21.7	(1.5)	20.8	21.4	(0.6)
Dividend ratio	0.4	0.4	-	0.6	0.5	0.1
Subtotal	104.8	101.5	3.3	104.8	102.6	2.2
Catastrophes[1]:						
-September 2008 Hurricanes	11.9	-	11.9	4.1	-	4.1
-All other	0.9	(0.4)	1.3	1.8	0.1	1.7
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(2.2)	2.1	(4.3)	(1.3)	1.2	(2.5)
Total combined ratio	115.4%	103.2%	12.2	109.4%	103.9%	5.5

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes , the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Commercial Markets combined ratio before catastrophes and net incurred losses attributable to prior years for both of the three and nine months periods ended September 30, 2008 was 104.8%, an increase of 3.3 and 2.2 points over the comparable periods in 2007. The increases in the claims and claim adjustment expense ratio in both periods primarily reflect a reduction in the assumed involuntary applied discount factor associated with certain involuntary pool workers compensation loss reserves (approximately 2.0 points and 0.7 points in the quarter and year-to-date, respectively) and a more competitive rate environment. Also impacting both periods was a higher claims and claims adjustment expense ratio in the workers compensation line of business due to increasing loss trends in California. In addition, the year-to-date increase reflects the impact of large property losses. The underwriting expense ratio in both periods was impacted by a reduction in premium taxes partially offset by a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the involuntary pools.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2008 was 115.4% and 109.4%, respectively, increases of 12.2 and 5.5 points over the same periods in 2007. The increases in both periods reflect the changes in the combined ratio previously discussed and higher catastrophe losses attributable to the September 2008 Hurricanes. In addition the year-to-date increase reflects losses related to tornados and Midwest flooding. These increases were partially offset by a decrease in net incurred losses attributable to prior years as a result of less workers compensation strengthening in 2008 versus the comparable period in 2007.

PTOI for the three and nine months ended September 30, 2008 was ($40) million and $155 million, respectively, decreases of $160 million and $174 million from the same periods in 2007.

AGENCY MARKETS

Overview – Agency Markets

Agency Markets offers personal and commercial insurance coverage to individuals and businesses through independent agents throughout the United States. Products are offered through eight regional insurance companies, Safeco, Summit, and Liberty Mutual Surety. The regional companies leverage the service-oriented focus of a regional company with the cost efficiencies of a national company to deliver quality products and services to independent agents and brokers and the customers they serve. Agency Markets expanded its personal, commercial and surety market presence with the acquisition of Safeco on September 22, 2008. Summit provides workers compensation in the Southeast (primarily Florida). Liberty Mutual Surety provides nationwide contract and commercial surety bonds.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008[1]**	**2007[2,3,4]**	**Change**	**2008[1]**	**2007[2,3,4]**	**Change**
Regional Companies Commercial Lines	$932	$812	14.8%	$2,724	$2,192	24.3%
Regional Companies Personal Lines	384	259	48.3	1,061	640	65.8
Safeco	134	-	NM	134	-	NM
Summit	82	128	(35.9)	510	648	(21.3)
Bond[5]	100	84	19.0	283	228	24.1
Other[6]	53	35	51.4	150	87	72.4
Total net written premium	$1,685	$1,318	27.8%	$4,862	$3,795	28.1%

1 Tables include the results of Safeco subsequent to September 22, 2008.
2 Tables include the results of Ohio Casualty subsequent to August 24, 2007.
3 Effective in the first quarter 2008, net written premium associated with Ohio Casualty, previously reported separately, is included in Regional Companies Commercial Lines, Regional Companies Personal Lines, Bond and Other. The prior periods have been restated to reflect this change.
4 Effective in the first quarter 2008, net written premium associated with the run-off operations of GoAmerica, previously included in Regional Companies Personal Lines, is included in Other. The prior periods have been restated to reflect this change.
5 Includes the operations of Liberty Mutual Surety.
6 Includes excess casualty and other specialty products, run-off operations and internal reinsurance.
NM= Not Meaningful

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Commercial Lines						
Workers compensation total:	$320	$330	(3.0%)	$1,204	$1,217	(1.1%)
- Summit	82	128	(35.9)	510	648	(21.3)
- All other	238	202	17.8	694	569	22.0
Commercial multiple peril	395	340	16.2	1,096	894	22.6
Commercial automobile	223	180	23.9	640	483	32.5
General liability	100	66	51.5	290	162	79.0
Bond	111	84	32.1	294	228	28.9
Other	60	56	7.1	172	157	9.6
Subtotal	$1,209	$1,056	14.5%	$3,696	$3,141	17.7%
Personal Lines						
Private passenger automobile	$291	$154	89.0%	$712	$389	83.0%
Homeowners	160	95	68.4	386	232	66.4
Other	25	13	92.3	68	33	106.1
Subtotal	$476	$262	81.7%	$1,166	$654	78.3%
Total net written premium	$1,685	$1,318	27.8%	$4,862	$3,795	28.1%

Net written premium for the three and nine months ended September 30, 2008 was $1.685 billion and $4.862 billion, respectively, increases of $367 million and $1.067 billion over the same periods in 2007. The increases in both periods reflect the impact of the Ohio Casualty (approximately $223 million and $926 million of premium in the quarter and year-to-date, respectively) and Safeco ($134 million in the quarter and year-to-date) acquisitions and organic growth in personal lines due to improved retention and an increase in new business. These increases represent additional written premium of approximately $85 million and $292 million for personal lines in the quarter and year-to-date, respectively, and approximately $272 million and $768 million for commercial lines in the quarter and year-to-date, respectively. These increases were partially offset by modest rate decreases in most states and lines of business due to a more competitive market environment and a decrease in Summit's premium due to both mandated workers compensation rate decreases in Florida and lower audit and retrospectively rated premium as the Florida economy contracts.

Results of Operations – Agency Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$1,824	$1,435	27.1%	$5,141	$3,926	30.9%
PTOI before catastrophes and net incurred losses attributable to prior years	$177	$115	53.9%	$412	$339	21.5%
Catastrophes[1]						
-September 2008 Hurricanes	(92)	-	NM	(92)	-	NM
-All other	(46)	(22)	109.1	(201)	(66)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	(1)	(100.0)
- All other[2]	177	216	(18.1)	290	287	1.0
Pre-tax operating income	$216	$309	(30.1%)	$409	$559	(26.8%)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of ($6) million and ($11) million for the three and nine months ended September 30, 2008, respectively, and ($4) million and $4 million for the comparable periods of 2007.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2008 were $1.824 billion and $5.141 billion, respectively, increases of $389 million and $1.215 billion over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2008 were $1.649 billion and $4.657 billion, respectively, increases of $346 million and $1.084 billion over the same periods in 2007. The increases in both periods reflect approximately $199 million and $888 million of premium related to the Ohio Casualty acquisition in the quarter and year-to-date, respectively, $135 million of premium related to the Safeco acquisition in the quarter and year-to-date, and earned premium associated with the changes in net written premium in 2007 and the first nine months of 2008.

Net investment income for the three and nine months ended September 30, 2008 was $158 million and $436 million, respectively, increases of $42 million and $131 million over the same periods in 2007. The increases in both periods reflect an increase in invested assets due to the continued investment of cash flow from operations and assets assumed from the Ohio Casualty and Safeco acquisitions.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 were $1.608 billion and $4.732 billion, respectively, increases of $482 million and $1.365 billion over the same periods in 2007. The increases in both periods primarily reflect the impact of the Ohio Casualty and Safeco acquisitions and higher catastrophe losses, which includes losses related to the September 2008 hurricanes. The year-to-date increase also reflects tornados, mainly in Tennessee, and the Midwest storm activity. In addition, the increase in both periods reflects an increase in non-catastrophe property losses due in part to adverse weather conditions, higher auto physical damage losses due to an increase in frequency and general cost increases. The increase in the quarter also reflects a decrease in favorable incurred losses attributable to prior years primarily related to liability lines. The year-to-date increase was partially offset by an increase in favorable incurred loss development attributable to prior years primarily related to liability lines.

AGENCY MARKETS	Three Months Ended September 30,			Nine Months Ended September 30,		
	2008	2007	Change (Points)	2008	2007	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	64.4%	65.7%	(1.3)	66.5%	65.7%	0.8
Underwriting expense ratio	32.8	33.2	(0.4)	32.6	32.3	0.3
Dividend ratio	0.3	0.8	(0.5)	0.6	0.9	(0.3)
Subtotal	97.5	99.7	(2.2)	99.7	98.9	0.8
Catastrophes[1]						
-September 2008 Hurricanes	5.5	-	5.5	2.0	-	2.0
-All other	2.8	1.7	1.1	4.3	1.9	2.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(10.7)	(16.6)	5.9	(6.2)	(8.1)	1.9
Total combined ratio	95.1%	84.8%	10.3	99.8%	92.7%	7.1

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company’s external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd’s Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Agency Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2008 was 97.5% and 99.7%, respectively, a decrease of 2.2 and an increase of 0.8 points versus the same periods in 2007. The decrease in the claims and claim adjustment expense ratio in the quarter was driven by a re-estimation of loss adjustment expense to more accurately reflect current market trends, partially offset by a more competitive rate environment. The increase in the claims and claim adjustment expense ratio year-to-date primarily reflects an increase in non-catastrophe property losses, higher auto physical damage losses resulting from an increase in frequency and a more competitive rate environment. The decrease in the underwriting expense ratio in the quarter reflects the impact of writing more personal lines business, which has a lower expense ratio. The increase in the year-to-date underwriting expense ratio reflects the impact of one-time integration costs associated with the Ohio Casualty acquisition primarily related to systems integration, partially offset by a decrease in premium taxes, primarily at Summit. The combined ratio in both periods was also impacted by a decrease in dividends incurred.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2008 was 95.1% and 99.8%, respectively, an increase of 10.3 points and 7.1 points over the same periods in 2007. The increases in both periods primarily reflect the changes in the combined ratio previously discussed and higher catastrophe losses. The increase in the quarter was also impacted by a decrease in favorable incurred losses attributable to prior years in liability lines.

PTOI for the three and nine months ended September 30, 2008 was $216 million and $409 million, respectively, decreases of $93 million and $150 million from the same periods in 2007.

INTERNATIONAL

Overview – International

International provides insurance products and services through two distinct approaches: local businesses, which sell personal and commercial lines products in specified countries, and LIU, which sells specialty commercial lines insurance and reinsurance through broker networks worldwide. International's local business operations consist of local insurance company operations selling traditional property, casualty and life insurance products to individuals and small businesses in countries with a large and growing middle class. Private passenger automobile insurance is the predominant line of business. In South America, International operates in Venezuela, Argentina, Colombia, Brazil and Chile. In Asia, International writes business in Singapore, Thailand, Vietnam and China (including Hong Kong). In Europe, the Company operates in Spain, Portugal, Poland and Turkey. LIU writes casualty, specialty casualty, marine, energy, engineering, construction and aviation coverages through offices in Asia, Australia, Europe, the Middle East and North America. LIU, through its Lloyd's Syndicate 4472, also provides multi-line insurance and reinsurance, including property catastrophe reinsurance, on a worldwide basis.

International net written premium by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
International Local Businesses Total	$1,071	$771	38.9%	$3,124	$2,365	32.1%
- Latin America	672	444	51.4	1,874	1,235	51.7
- Europe	345	282	22.3	1,086	1,000	8.6
- Asia Pacific	54	45	20.0	164	130	26.2
Liberty International Underwriters	673	671	0.3	1,902	1,884	1.0
Total net written premium (NWP)	$1,744	$1,442	20.9%	$5,026	$4,249	18.3%
Foreign exchange effect on growth			4.9%			7.0%
NWP growth excluding foreign exchange			16.0%			11.3%

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

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

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

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Local businesses – private passenger auto	$668	$486	37.4%	$1,908	$1,407	35.6%
Local businesses – all other[1]	403	285	41.4	1,216	958	26.9
LIU reinsurance	233	294	(20.7)	719	825	(12.8)
LIU inland marine program	158	160	(1.3)	460	424	8.5
LIU third party	211	134	57.5	517	394	31.2
LIU first party	59	75	(21.3)	168	214	(21.5)
LIU other	12	8	50.0	38	27	40.7
Total net written premium	$1,744	$1,442	20.9%	$5,026	$4,249	18.3%

1 Premium related to commercial and other personal lines insurance products sold by local business operations.

Net written premium for the three and nine months ended September 30, 2008 was $1.744 billion and $5.026 billion, respectively, increases of $302 million and $777 million over the same periods in 2007. The increases in both periods reflect organic growth in the local businesses, primarily in Latin America, the acquisition of Brazilian insurer Indiana Seguros (approximately $63 million and $165 million in the quarter and year-to-date, respectively), the start-up operations in Poland and stronger foreign currencies versus the U.S. dollar (approximately $71 million and $299 million in the quarter and year-to-date, respectively). Growth in both periods also reflects a decrease in the amount of ceded written premium in LIU's third party business due to a change in the structure of a reinsurance program. The year-to-date increase also reflects the continued expansion of LIU's inland marine program. The increases in both periods were partially offset by rate decreases in LIU's reinsurance and third party businesses due to a more competitive environment, increased ceded written premium in LIU's first party business as well as a reduction in aggregate exposure in LIU reinsurance.

Results of Operations – International

$ in Millions	Three Months Ended September 30, 2008	2007	Change	Nine Months Ended September 30, 2008	2007	Change
Revenues	$1,727	$1,565	10.4%	$5,225	$4,511	15.8%
PTOI before catastrophes and net incurred losses attributable to prior years	$174	$59	194.9%	$436	$338	29.0%
Catastrophes[1, 2]:						
-September 2008 Hurricanes	(101)	-	NM	(101)	-	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	57	18	NM	96	40	140.0
Pre-tax operating income	$130	$77	68.8%	$431	$378	14.0%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to external reinsurance assumed through Lloyd's Syndicate 4472 except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Assumed catastrophe losses related to the September 2008 Hurricanes reflect the impact of net catastrophe reinsurance premium earned of $7 million for the three and nine months ended September 30, 2008.

3 Net of earned premium attributable to prior years of ($2) million for the three and nine months ended September 30, 2008, respectively, and ($1) million and $5 million for the comparable periods of 2007.

Revenues for the three and nine months ended September 30, 2008 were $1.727 billion and $5.225 billion, respectively, increases of $162 million and $714 million over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2008 was $1.571 billion and $4.716 billion, respectively, increases of $188 million and $685 million over the same periods in 2007. The increases in both periods reflect the earned premium associated with the changes in net written premium in 2007 and the first nine months of 2008, as well as the impact of foreign exchange of approximately $91 million and $302 million in the quarter and year-to-date, respectively.

Net investment income for the three and nine months ended September 30, 2008 was $156 million and $455 million, respectively, increases of $24 million and $70 million over the same periods in 2007. The increases in both periods primarily reflect a higher invested asset base and the impact of foreign exchange, approximately $12 million and $31 million in the quarter and year-to-date, respectively.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 were $1.633 billion and $4.847 billion, respectively, increases of $134 million and $714 million over the same periods in 2007. The increases in both periods primarily reflect business growth in the local businesses, primarily in Latin America, including the acquisition of Indiana Seguros in Brazil, stronger foreign currencies versus the U.S. dollar and increased current accident year loss activity within LIU's third party business. The increases in both periods also reflect catastrophe losses related to the September 2008 Hurricanes in LIU's first party and reinsurance lines of business. Partially offsetting the increases in both periods was a reduction in severe large loss events within LIU's reinsurance business in 2008 versus 2007 and an increase in the amount of favorable incurred loss development attributable to prior years primarily from LIU's third party, first party and reinsurance lines of business.

INTERNATIONAL	Three Months Ended September 30, 2008	2007	Change (Points)	Nine Months Ended September 30, 2008	2007	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	66.6%	73.5%	(6.9)	68.1%	68.9%	(0.8)
Underwriting expense ratio	31.7	31.2	0.5	31.8	31.2	0.6
Dividend ratio	-	-	-	-	-	-
Subtotal	98.3	104.7	(6.4)	99.9	100.1	(0.2)
Catastrophes[1]:						
-September 2008 Hurricanes	6.5	-	6.5	2.2	-	2.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.7)	(1.3)	(2.4)	(2.1)	(1.0)	(1.1)
Total combined ratio	101.1%	103.4	(2.3)	100.0%	99.1%	0.9

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to external reinsurance assumed through Lloyd's Syndicate 4472 except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes ,the 2005 U.S. Hurricanes and September 2008 U.S. Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2008 was 98.3% and 99.9%, respectively, a decrease of 6.4 points and 0.2 points over the comparable periods in 2007. The decreases in the claims and claim adjustment expense ratio in both periods primarily reflect a decline in loss activity within LIU's reinsurance business resulting from less severe large loss events (excluding the September 2008 Hurricanes) in 2008 versus 2007, partially offset by the effects of a more competitive rate environment on both LIU's reinsurance and third party businesses. The year-to-date decrease in the claims and claim adjustment expense ratio is partially offset by increased loss activity within LIU's first party business. The increase in the underwriting expense ratio in both periods was primarily due to higher acquisition costs in Latin America and Europe, a change in the structure of a reinsurance program in LIU's third party business, which reduced the amount of ceded commissions received versus 2007, and a reduction of premium volume in LIU's reinsurance business.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2008 was 101.1% and 100.0%, respectively, a decrease of 2.3 points and an increase of 0.9 points versus the comparable periods in 2007. These movements reflect the aforementioned changes in the combined ratio components, the impact of catastrophe losses related to the September 2008 Hurricanes in LIU's first party and reinsurance lines of business and an increase in the amount of favorable incurred loss development attributable to prior years.

PTOI for the three and nine months ended September 30, 2008 was $130 million and $431 million, increases of $53 million over the comparable periods in 2007.

CORPORATE and OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

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

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

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

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

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

- For presentation in this MD&A, domestic property and casualty operations' investment income is allocated to the business units based on planned ordinary investment income returns by investment category. Investments are allocated to the business units in an amount equal to their respective liabilities net of insurance assets (reinsurance, premiums receivable, etc.) plus allocated statutory policyholders' surplus. The difference between allocated net investment income and actual net investment income is included in Corporate and Other.

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

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

- Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Internal reinsurance[1]	$40	$55	(27.3%)	$180	$215	(16.3%)
Workers compensation[2]	59	56	5.4	(30)	(79)	62.0
Other	3	2	50.0	5	4	25.0
Total net written premium	$102	$113	(9.7%)	$155	$140	10.7%

[1] Net of external cessions
[2] Booked as billed adjustment

Net written premium for the three and nine months ended September 30, 2008 was $102 million and $155 million, respectively, a decrease of $11 million and an increase of $15 million versus the same periods in 2007. The decrease in the quarter is primarily driven by a decrease in internal reinsurance premium due to an increase in external ceded reinsurance as a result of the Company purchasing additional catastrophe reinsurance. The year-to-date increase reflects a decrease in the Company's workers compensation "booked as billed" adjustment, partially offset by the aforementioned decrease in internal reinsurance program in 2008.

Results of Operations – Corporate and Other

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	($116)	$260	NM	$230	$780	(70.5%)
PTOI before catastrophes and net incurred losses attributable to prior years	($5)	($10)	(50%)	$46	$21	119.0%
Catastrophes[1]:						
-September 2008 Hurricanes	(80)	-	NM	(80)	-	NM
-All other	(1)	-	NM	(11)	-	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(1)	(95)	(98.9)	(5)	(95)	(94.7)
- All other[3]	(7)	(117)	(94.0)	(27)	(360)	(92.5)
Pre-tax operating loss	($94)	($222)	(57.7%)	($77)	($434)	(82.3%)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472). Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums of $5 million and $6 million for the three and nine months ended September 30, 2008 respectively and zero for the comparable periods of 2007.
2 Net of allowance for uncollectible reinsurance reduction of zero and $7 million for the three and nine months ended September 30, 2008, and zero and $3 million for the comparable periods of 2007.
3 Net of amortization of deferred gains on retroactive reinsurance of $5 million and $15 million for the three and nine months ended September 30, 2008, and $4 million and $15 million for the comparable periods of 2007.
4 NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2008 were ($116) million and $230 million, respectively, decreases of $376 million and $550 million from the same periods in 2007. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2008 was $51 million and $141 million, respectively, decreases of $11 million and $38 million from the same periods in 2007. The decreases in both periods reflect an increase in external ceded reinsurance.

Net investment income for the three and nine months ended September 30, 2008 was $1 million and $174 million, respectively, decreases of $140 million and $191 million from the same periods in 2007. The decreases in both periods primarily reflect a decline in limited partnerships and limited liability companies income due to reduced valuations and IPO/takeover activities, an increase in cash balances in anticipation of funding the Safeco acquisition, lower investment yields and a shift to tax-exempt securities. Partially offsetting the decreases in both periods was an increase in interest income due to cash proceeds received from the May 2008 debt issuance.

Net realized investment losses for the three and nine months ended September 30, 2008 were $203 million and $184 million, respectively, compared to gains of $32 million and $142 million in the same periods of 2007. The losses in both periods reflect higher impairment losses on fixed maturity and equity investments related to securities subsequently sold to raise funds for the acquisition of Safeco and securities deemed to be other than temporarily impaired due to recent market conditions. Partially offsetting these losses were $83 million and $116 million, respectively, in net gains related to derivative contracts the Company used to partially hedge its equity exposure for the three and nine months ended September 30, 2008. In addition, the Company recognized a $106 million gain from the sale of an investment property

Fee and other revenues for the three and nine months ended September 30, 2008 were $35 million and $99 million, respectively, increases of $10 million and $5 million over the same periods in 2007. The increases in both periods primarily reflect an increase in oil and gas revenues, partially offset by the loss of revenue associated with the sale of a Company owned property in 2007.

Claims, benefits and expenses for the three and nine months ended September 30, 2008 were $181 million and $491 million, respectively, decreases of $269 million and $581 million from the same periods in 2007. The decreases in both periods primarily reflect a decrease in the amount of unfavorable incurred losses attributable to prior years primarily related to pre-2005 fully insured workers compensation business, assumed voluntary reinsurance business, a $90 million increase in asbestos reserves related to the Company's completion of its biennial ground-up asbestos study in the third quarter of 2007 which did not recur in 2008, and a decrease in unfavorable variable annuity reserves development. In addition, variable incentive compensation and other corporate expenses decreased in both periods, partially offset by an increase in catastrophe losses related to the September 2008 Hurricanes and Midwest storms subject to internal reinsurance programs and higher interest expense as a result of the Company's March 2007 and May 2008 debt offerings.

Pre-tax operating loss for the three and nine months ended September 30, 2008 was $94 and $77 million, respectively, decreases of $128 million and $357 million over the same periods in 2007.

INVESTMENTS

General

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

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

Invested Assets (including cash and cash equivalents)

The following table summarizes the Company's invested assets by asset category as of September 30, 2008 and December 31, 2007:

$ in Millions	As of September 30, 2008		As of December 31, 2007	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$47,754	78.8%	$46,934	82.1%
Equity securities, available for sale, at fair value	2,772	4.6	3,285	5.7
Trading securities, at fair value	15	-	16	-
Limited partnerships and limited liability companies	2,545	4.2	2,134	3.7
Commercial mortgage loans	1,028	1.7	657	1.2
Short-term investments	1,312	2.2	764	1.3
Other investments	206	0.3	214	0.4
Cash and cash equivalents	4,940	8.2	3,199	5.6
Total invested assets	$60,572	100.0%	$57,203	100.0%

Total invested assets as of September 30, 2008 were $60.572 billion, an increase of $3.369 billion or 5.9% from December 31, 2007. The increase reflects $8.119 billion in invested assets acquired with the Safeco acquisition on September 22, 2008. Partially offsetting the increase was the liquidation of assets to fund the Safeco acquisition and an increase in unrealized losses primarily due to an increase in credit spreads and a general decline in market values related to both fixed income and equity markets.

Fixed maturities as of September 30, 2008 were $47.754 billion, an increase of $820 million or 1.7% from December 31, 2007. The increase reflects net fixed maturities acquired from the Safeco acquisition offset by the market value declines in fixed income securities, and the aforementioned liquidation of securities to fund the acquisition.

Equity securities available for sale, as of September 30, 2008 were $2.772 billion ($2.289 billion common stock and $483 million preferred stock), a decrease of $513 million or 15.6% from December 31, 2007. The decrease primarily reflects the liquidation of securities in the second and third quarter to help fund the acquisition of Safeco and to reduce the Company's exposure to the equity markets. The decrease also reflects a decrease in unrealized gains related to a general decline in equity market indices. These decreases were partially offset by an increase related to the equities acquired through the Safeco acquisition.

Limited partnerships and limited liability companies as of September 30, 2008 were $2.545 billion, an increase of $411 million or 19.3% over December 31, 2007. These investments consist of traditional private equity partnerships of $1.587 billion, other partnerships (primarily energy) of $485 million, and real estate partnerships of $473 million. The increase over December 31, 2007 reflects new investments across all three categories as the Company continues to diversify its private equity portfolio. The Company's investments in limited partnerships and limited liability companies are long-term in nature and highly illiquid. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Commercial mortgage loans as of September 30, 2008 were $1.028 billion which is net of $1 million of loss reserve or 0.11% of the outstanding loan portfolio, an increase of $371 million or 56.5% over December 31, 2007. The increase reflects $392 million of new capital loaned, net of $20 million in principal repayments. The entire commercial loan portfolio is U.S. based. The average total loan size was $1.4 million and the average loan participation size was $.5 million. The number of loans in the portfolio increased from 1,406 at December 31, 2007 to 2,084 at September 30, 2008.

Short term investments as of September 30, 2008 were $1.312 billion, an increase of $548 million or 71.7% over December 31, 2007. This increase reflects short term assets assumed from the acquisition of Safeco and Indiana Seguros S.A., a Brazilian insurer, and short term assets received as collateral for the Company's security lending program.

In January 2008, the Company adopted SFAS 157, which establishes a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value. As of September 30, 2008, excluding separate accounts and other assets, the Company reflected $3.295 billion as level 1 (quoted prices in active markets) and this primarily comprised 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 September 30, 2008, the Company reported $47.550 billion as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported $2.145 billion as level 3 (unobservable inputs) and this primarily comprised international and privately held securities for which a market price is not readily available, and commercial mortgage loans which are carried at amortized cost.

As of September 30, 2008, the Company had unfunded commitments in traditional private equity partnerships, real estate, energy and other, and commercial mortgage loans of $1.070 billion, $463 million, $467 million and $70 million, respectively. As of September 30, 2008, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair market value of $5 million.

As of September 30, 2008, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1% of invested assets.

The following table summarizes the Company's fixed maturity portfolio by security type as of September 30, 2008 and December 31, 2007:

$ in Millions	**As of September 30, 2008**			**As of December 31, 2007**		
Fixed Maturities by Security Type	**Book Value**	**Market Value**	**MV % of Total**	**Book Value**	**Market Value**	**MV % of Total**
U.S. Government and agency securities	$2,215	$2,366	5.0%	$3,156	$3,318	7.1%
Mortgage and asset-backed securities	12,365	12,119	25.4	13,459	13,491	28.7
U.S. state and municipal	14,198	13,377	28.0	9,902	10,001	21.3
Corporate and other	18,749	17,262	36.1	17,636	17,438	37.2
Foreign government securities	2,663	2,630	5.5	2,695	2,686	5.7
Total fixed maturities	$50,190	$47,754	100.0%	$46,848	$46,934	100.0%

The changes in asset allocation as of September 30, 2008 compared to December 31, 2007 are primarily driven by the Safeco acquisition. The decrease in U.S. government and agency securities and mortgage and asset-backed securities reflects the liquidation of these securities to fund the acquisition of Safeco. This was offset by an increase in U.S. state and municipal securities due to the addition of Safeco invested assets which are more highly concentrated in this security type. Also, impacting the September 30, 2008 valuation is an increase in unrealized losses due to the general decline in market values.

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of September 30, 2008:

$ in Millions	As of September 30, 2008							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$1,074	$ -	$2	$1	$ -	$ -	$1,077	8.9%
GNMA residential mortgage	850	-	-	-	-	-	850	7.0
FNMA residential mortgage	2,673	-	-	-	-	-	2,673	22.1
FHLMC residential mortgage	3,992	-	-	-	-	-	3,992	32.9
Prime residential mortgage	567	9	-	-	-	3	579	4.8
Alt-A residential mortgage	187	3	-	-	-	-	190	1.6
Sub-prime residential mortgage	39	28	-	1	-	-	68	0.6
Commercial mortgage backed securities	2,049	109	24	10	-	-	2,192	18.0
Non-mortgage asset backed securities	350	54	34	48	3	9	498	4.1
Total	$11,781	$203	$60	$60	$3	$12	$12,119	100%
% of Total	97.3%	1.7%	0.5%	0.5%	-	-	100%	-

More than 70 percent of the Company's securitized portfolio is explicitly backed by the U.S. government (GNMA and SBA) or by government sponsored entities (FHLMC and FNMA). Ninety-seven percent of these holdings remain rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with 98.4% rated AA or above, approximately 20% of the underlying collateral having been defeased with U.S. Treasuries and less than 10% of holdings backed by 2006 to 2008 vintage transactions.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of September 30, 2008 and December 31, 2007:

$ in Millions	As of September 30, 2008		As of December 31, 2007	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$21,671	45.4%	$24,576	52.4%
AA+, AA, AA-	9,789	20.5	7,586	16.2
A+, A, A-	7,906	16.6	7,196	15.3
BBB+, BBB, BBB-	5,225	10.9	4,405	9.4
BB+, BB, BB-	1,835	3.8	1,797	3.8
B+, B, B-	1,006	2.1	1,165	2.5
CCC or lower	322	0.7	209	0.4
Total fixed maturities	$47,754	100.0%	$ 46,934	100.0%

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

The Company's allocation to investment grade securities increased slightly to 93.4% at September 30, 2008 from 93.3% December 31, 2007. The change reflects the mix of securities liquidated to fund the Safeco acquisition and the assets acquired with the acquisition. Overall, the average credit quality rating stands at AA-.

The Company had 6.6% of its fixed maturity securities invested in non-investment grade securities at September 30, 2008. The Company's holdings of below investment grade securities primarily consist of: (1) an actively managed diversified portfolio of high yield securities and loans within the domestic

insurance portfolios; and (2) investments in emerging market sovereign and corporate debt primarily in support of the Company's international insurance companies.

The following table summarizes the Company's allocation of fixed maturities by maturity date as of September 30, 2008 and December 31, 2007:

$ in Millions	As of September 30, 2008		As of December 31, 2007	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,533	3.2%	$1,376	3.0%
Over 1 yr through 5 yrs	9,874	20.7	9,295	19.8
Over 5 yrs through 10 yrs	9,839	20.6	9,567	20.4
Over 10 years	14,389	30.1	13,205	28.1
Mortgage and asset-backed securities	12,119	25.4	13,491	28.7
Total fixed maturities	$47,754	100.0%	$46,934	100.0%

During 2008, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company made only minor adjustments to the average life of its investment portfolio.

Net Investment Income

The following table summarizes the Company's net investment income for the three and nine months ended September 30, 2008 and 2007:

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Net Investment Income	**2008**	**2007**	**2008**	**2007**
Taxable interest income	$580	$545	$1,729	$1,631
Tax-exempt interest income	104	89	316	241
Dividends	18	18	73	60
Limited partnerships and limited liability companies	10	127	128	277
Commercial mortgage loans	14	7	36	18
Other investment income	7	2	18	5
Gross investment income	733	788	2,300	2,232
Investment expenses	(28)	(29)	(84)	(90)
Net investment income	$705	$759	$2,216	$2,142

Net investment income for the three and nine months ended September 30, 2008 was $705 million and $2.216 billion, respectively, representing a $54 million decrease and a $74 million increase versus the same periods in 2007. The decrease in net investment income for the quarter is primarily driven by a $117 million decrease in limited partnerships and limited liability companies income due to reduced valuations and IPO/takeover activities as compared to the same period in 2007, lower investment yields and a shift to tax-exempt securities. The year-to-date improvement reflects an increase in interest income, primarily due to a higher invested asset base resulting from the continued investment of cash flow from operations and cash proceeds received from the May 2008 debt issuance, respectively. In addition, interest income increased slightly as a result of net assets assumed from the acquisition of Safeco. Partially offsetting these increases were lower investment yields, a shift to tax-exempt securities, and the decrease in limited partnerships and limited liability companies income.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and nine months ended September 30, 2008 and 2007:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Three Months Ended September 30, 2008:				
Fixed maturities	($14)	($133)	$-	($147)
Common and preferred stock	-	(290)	-	(290)
Other	109	(4)	83	188
Total	$95	($427)	$83	($249)
Three Months Ended September 30, 2007:				
Fixed maturities	($14)	($14)	$-	($28)
Common and preferred stock	16	-	-	16
Other	31	-	-	31
Total	$33	($14)	$-	$19
Nine Months Ended September 30, 2008:				
Fixed maturities	($34)	($169)	$-	($203)
Common and preferred stock	74	(349)	-	(275)
Other	110	(4)	116	222
Total	$150	($522)	$116	($256)
Nine Months Ended September 30, 2007:				
Fixed maturities	$4	($14)	$-	($10)
Common and preferred stock	104	(2)	-	102
Other	67	(15)	-	52
Total	$175	($31)	$-	$144

$ in Millions	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Components of Net Realized Investment Gains (Losses)	**2008**	**2007**	**2008**	**2007**
Fixed maturities:				
Gross realized gains	$31	$28	$86	$82
Gross realized losses	(178)	(56)	(289)	(92)
Equities:				
Gross realized gains	9	23	120	114
Gross realized losses	(299)	(7)	(395)	(12)
Other:				
Gross realized gains	192	35	228	71
Gross realized losses	(4)	(4)	(6)	(19)
Total net realized investment gains (losses)	($249)	$19	($256)	$144

Net realized investment losses for the three and nine months ended September 30, 2008 were $249 million and $256 million, respectively, compared to gains of $19 million and $144 million in the same periods in 2007, both periods reflect higher impairment losses on fixed maturity and equity investments related to securities subsequently sold to raise funds for the acquisition of Safeco and securities deemed to be other than temporarily impaired due to recent market conditions (primarily FNMA, FHLMC, Lehman, Wachovia and Washington Mutual). Partially offsetting these losses were $83 million and $116 million respectively, in net gains related to derivative contracts the Company used to partially hedge its equity exposure for the three and nine months ended September 30, 2008. In addition, the Company recognized a $106 million gain from the sale of an investment property.

The following table summarizes the Company's impairments by issuer for the three and nine months ended September 30, 2008:

$ in Millions	**Three Months Ended September 30, 2008**			
Impairments by Issuer	**Fixed Maturities**	**Preferred Stock**	**Common Stock**	**Total by Issuer**
Wachovia	$-	($18)	($3)	($21)
FHLMC	-	(110)	(1)	(111)
FNMA	-	(111)	(4)	(115)
Lehman Brothers	(49)	-	(1)	(50)
Washington Mutual	(3)	-	(1)	(4)
Other	(81)	(9)	(32)	(122)
Total by Security Type	($133)	($248)	($42)	($423)

$ in Millions	**Nine Months Ended September 30, 2008**			
Impairments by Issuer	**Fixed Maturities**	**Preferred Stock**	**Common Stock**	**Total by Issuer**
Wachovia	$-	($18)	($3)	($21)
FHLMC	(1)	(110)	(1)	(112)
FNMA	(4)	(111)	(9)	(124)
Lehman Brothers	(49)	-	(1)	(50)
Washington Mutual	(3)	-	(3)	(6)
Other	(112)	(15)	(78)	(205)
Total by Security Type	($169)	($254)	($95)	($518)

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment as of September 30, 2008:

$ in Millions	**Less Than 12 Months**		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($2)	$292	($2)	$10
Mortgage and asset-backed securities	(242)	5,786	(126)	1,196
U.S. state and municipal	(647)	11,058	(204)	1,131
Corporate and other	(826)	9,589	(774)	4,334
Foreign government securities	(77)	797	(10)	255
Total fixed maturities	(1,794)	27,522	(1,116)	6,926
Common stock	(167)	847	(19)	31
Preferred stock	(111)	305	(124)	112
Total equities	(278)	1,152	(143)	143
Total	($2,072)	$28,674	($1,259)	$7,069

Unrealized losses increased from $934 million as of December 31, 2007 to $3.331 billion as of September 30, 2008 primarily due to an increase in credit spreads and a general decline in market values related to both fixed income and equity markets. Unrealized losses less than 12 months increased from $510 million at December 31, 2007 to $2.072 billion as of September 30, 2008 and accounted for $1.562 billion, or 65.2%, of the overall increase in unrealized losses. Unrealized losses greater than 12 months increased from $424 million to $1.259 billion at December 31, 2007 and September 30, 2008 respectively, an increase of $835 million. Included in the $1.259 billion of unrealized losses were $142 million of securities that had been in an unrealized loss position of 10% or greater for more than twelve months. The Company monitors the difference between the amortized cost and estimated fair value of investments to ascertain whether declines in value are temporary in nature. The acquisition of Safeco assets assumed in the third quarter 2008 had a minimal impact on unrealized gains and losses, as these assets were valued at fair value on the date of acquisition on September 22, 2008. The Company employs a systematic methodology utilizing a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in shareholders' equity. If the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to fair value and a realized loss is recorded. As a result of this review, the Company recorded a $133 million impairment loss related to fixed maturities in the third quarter 2008 and has concluded that the remaining gross unrealized losses of fixed maturity securities as of September 30, 2008 are temporary.

The gross unrealized losses recorded on equity securities at September 30, 2008 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. Therefore, these decreases are also viewed as temporary in accordance with the Company's policy with respect to recognizing impairments in the investment portfolio. The Company recorded $290 million in equity impairment losses in the third quarter 2008 that were deemed to be other than temporary.

LIQUIDITY AND CAPITAL RESOURCES

General

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

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. For ongoing business, the Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of September 30, 2008 (including cash and cash equivalents) totaled $60.572 billion.

Short-term debt outstanding at September 30, 2008 and December 31, 2007 was as follows:

$ in Millions	**As of September 30, 2008**	**As of December 31, 2007**
Commercial paper	$-	$-
Revolving credit facilities	-	70
Current maturities of long-term debt	18	21
Total short-term debt	$18	$91

Long-term debt outstanding at September 30, 2008 and December 31, 2007 was as follows:

$ in Millions	**As of September 30, 2008**	**As of December 31, 2007**
4.875% Senior notes, due 2010[1]	$300	$-
7.25% Senior notes, due 2012[1]	204	-
8.00% Prudential notes—series B, due 2013	260	260
7.86% Medium term notes, due 2013	25	25
5.75% Senior notes, due 2014	500	500
7.30% Senior notes, due 2014[2]	200	200
6.70% Senior notes, due 2016	250	250
7.00% Junior subordinated notes, due 2067[3]	300	300
8.50% Surplus notes, due 2025	150	150
7.875% Surplus notes, due 2026	250	250
7.63% Notes, due 2028	3	3
7.00% Senior notes, due 2034	250	250
6.50% Senior notes, due 2035	500	500
7.50% Senior notes, due 2036	500	500
7.80% Junior subordinated notes, due 2087[4]	700	700
10.75% Junior subordinated notes, due 2088[5]	1,250	-
7.697% Surplus notes, due 2097	500	500
Subtotal	6,142	4,388
Unamortized discount[6]	(54)	(28)
Total long-term debt excluding current maturities	$6,088	$4,360

[1] Reflects debt issued by Safeco.
[2] Reflects debt issued by Ohio Casualty.
[3] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.
[4] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.
[5] The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

[6] Includes purchase accounting adjustment related to Ohio Casualty $200 million senior notes, due 2014, Safeco $300 million senior notes, due 2010, and Safeco $204 million senior notes, due 2012.

On September 2, 2008, LMIC entered into a $750 million, 364 day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

Liberty Corporate Capital Limited entered into a $100 million 364 day revolving credit facility, which became effective October 26, 2007. The facility is available to provide working capital to the Company's Lloyd's Syndicate business. The 364 day credit facility is guaranteed by LMIC. As of September 30, 2008, no borrowings were outstanding under the facility.

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

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

Liberty Mutual Insurance Europe Limited entered into a $20 million revolving loan facility, which became effective June 9, 2006. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of September 30, 2008, no borrowings were outstanding under the facility.

The Company's Venezuelan subsidiary, Inversora Segucar, C.A., maintains a $115 million revolving credit facility to provide liquidity for working capital purposes. As of September 30, 2008, no borrowings were outstanding under the facility.

The $73 million decrease in short-term debt outstanding is due to a decrease of $70 million in outstanding borrowings under the Venezuelan credit facility, redemption of the Company's 7.10% Medium Term notes on May 15, 2008 for $2 million, and $1 million partial redemption of the 5.0% Prudential notes due 2008.

On May 29, 2008, LMGI issued series C junior subordinated notes (the "Series C Notes") with a face amount of $1.25 billion. The Series C Notes are scheduled for redemption on June 15, 2058 with a final maturity of June 15, 2088. LMGI may redeem the Series C Notes in whole or in part, on June 15, 2038 and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or prior to June 15, 2038, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 10.75% up to, but excluding, the final fixed rate interest payment date. In the event the Series C Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 7.12%, payable quarterly in arrears. LMGI has the right to defer interest payments on the Series C Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Series C Notes, LMGI entered into a replacement capital covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, defease or purchase the Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Notes, and may not be enforced by the holders of the Series C Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036). The $1.728 billion increase in long-term debt outstanding is primarily the result of this offering. In addition, as a result of the Safeco acquisition, Safeco's $300 million of 4.875% senior notes due 2010 and $204 million of 7.25% senior notes due 2012 are included as part of the Company's long-term debt outstanding.

Consolidated interest expense for the three and nine months ended September 30, 2008 was $114 million and $290 million, respectively, increases of $28 million and $59 million over the same periods in 2007.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, the subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of September 30, 2008, the Company, through its downstream subsidiary LMGI, had $4.538 billion of debt outstanding, excluding discount.

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

The authorized control level risk-based capital (as of December 31, 2007) and 2008 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio [1]**			**Dividend Capacity[2]**
RBC Ratios and Dividend Capacity	**2007**	**2006**	**Change**	**2008**
LMIC [3]	519%	554%	(35 points)	$1,182
LMFIC	507%	579%	(72 points)	$87
EICOW [3]	516%	395%	121 points	$130

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

LMGI also has access to funds at Liberty Corporate Services LLC ("Corporate Services"). Through its subsidiaries, Corporate Services collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three and nine months ended September 30, 2008, Corporate Services recorded $67 million and $199 million in pre-tax income, respectively.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $11.331 billion and $14.155 billion at September 30, 2008, and December 31, 2007, respectively. The decrease in surplus primarily reflects the impact of the Safeco acquisition that resulted in approximately $3.6 billion of non-admitted goodwill (due to the regulatory limitation of 10% of adjusted surplus) and unrealized investment losses, partially offset by a capital contribution associated with the Company's May 2008 debt offering and net income (the sum of earnings from the Company's 49 domestic insurance companies and dividends from subsidiaries).

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company's principal estimates include:

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

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

Certain reclassifications have been made to the 2007 tables to conform to the 2008 tables.

Adoption of New Accounting Standards

Effective January 1, 2008, the Company had the option to adopt Statement of Financial Accounting Standards No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS 115*" ("SFAS 159"). The Company has not made any fair value elections as allowed under SFAS 159.

Effective January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") issue No. 06-4, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"* ("EITF 06-4"). This issue provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. The adoption of EITF 06-4 resulted in a decrease to equity of $41 million.

Effective January 1, 2008, the Company adopted EITF issue No. 06-10, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements* ("EITF 06-10"). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Opinion 12. The adoption of EITF 06-10 had no impact on the Company's financial statements.

Future Adoption of New Accounting Standards

In December 2007, the FASB issued SFAS No. 141(R), "*Applying the Acquisition Method"* ("SFAS 141(R)"). This issue will result in significant changes to accounting for business combinations. Prospective adoption is required and early adoption is not permitted. The Company is required to adopt SFAS 141(R) effective January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "*Accounting for Noncontrolling Interests"* ("SFAS 160"). SFAS 160 will result in the consolidation of all non-controlling interests within the income statement and balance sheet of the Company for all consolidated subsidiaries. SFAS 160 is required to be adopted on January 1, 2009. Prospective adoption is required, except for the required reclassifications which are to be applied retrospectively. Early adoption is not permitted. The Company is in the process of evaluating the impact of adoption.

In March 2008, FASB issued SFAS No. 161, "*Disclosures about Derivative Instruments and Hedging Activities"* ("SFAS 161"). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008.

In May 2008, the FASB issued SFAS No. 162, "*The Hierarchy of Generally Accepted Accounting Principles"* ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of entities that are presented in conformity with generally accepted accounting principles in the United States. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company is in the process of evaluating the impact of adoption.

In May 2008, the FASB issued SFAS No. 163, "*Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60,"* ("SFAS 163"). SFAS 163 is intended to increase comparability in financial reporting of financial guarantee insurance contracts by insurance companies. SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. SFAS 163 is effective for fiscal years beginning after December 15, 2008. As the Company does not write financial guarantee insurance contracts, SFAS 163 will have no impact.

In October 2008, the FASB issued FSP FAS 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*," ("FSP FAS 157-3") that provided FAS 157 implementation guidance for fair value considerations of thinly traded securities. Management is currently evaluating the impact of FSP FAS 157-3 to the Company. As of September 30, 2008, this guidance has not been applied.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $49.618 billion and $42.992 billion at September 30, 2008 and December 31, 2007, respectively. The increase was primarily due to business growth less the on-going settlement of claims.

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

Establishing loss reserves, including loss reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigated cases, medical costs, and cost of repair materials and labor rates can all affect ultimate claim costs. In addition, the span of time between the incidence of a loss and the payment or settlement of the claim can be a critical part of reserving determinations and will

cause more variability in the ultimate claim cost. Accordingly, "short-tail" claims, such as property damage claims, tend to be easier to estimate than "long-tail" claims, such as workers compensation or general liability claims.

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

Asbestos and Environmental

The Company's A&E reserves for unpaid claims and claim adjustment expenses were $1.473 billion and $1.334 billion at September 30, 2008 and December 31, 2007, respectively, net of reinsurance and including an allowance for uncollectible reinsurance. The year-to-date increase was primarily due to including Safeco A&E liabilities as of September 30, 2008, offset partially by ongoing claim settlement activity.

In the third quarter of 2007, the Company completed its biennial ground-up asbestos reserve study and increased its asbestos reserves by $90 million. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. In addition, an internationally known actuarial consulting firm performed its own independent review of the Company's asbestos reserves and confirmed the reasonableness of the reserve increase.

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

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of PruPac included $190 million and $130 million of gross and net A&E reserves, respectively. Any increase in A&E reserves related to PruPac is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial, Inc.

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

Reinsurance Recoverables

The Company reported reinsurance recoverables of $15.664 billion and $15.518 billion at September 30, 2008 and December 31, 2007, respectively, net of allowance for doubtful accounts. The increase is primarily due to the acquisition of Safeco, partially offset by ongoing settlement activity.

The reinsurance recoverables from Nationwide Indemnity Company have been fully guaranteed by its parent, Nationwide Mutual Insurance Company, which has a financial strength rating of A+ from Standard & Poor's and A+ from A.M. Best. The reinsurance recoverables from state mandated involuntary pools and associations represent the Company's servicing carrier business. As a servicing carrier, the Company

retains no direct underwriting risk but instead cedes 100% of the involuntary market premium and losses back to the pool. Payment of losses is shared by the pool participants in proportion to their pool participation. Credit risk with respect to this servicing carrier business is the composite of the cumulative creditworthiness of all participants in their respective pools.

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

Approximately 95% of the Company's reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at September 30, 2008. Collateral held against outstanding gross reinsurance recoverable balances was $4.732 billion and $4.584 billion at September 30, 2008 and December 31, 2007, respectively.

The remaining 5% of the Company's net reinsurance recoverable balance is well diversified. No single reinsurer rated B++ or below by A.M. Best accounts for more than 2% of statutory surplus as regards policyholders. In addition, the average net reinsurance recoverable balance from individual reinsurers rated below A- or not rated by A.M. Best was approximately $1 million as of September 30, 2008.

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

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million) that are amortized into income using the effective interest method over the estimated settlement periods. At September 30, 2008, and December 31, 2007, deferred gains related to these reinsurance arrangements were $749 million and $786 million, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the "funds held" balances for the three months and nine months ended September 30, 2008, was $30 million and $89 million, respectively, as compared to $29 million and $86 million, for the three months and nine months ended September 30, 2007, respectively. Deferred gain amortization for the three months and nine months ended September 30, 2008, was $16 million and $49 million, respectively, as compared to $16 million and $45 million for the three months and nine months ended September 30, 2007, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $2.179 billion and $2.222 billion as of September 30, 2008, and December 31, 2007, 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.

In 2006, the Company entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 million of additional reinsurance coverage for the Company in the event of a Northeast hurricane. The reinsurance agreements are collateralized through a trust and guarantee received by Mystic Re from the issuance of catastrophe bonds and provide coverage for hurricane-related losses from Washington, D.C. to Maine based on industry insured losses as reported by Property Claim Services. In 2007, the Company supplemented this reinsurance in a similar transaction with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 million of additional reinsurance coverage for the Company in the event of a Northeast and/or Florida hurricane event. The Company has not recorded any recoveries under these programs. Neither Mystic Re nor Mystic Re II has any other reinsurance in force.

In 2008, the Company purchased property catastrophe reinsurance of which $418 million of limits are collateralized from the inception of the contracts. The Company has not recorded any recoveries under these programs.

Impairment Losses on Investments

The total impairment losses on investments for the three and nine months ended September 30, 2008 were $427 million and $522 million, respectively, an increase of $413 million and $491 million compared to the same periods in 2007. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company's accounting policy for other-than-temporary impairment recognition requires other-than-temporary impairment charges to be recorded when it is determined that the Company is unlikely to recover its cost basis in an investment in the near-term. Factors considered in evaluating whether a decline in value is other-than-temporary include: (a) the length of time and extent to which the fair value has been below cost; (b) the financial condition and near-term prospects of the issuer; and (c) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

The Company employs a systematic methodology to evaluate declines in fair value below the book value for equity securities and other investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below carrying value is evaluated in a disciplined manner. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy. Continued turbulence in the financial markets subsequent to the quarter end has not resulted in any additional material other-than-temporary impairments. However, the Company reserves the flexibility to trade any investment as deemed appropriate based on changes in credit or other market factors in managing the invested assets positions of the Company.

Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, *"Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51"* ("FIN 46"). The Company's exposure to investment structures subject to analysis under FIN 46(R), relate primarily to investments in energy, private equity, and real estate limited partnerships that are accounted for under the equity method. The Company has been deemed to be the primary beneficiary for 2 VIEs in the energy investment sector, therefore it consolidates these 2 VIEs in its financial statements. In addition, the Company has investments in 51 and 40 VIEs for which it is not the primary beneficiary at September 30, 2008 and December 31, 2007, respectively. The Company's investments in VIEs were $709 million and $386 million at September 30, 2008 and December 31, 2007, respectively. The Company's maximum exposure to losses from VIEs was $1.300 billion and $786 million as of September 30, 2008 and December 31, 2007, respectively, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Derivatives

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. As of September 30, 2008 and December 31, 2007, the Company had two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of both September 30, 2008 and December 31, 2007, the value of these instruments was approximately ($5) million.

Beginning in January 2008, the Company, as part of its risk management program, diversification, and economic hedging strategies, entered into several futures contracts related to the equities market with notional amounts totaling $599 million. All futures contracts expired in March 2008 and the Company realized gains of $26 million on these transactions. Subsequent to the above transactions, the Company has entered into three separate equity swap agreements with notional amounts totaling $935 million. For the period ending September 30, 2008 the Company incurred a $90 million net gain related to the swap contracts. These contracts expire in January 2009; however, earlier termination is allowed.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were $2.719 billion and $2.045 billion as of September 30, 2008 and December 31, 2007, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses. Acquired in-force policy intangibles are costs associated with the acquisition of Ohio Casualty that equal the fair value of in-force insurance contracts at the date of acquisition.

Goodwill

Goodwill assets were $4.548 billion and $1.962 billion at September 30, 2008 and December 31, 2007, respectively. The increase was primarily due to the acquisition of Safeco and Indiana Seguros, S.A..

Deferred Income Taxes

The net deferred income tax asset was $2.710 billion and $1.469 billion as of September 30, 2008 and December 31, 2007, respectively, net of a valuation allowance of $142 million and $117 million, respectively. The net increase in the Company's valuation allowance is primarily due to increases in the uncertainty of the realization of certain foreign net operating losses, foreign currency translation adjustments and changes in foreign statutory tax rates, offset by decreases due to positive expectations for future realization of certain foreign net operating losses. Management believes it is more likely than not that the Company's net deferred income tax asset will be realized based on the Company's ability and likelihood of generating future taxable income.

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

The liability for unrecognized tax benefits at January 1, 2008 was $175 million. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

($ in millions)	
Balance at January 1, 2008	$175
Additions based on tax positions related to current year	-
Additions for tax positions of prior years	(5)
Reductions for tax positions of prior years	-
Settlements	(14)
Increases in unrecognized tax benefits acquired or assumed in a business combination	17
Balance at September 30, 2008	$173

Included in the balance at September 30, 2008, are $42 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 and foreign income tax expense. During the nine month period ended September 30, 2008, the Company recognized a benefit of approximately $10 million in interest and penalties. The Company had approximately $43 million of interest and penalties accrued at September 30, 2008.

On October 15, 2008, the Company prevailed in its suit for refund of overpaid federal income tax for the tax year 1990, based on the treatment of salvage and subrogation. The United States District Court, District of Massachusetts, in *Liberty Mutual Insurance Co. v. United States* and *Liberty Mutual Fire Ins. Co. v. United States,* ruled that the amount of income tax refund due and deficiency interest refund due was $42 million and $40 million respectively, plus statutory interest on the income tax and deficiency interest refunds until paid. The Government has the right to appeal the decision.

The Company does not expect any material changes to the unrecognized tax benefits within 12 months of the reporting date.

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

About the Company

Boston-based Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of entities ("LMG" or the "Company"), is a diversified global insurer and sixth largest property and casualty insurer in the U.S. based on 2006 direct written premium. The Company also ranks 94th on the Fortune 500 list of largest corporations in the United States based on 2007 revenue. As of December 31, 2007, LMG had $94.742 billion in consolidated assets, $82.376 billion in consolidated liabilities, and $25.961 billion in annual consolidated revenue.

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

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

LMG employs more than 45,000 people in more than 900 offices throughout the world. For a full description of the Company's business operations, products and distribution channels, please visit Liberty Mutual's Investor Relations web site at www.libertymutual.com/investors.