Liberty Mutual Holding Company Inc.

Third Quarter 2009

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(Unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues				
Premiums earned	$ 6,942	$ 6,218	$ 20,783	$ 18,160
Net investment income	710	705	1,744	2,216
Fee and other revenues	229	197	611	584
Net realized gains, excluding other-than-temporary impairment losses	70	178	224	266
Other-than-temporary impairment losses:				
Total other-than-temporary impairment losses (Note 1)	(23)	(427)	(226)	(522)
Change in portion of loss recognized in other comprehensive income	(12)	-	16	-
Net impairment losses recognized in earnings	(35)	(427)	(210)	(522)
Total revenues	7,916	6,871	23,152	20,704
Claims, Benefits and Expenses				
Benefits, claims and claim adjustment expenses	5,111	4,897	15,190	13,851
Insurance operating costs and expenses	2,344	1,896	6,740	5,618
Interest expense	119	114	364	290
Interest credited to policyholders	49	54	148	143
Total claims, benefits and expenses	7,623	6,961	22,442	19,902
Income (loss) before income tax expense	293	(90)	710	802
Income tax expense (benefit)	28	(96)	143	136
Net income	$ 265	$ 6	$ 567	$ 666

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(Unaudited)

	September 30, 2009	December 31, 2008
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of $53,807 and $49,902)	$ 55,958	$ 47,731
Equity securities, available for sale, at fair value (cost of $1,083 and $1,279)	1,112	1,184
Trading securities, at fair value (cost of $1 and $1)	1	1
Short-term investments	580	1,193
Mortgage loans	1,053	1,090
Other investments	2,580	2,728
Total investments	61,284	53,927
Cash and cash equivalents	4,599	5,848
Premium and other receivables (net of allowance of $114 and $136)	7,885	7,834
Reinsurance recoverables (net of allowance of $433 and $344)	15,414	15,309
Deferred income taxes (net of valuation allowance of $160 and $131)	1,820	3,166
Deferred acquisition costs and acquired in-force policy intangibles	2,607	2,541
Goodwill	4,750	4,645
Prepaid reinsurance premiums	1,688	1,565
Separate account assets	3,507	3,062
Other assets	6,442	6,419
Total assets	$ 109,996	$ 104,316
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	$ 49,328	$ 48,727
Life	6,525	6,258
Other policyholder funds and benefits payable	3,240	3,031
Unearned premiums	13,547	12,944
Funds held under reinsurance treaties	1,851	1,855
Current maturities of long-term debt	300	-
Long-term debt	5,585	6,089
Separate account liabilities	3,507	3,062
Other liabilities	12,280	12,190
Total liabilities	96,163	94,156
Policyholders' equity:		
Unassigned equity	13,315	12,720
Accumulated other comprehensive income (loss)	518	(2,560)
Total policyholders' equity	13,833	10,160
Total liabilities and policyholders' equity	$ 109,996	$ 104,316

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

(Unaudited)

	Nine Months Ended September 30,	
	2009	**2008**
Balance at beginning of the period	$ 10,160	$ 12,366
Net income	567	666
Other comprehensive income (loss), net of taxes:		
Unrealized gains (losses) on securities	2,849	(2,013)
Foreign currency translation and other adjustments	257	(170)
Total other comprehensive income (loss), net of taxes	3,106	(2,183)
Total comprehensive income (loss)	3,673	(1,517)
Cumulative effect of accounting change (Note 1)	-	(41)
Balance at end of the period	$ 13,833	$ 10,808

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(unaudited)

	Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 567	$ 666
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	250	220
Realized investment (gains) losses	(14)	256
Undistributed private equity investment losses (gains)	407	(120)
Premium, other receivables, and reinsurance recoverables	(266)	(709)
Deferred policy acquisition costs	(111)	(196)
Liabilities for insurance reserves	958	2,984
Taxes payable, net of deferred	(244)	(265)
Other, net	21	(264)
Total adjustments	1,001	1,906
Net cash provided by operating activities	1,568	2,572
Cash flows from investing activities:		
Purchases of investments	(15,611)	(10,186)
Sales and maturities of investments	12,745	13,557
Property and equipment purchased, net	(267)	(71)
Payment for purchase of companies, net of cash acquired	-	(5,402)
Other investing activities	(83)	(234)
Net cash used in investing activities	(3,216)	(2,336)
Cash flows from financing activities:		
Net activity in policyholder accounts	90	77
Debt financing, net	(139)	1,139
Net security lending activity and other financing actitivites	471	329
Net cash provided by financing activities	422	1,545
Effect of exchange rate changes on cash	(23)	(40)
Net (decrease) increase in cash and cash equivalents	(1,249)	1,741
Cash and cash equivalents, beginning of period	5,848	3,199
Cash and cash equivalents, end of period	$ 4,599	$ 4,940

See accompanying notes to the unaudited consolidated financial statements.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2008 consolidated financial statements to conform to the 2009 presentation. All material intercompany transactions and balances have been eliminated.

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

Adoption of New Accounting Standards
In June 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2009-01, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162*. The FASB Accounting Standards Codification ("ASC") is intended to be the source of authoritative U.S. GAAP and reporting standards as issued by the FASB. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. ASU 2009-01 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification does not change or alter existing GAAP. The adoption of the Codification changed the Company's references to GAAP accounting standards but did not impact the Company's consolidated financial position or results of operations.

In May 2009, the FASB issued new guidance for accounting for subsequent events. Effective June 30, 2009, the Company adopted the new guidance, which is now part of ASC 855, *Subsequent Events*. The new guidance establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued, and specifies the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize these events or transactions, and the respective required disclosures. See Note 11 for disclosure requirements.

In April 2009, the FASB issued new guidance for the accounting for other-than-temporary impairments. The new guidance is now part of ASC 320, *Investments – Debt and Equity Securities*. The new guidance amended the accounting for other-than-temporary impairment of debt securities, requires the establishment of a policy for determining when "credit losses" exist, and provides direction on determining the amount of impairment to be recognized in the statement of income. As a result of the adoption, the Company recognized an increase of $28 (net of tax) to policyholders' unassigned equity and a corresponding decrease to accumulated comprehensive loss.

In April 2009, the FASB issued new guidance for determining whether a market is inactive, and if so, whether a transaction in that market is distressed. The Company adopted the new guidance, which is now part of ASC 820, *Fair Value Measurements and Disclosures,* effective January 1, 2009. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

Effective January 1, 2009, the Company adopted the following new or revised guidance, none of which had a material impact on the Company's consolidated financial statements:

- Accounting for business combinations as contained in ASC 805, *Business Combinations;*
- Accounting for noncontrolling interests as contained in ASC 810, *Consolidation;*
- Disclosure of derivative instruments and hedging activities as contained in ASC 815, *Derivatives and Hedging Activities*
- Determination of the useful life of intangible assets as contained in ASC 350, *Intangibles – Goodwill and Other*
- Accounting for equity method investment considerations as contained in ASC 323, *Investments – Equity Method and Joint Ventures*

Effective January 1, 2008, the Company adopted the fair value option guidance as codified in ASC 825, *Financial Instruments*. The Company has not made any fair value elections in accordance with this guidance.

Effective January 1, 2008, the Company adopted the fair value guidance as codified in ASC 820, *Fair Value Measurements and Disclosures*. The guidance defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and enhances disclosures about fair value measurements. The guidance provides direction on how to measure fair value when required under existing accounting standards. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value based on the requirements of ASC 815, *Derivatives and Hedging* are impacted by the application of the guidance in ASC 820. The adoption of the guidance did not have a material effect on the Company's results of operations, financial position or liquidity. See Note 8 for disclosure requirements.

(dollars in millions)

Effective January 1, 2008, the Company adopted the guidance related to the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements as codified in ASC 715, *Compensation – Retirement Plans*. The adoption of this guidance resulted in a decrease to policyholders' unassigned equity of $41.

Effective January 1, 2008, the Company adopted the guidance related to the recognition of a liability for a postretirement benefit in connection with a collateral assignment split-dollar life insurance arrangement as codified in ASC 715, *Compensation – Retirement Plans*, which requires an employer to recognize a liability if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive agreement with the employee. The adoption of this guidance had no impact on the Company's consolidated financial statements.

Future Adoption of New Accounting Standards

In December 2008, the FASB issued new guidance on the disclosures of postretirement benefit plan assets. The new guidance, which is now part of ASC 715, *Compensation – Retirement Benefits,* requires an employer to provide certain disclosures about plan assets of a defined benefit pension or other postretirement plan. The required disclosures include the investment policies and strategies of the plans, the fair value of the major categories of plan assets, the inputs and valuation techniques used to develop fair value measurements and a description of significant concentrations of risk in plan assets. The new guidance is effective on a prospective basis for fiscal years ending after December 15, 2009.

In June 2009, the FASB issued revised guidance on the accounting for variable interests. The revised guidance, which was issued as Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R),* ("SFAS 167"), has not yet been adopted into Codification. The revised guidance reflects the elimination of the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the pervious guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has (1) the power to direct the activities of an entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. The Company is required to adopt SFAS 167 effective January 1, 2010. The Company is in the process of evaluating the impact of adoption of SFAS 167.

Accumulated Other Comprehensive Income (Loss)

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

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

	September 30, 2009	**December 31, 2008**
Unrealized gains (losses) on securities	$1,392	$(1,457)
Foreign currency translation & other adjustments	273	51
Accumulated pension liability adjustments	(1,119)	(1,154)
Cumulative effect of accounting change	(28)	-
Accumulated other comprehensive income (loss)	$518	$(2,560)

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation

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

(dollars in millions)

Integration Activities

As part of the Safeco Corporation acquisition, management has received board authorization to implement certain integration efforts, principally employee and contract terminations. Changes to the restructuring reserves for the nine months ended September 30, 2009 are as follows:

	2009
Balance at beginning of year	$83
Net adjustments to liability	50
Payments applied against liability	(97)
Balance at September 30, 2009	$36

Indiana Seguros, S.A.
On January 9, 2008, the Company through its Brazilian subsidiary, Liberty International Brazil Ltda., acquired Indiana Seguros, S.A., a writer of auto insurance in Brazil for $143. Goodwill recognized from the transaction was $103. The results of operations of Indiana Seguros, S.A. are included in the Company's financial statements subsequent to January 9, 2008.

Dispositions
On January 22, 2009, the Company established Liberty Mutual Middle Market, a new market segment in Commercial Markets that combines the Business Market and Wausau Insurance market segments. As part of this change, the Company eliminated its direct distribution channel to its mid-sized commercial lines customers and retired the Wausau brand. Middle Market provides Liberty Mutual products and services exclusively through independent agents and brokers. As part of this change, on February 27, 2009, the Company completed the sale of the policy renewal rights of the existing Business Market and Wausau Insurance policyholders in various portions to three nationally recognized brokerage firms.

(3) INVESTMENTS

The following table summarizes the Company's available for sale portfolio by security type as of September 30, 2009 and December 31, 2008:

September 30, 2009	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government and agency securities	$2,144	$184	($3)	$ 2,325
Mortgage and asset-backed securities:				
Residential	10,493	474	(162)	10,805
Commercial	2,229	53	(63)	2,219
Other mortgage and ABS securities	1,689	91	(26)	1,754
U.S. state and municipal	14,694	1,005	(62)	15,637
Corporate and other	19,076	999	(438)	19,637
Foreign government securities	3,482	145	(46)	3,581
Total fixed maturities	53,807	2,951	(800)	55,958
Total equity securities	1,083	199	(170)	1,112
Total securities available for sale	$54,890	$3,150	($970)	$57,070

(dollars in millions)

December 31, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,105	$272	($2)	$2,375
Mortgage and asset-backed securities:				
Residential	8,422	267	(247)	8,442
Commercial	2,229	6	(256)	1,979
Other mortgage and ABS securities	1,614	27	(62)	1,579
U.S. state and municipal	14,277	143	(702)	13,718
Corporate and other	18,637	236	(1,866)	17,007
Foreign government securities	2,618	123	(110)	2,631
Total fixed maturities	49,902	1,074	(3,245)	47,731
Total equity securities	1,279	215	(310)	1,184
Total securities available for sale	$51,181	$1,289	($3,555)	$48,915

Equity securities available for sale as of September 30, 2009 were $1,112 ($655 common stock and $457 preferred stock) and $1,184 ($694 common stock and $490 preferred stock) as of December 31, 2008. Of the $655 of common stock at September 30, 2009, $265 relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The decrease in total equity securities available for sale primarily reflects the sale of existing and acquired exposure to the common equities in the first quarter, partially offset by market appreciation.

The following table summarizes the Company's allocation of fixed maturities by maturity date as of September 30, 2009 and December 31, 2008:

	As of September 30, 2009		As of December 31, 2008	
Fixed Maturities by Maturity Date	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
1 year or less	$2,295	4.1%	$1,669	3.5%
Over 1 year through 5 years	11,779	21.0	9,764	20.5
Over 5 years through 10 years	11,179	20.0	9,689	20.3
Over 10 years	15,927	28.5	14,609	30.6
Mortgage and asset-backed securities	14,778	26.4	12,000	25.1
Total fixed maturities	$55,958	100.0%	$47,731	100.0%

The following table summarizes the Company's gross realized gains and losses by asset type for the three and nine months ended September 30, 2009 and 2008:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Components of Net Realized Investment Gains (Losses)	**2009**	**2008**	**2009**	**2008**
Fixed maturities:				
Gross realized gains	$73	$31	$128	$86
Gross realized losses	(52)	(178)	(236)	(289)
Equities:				
Gross realized gains	25	9	133	120
Gross realized losses	(1)	(299)	(63)	(395)
Other:				
Gross realized gains	8	192	78	228
Gross realized losses	(18)	(4)	(26)	(6)
Total net realized investment gains (losses)	$35	($249)	$14	($256)

(dollars in millions)

The following table summarizes the Company's impairments by issuer for the three and nine months ended September 30, 2009:

Three Months Ended September 30, 2009

Impairments by Issuer	Fixed Maturities	Preferred Stock	Common Stock	Other	Total by Issuer
American International Group	($14)	$-	$-	$-	($14)
Hawker Beechcraft	(8)	-	-	-	(8)
Tenneco	(5)	-	-	-	(5)
Other	(8)	-	-	-	(8)
Total by Security Type	**($35)**	**$-**	**$-**	**$-**	**($35)**

Nine Months Ended September 30, 2009

Impairments by Issuer	Fixed Maturities	Preferred Stock	Common Stock	Other	Total by Issuer
Bank of America	($20)	($16)	$-	$-	($36)
American International Group	(14)	(5)	-	-	(19)
MGM Mirage	(12)	-	-	-	(12)
Commonwealth of Puerto Rico	(10)	-	-	-	(10)
Hawker Beechcraft	(10)	-	-	-	(10)
Other	(95)	(13)	(10)	(5)	(123)
Total by Security Type	**($161)**	**($34)**	**$(10)**	**$(5)**	**($210)**

The following table summarizes the Company's unrealized losses and fair value by security type by duration of potential impairment as of September 30, 2009:

Unrealized Losses & Fair Value by Security Type	Less Than 12 Months: Unrealized Losses	Less Than 12 Months: Fair Value of Investments with Unrealized Losses	Greater Than 12 Months: Unrealized Losses	Greater Than 12 Months: Fair Value of Investments with Unrealized Losses
U.S. Government and agency securities	($1)	$76	($2)	$1
Mortgage and asset-backed securities:				
Residential	(19)	154	(143)	383
Commercial	(9)	138	(54)	594
Other mortgage and ABS securities	(18)	88	(8)	24
U.S. state and municipal	(9)	226	(53)	551
Corporate and other	(50)	849	(388)	3,234
Foreign government securities	(21)	594	(25)	166
Total fixed maturities	(127)	2,125	(673)	4,953
Common stock	(1)	23	(37)	128
Preferred stock	(3)	20	(129)	305
Total equities	(4)	43	(166)	433
Total	($131)	$2,168	($839)	$5,386

Unrealized losses decreased from $3,555 as of December 31, 2008 to $970 as of September 30, 2009 primarily due to a decrease in credit spreads. Unrealized losses less than 12 months decreased from $1,869 at December 31, 2008 to $131 as of September 30, 2009 and accounted for $1,738 of the overall decrease in unrealized losses. Unrealized losses greater than 12 months decreased from $1,686 to $839 at December 31, 2008 and September 30, 2009 respectively, a decrease of $847. Included in the $839 of unrealized losses were $513 of unrealized losses on 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 debt securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed income securities before they recover their fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be "other-than-temporary," and the Company believes it will not be able to collect all cash flows due on its fixed income securities, then the carrying value of the investment is written down to the expected cash flow amount and a realized loss is recorded as a credit impairment. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes as the difference between expected cash flow and fair value.

As a result of the Company's quarterly other-than-temporary impairment review, for the three and nine months ended September 30, 2009, the Company recorded $35 and $161, respectively, of impairment losses related to fixed maturities and has concluded that the remaining gross unrealized losses of fixed maturity securities as of September 30, 2009 are temporary. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes as the difference between expected cash flow and fair value. The total fixed income and equity impairment losses for the three and nine months ended September 30, 2009 were $35 and $210, respectively, a decrease of $392 and $312 versus the same periods in 2008. Of the $35 and $161 of fixed maturity impairments recognized for the three and nine months ended September 30, 2009, respectively, ($12) and $16 were recognized as non-credit impairments.

For equity securities, if the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to fair value and a realized loss is recorded. The gross unrealized losses recorded on equity securities at September 30, 2009 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. For the nine months ended September 30, 2009, the Company recorded $44 of impairment losses related to equity securities and has concluded that the remaining gross unrealized losses of equity securities as of September 30, 2009 are temporary.

The Company reviews fixed income, public equity securities and private equity and private equity co-investment securities for impairment on a quarterly basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to: (a) the extent of the decline in fair value below book value, (b) the duration of the decline, (c) significant adverse changes in the financial condition or near term prospects of the investment or issuer, (d) significant change in the business climate or credit ratings of the issuer, (e) general market conditions and volatility, (f) industry factors, and (g) the past impairment of the security holding or the issuer. For fixed income securities where the Company does not expect to recover the entire amortized cost basis of the security, the Company will evaluate whether the other-than-temporary is a credit or a non-credit. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the debt security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration, (e) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all debt securities and certain preferred equity securities) or the Company's intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in market value.

For impaired securities which a portion of the impairment loss was credit related and a portion non-credit related, the balance of the cumulative credit component is immaterial to the Company as of September 30, 2009.

Subsequent to September 30, 2009, the Company has not recognized any additional material other-than-temporary impairments.

Variable Interest Entities

The Company's exposure to investment structures subject to Variable Interest Entity ("VIE") analysis relates 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, and therefore it consolidates those 2 VIEs in its financial statements. In addition, the Company has investments in 64 VIEs for which it is not the primary beneficiary at September 30, 2009 and December 31, 2008. The Company's investments in VIEs were $628 and $623 at September 30, 2009 and December 31, 2008, respectively. The Company's maximum exposure to losses from VIEs was $1,208 and $1,267 as of September 30, 2009 and December 31, 2008, 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, 2009 and December 31, 2008, the Company had one interest rate swap remaining that was acquired with the assets and liabilities of the Genesis life insurance business, with a value of approximately $0.4.

Beginning in January 2008, the Company, as part of its risk management program and diversification strategy, entered into several futures contracts related to the equities market with notional amounts totaling $599. All futures contracts concluded in March 2008 and the Company realized gains of $26 on these transactions. Subsequent to the above transactions, the Company entered into a $600 notional equity swap agreement. For the nine months ended September 30, 2008 the Company recognized a $90 realized gain related to the change in value of this swap contract. The contract was terminated in December 2008 and the Company realized gains of $187 on this transaction. In August 2008, the Company entered into two additional equity swap agreements with a total notional amount of $335. These contracts matured in January 2009 resulting in realized gains of $25 for the nine months ended September 30, 2009.

(4) REINSURANCE

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 that are amortized into income using the effective interest method over the estimated settlement periods). At September 30, 2009, and December 31, 2008, deferred gains related to these reinsurance arrangements were $701 and $725, 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, 2009 was $29 and $87, respectively, as compared to $30 and $89 for the three months and nine months ended September 30, 2008, respectively. Deferred gain amortization for the three months and nine months ended September 30, 2009 was $17 and $50, respectively, as compared to $16 and $49 for the three months and nine months ended September 30, 2008, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $2,137 and $2,165 at September 30, 2009, and December 31, 2008, respectively.

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

In 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 of additional reinsurance coverage for the Company in the event of a Northeast hurricane. The reinsurance agreements were collateralized through a trust and guarantee received by Mystic Re from the issuance of catastrophe bonds and provided coverage for hurricane-related losses from Washington, D.C. to Maine based on industry insured losses as reported by Property Claim Services. As of December 31, 2008, $325 of the original $525 of Mystic Re matured. As of May 31, 2009, the remaining $200 matured. As no events attached to these issues, the respective collateral was released. Mystic Re does not have any other reinsurance in force.

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

In 2009, the Company entered into Property Catastrophe reinsurance programs for which the Company has received $239 of collateral. The Company has not recorded any recoveries under these programs.

(5) DEBT OUTSTANDING

Current maturities of long-term debt were $300 and zero as of September 30, 2009 and December 31, 2008, respectively.

(dollars in millions)

Long-term debt outstanding at September 30, 2009, and December 31, 2008, includes the following:

	September 30, 2009	December 31, 2008
4.875% Notes, due 2010[1]	$ -	$300
7.25% Notes, due 2012[1]	204	204
8.00% Notes, due 2013	260	260
7.86% Medium Term Notes, due 2013	25	25
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014[2]	200	200
6.70% Notes, due 2016	249	250
7.00% Subordinated Notes, due 2067[3]	300	300
8.50% Surplus Notes, due 2025	140	150
7.875% Surplus Notes, due 2026	227	250
7.63% Notes, due 2028	3	3
7.00% Notes, due 2034	231	250
6.50% Notes, due 2035	471	500
7.50% Notes, due 2036	440	500
7.80% Subordinated Notes, due 2087[4]	700	700
10.75% Subordinated Notes, due 2088[5]	1,250	1,250
7.697% Surplus Notes, due 2097	435	500
	5,635	6,142
Unamortized discount	(50)	(53)
Total long-term debt excluding current maturities	$5,585	$6,089

[1] Reflects debt originally issued by Safeco. On December 29, 2008, $281 of the outstanding $300, 4.875% notes due 2010 and $187 of the outstanding $204, 7.25% notes due 2012 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.
[2] Reflects debt originally issued by Ohio Casualty. On December 29, 2008, $180 of the outstanding $200, 7.30% senior notes were exchanged for a like principal amount of newly issued LMGI notes.
[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.

Short-term Debt
On September 1, 2009, Liberty Mutual Insurance Company ("LMIC") renewed its existing $750, 364-day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

On March 11, 2009, LMIC became a member of the Federal Home Loan Bank of Boston. To date, no funds have been borrowed.

The Company periodically issues commercial paper to meet short-term operating needs. The total facility was $1,000 at September 30, 2009, and December 31, 2008, and is supported by two credit facilities totaling $750. There was zero commercial paper issued and outstanding at September 30, 2009, and December 31, 2008.

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

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a $20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of September 30, 2009, no borrowings were outstanding under the facility.

Long-term Debt
As part of its overall capital strategy, the Company may issue, repurchase or exchange debt depending on market considerations. Debt repurchases, if any, may be done through open market or other appropriate transactions. During the nine months ended September 30, 2009, the Company repurchased $65 of the 7.697% Surplus Notes due 2097, $60 of the 7.50% Notes due 2036, $29 of the 6.50% Notes due 2035, $23 of the 7.875% Notes due 2026, $19 of the 7.00% Notes due 2034, $10 of the 8.50% Surplus Notes due 2025 and $1 of the 6.70% Notes due 2016. A gain of $59 was recorded on the transactions and is included in fee and other revenues in the Consolidated Statements of Income. The Company continues to evaluate market conditions and may periodically effect transactions in its debt, subject to applicable limitations.

On December 29, 2008, LMGI exchanged $281 of the outstanding $300 Safeco 4.875% Senior Notes due 2010 for a like principal amount of newly issued LMGI 4.875% Senior Notes due 2010. LMGI exchanged $187 of the outstanding $204 Safeco 7.25% Senior Notes due 2012 for a like principal amount of newly issued LMGI 7.25% Senior Notes due 2012. LMGI exchanged $180 of the outstanding $200 Ohio Casualty 7.30% Senior Notes due 2014 for a like principal amount of newly issued LMGI 7.30% Senior Notes due 2014. The above transactions were not deemed to be substantial modifications to the Safeco and Ohio Casualty Senior Notes. Safeco and Ohio Casualty received and accepted the requisite consents to enable each to execute a supplemental indenture governing the Safeco and Ohio Casualty Senior Notes that remain outstanding. The supplemental indenture eliminated substantially all restrictive covenants and eliminated or modified certain events of default.

(dollars in millions)

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

On May 29, 2008, LMGI issued Series C junior subordinated notes (the "Series C Notes") with a face amount of $1,250. 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, decease 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).

(6) ASBESTOS AND ENVIRONMENTAL

In the third quarter of 2009, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal review, potential exposures of certain policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with the latest published actuarial paper on asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. The remaining policyholders (those with less potential exposure) were evaluated using aggregate methods that utilized information and experience specific to these insureds. The net increase to asbestos reserves was $242 for the period ended September 30, 2009.

(7) INCOME TAXES

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 net unrealized capital gains and losses on certain investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs, employee benefits, net operating losses and intangible assets.

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

Balance at January 1, 2009	$221
Additions based on tax positions related to current year	26
Additions for tax positions of prior years	25
Reductions for tax positions of prior years	(1)
Settlements	(1)
Balance at September 30, 2009	$270

The beginning balance has been adjusted to reflect tax liabilities and to remove anticipated tax recoverables. Included in the tabular rollforward of unrecognized tax benefits is interest in the amount of $72 and $87 at January 1, 2009 and September 30, 2009 respectively.

Included in the balance at September 30, 2009, are $191 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. During the nine months ended September 30, 2009 and the year ended December 31, 2008, the Company recognized approximately $15 and $8 in interest and penalties, respectively. The Company had approximately $81 and $66 of interest and penalties accrued at September 30, 2009 and December 31, 2008, respectively.

(dollars in millions)

(8) FAIR VALUE MEASUREMENT

ASC 820 establishes a framework for measuring fair value and disclosures about fair value measurements. It provides guidance on how to measure fair value when required under existing accounting standards and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value are impacted by the application of this guidance. The Company has variable annuity contracts containing embedded derivatives.

The hierarchy requires the use of market observable information when available for assessing fair value. The following table summarizes the Company's assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2009, along with a brief description of the valuation technique for each type of asset and liability:

Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed maturities, available for sale	$1,378	$53,530	$1,050	$55,958
Equity securities, available for sale	610	468	34	1,112
Trading securities	-	1	-	1
Short-term investments	78	489	13	580
Other investments	-	54	75	129
Separate account assets	1,163	1,728	12	2,903
Other assets	13	75	18	106
Total assets	$3,242	$56,345	$1,202	$60,789
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$149	$149
Total liabilities	$ -	$ -	$149	$149

Fixed maturities and short-term investments are recorded at fair value in the Company's financial statements. In instances where there are quoted prices in active markets for identical instruments, as is the case within the US Treasury market, these securities are categorized as Level 1 of the fair value hierarchy. For securities where the fair value of fixed income securities are estimated using recently executed transactions, market price quotations, bond spreads, or models that have inputs from published interest rate yield curves, these securities are generally categorized as Level 2 of the hierarchy. Additionally, in some instances where fixed maturity securities use significant inputs that are unobservable, they are categorized as Level 3 of the hierarchy.

Equity and trading securities are recorded at fair value in the Company's financial statements. The fair value of common stocks are generally based on quoted prices in active markets. As such, common stocks are generally categorized as Level 1 of the fair value hierarchy. The fair value of preferred stocks are generally determined by quoted prices for similar instruments in active markets, hence they are categorized as Level 2 of the fair value hierarchy.

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

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

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

(dollars in millions)

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

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

	Balance January 1, 2009	**Net Realized Gains (Losses)**	**Net Unrealized Gains (Losses)**	**Net Purchases, (Sales) and (Maturities)**	**Transfer in and/ or out of Level 3**	**Balance September 30, 2009**
Fixed maturities	$897	$4	$76	$85	$(12)	$1,050
Equity securities	110	(5)	9	-	(80)	34
Short-term investments	73	-	-	(60)	-	13
Other investments	62	(2)	-	14	1	75
Separate account assets	2	-	-	-	10	12
Other assets	27	(13)	-	4	-	18
Total assets	$1,171	$(16)	$85	$43	$(81)	$1,202
Life insurance obligations	$223	$(37)	$-	$(37)	$-	$149
Total liabilities	$223	$(37)	$-	$(37)	$-	$149

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held at September 30, 2009.

For the nine months ended September 30, 2009, there were no impairments recognized for items measured at fair value on a nonrecurring basis.

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

(dollars in millions)

(9) BENEFIT PLANS

The net benefit costs for the three months ended September 30, 2009, and 2008, include the following components:

Three months ended September 30,	Pension Benefits		Supplemental * Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit costs						
Service costs	$ 50	$ 35	$ 3	$ 2	$ 7	$ 4
Interest costs	68	60	4	3	11	10
Expected return on plan assets	(62)	(65)	-	-	(1)	-
Loss recognized due to settlement	1	-	-	-	-	-
Amortization of unrecognized:						
Net loss	14	3	2	2	-	-
Prior service cost	2	2	1	1	(1)	(1)
Net transition (assets)/obligation	(2)	(2)	-	-	3	3
Net periodic benefit costs	$ 71	$ 33	$ 10	$ 8	$ 19	$ 16

The net benefit costs for the nine months ended September 30, 2009, and 2008, include the following components:

Nine months ended September 30,	Pension Benefits		Supplemental * Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008	2009	2008
Components of net periodic benefit costs						
Service costs	$ 149	$ 105	$ 9	$ 7	$ 21	$ 15
Interest costs	203	180	14	11	35	29
Expected return on plan assets	(185)	(195)	-	-	(1)	(1)
Loss recognized due to settlement	1	-	-	-	-	-
Amortization of unrecognized:						
Net loss	41	8	7	4	1	(1)
Prior service cost	5	5	2	2	(2)	(2)
Net transition (assets)/obligation	(5)	(5)	-	-	7	7
Net periodic benefit costs	$ 209	$ 98	$ 32	$ 24	$ 61	$ 47

* The Company sponsors supplemental retirement plans to provide pension benefits above the levels provided by the pension plans without regard to the statutory earnings limitations of qualified defined benefit pension plans. The supplemental plans are unfunded.

The Company expects to contribute approximately $201 to the qualified plans in 2009.

(10) COMMITMENTS AND CONTINGENT LIABILITIES

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

Until recently, the Company has been in various insurance coverage disputes with Armstrong World Industries (“Armstrong”) for over twenty years relating to asbestos liabilities and insurance covering the period of 1973 to 1981. In October 2009, Liberty Mutual executed a settlement agreement with the Armstrong World Industries Asbestos Personal Injury Trust (the “Trust”), as successor to certain of Armstrong’s rights under certain of the Liberty Mutual insurance policies, to resolve all disputes regarding Liberty Mutual’s alleged coverage obligations with respect to asbestos bodily injury claims, including but not limited to all actions pending in the United States District Court for the Eastern District of Pennsylvania, and related civil actions more recently filed in state court in Illinois, for a payment of $300. The parties also agreed to a further contingent payment of $115 payable no earlier than the first day of the sixth year anniversary of the “effective date” of the agreement, only if a certain aggregate value of qualified claims has been accepted by the Trust by that time or within a two year period thereafter. The settlement, which must be approved by the District Court before it becomes “effective,” will entitle Liberty Mutual to the full benefits and protections afforded by the Section 524(g) channeling injunction issued to Armstrong in the bankruptcy proceedings which concluded in 2006. Armstrong, the Trust Advisory Committee, and the Futures

Representative, in addition to the Trust, have all concurred in the settlement. The settlement will become "effective" once the channeling injunction has been issued, the Illinois suits dismissed with prejudice, and all related appeals exhausted.

As of September 30, 2009, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of $985, $379, and $955, respectively. As of September 30, 2009, the Company had commitments to purchase various residential mortgage-backed securities at a cost of $93 (fair value of $94) and various corporate and municipal securities at a cost and fair value of $39.

(11) SUBSEQUENT EVENTS

Management has assessed and concluded that there were no material subsequent events through October 27, 2009, the date of the third quarter 2009 earnings release.