



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

Quarter Ended September 30, 2009

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, 2009 and 2008. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2008 Annual Report, Third Quarter 2009 Unaudited Consolidated Financial Statements and Third Quarter 2009 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 in conformity with U.S generally accepted accounting principle ("GAAP") on an after-tax 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; recessionary 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 stress in financial markets and economic conditions; 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; adverse developments in the cost, availability and/or ability to collect reinsurance, which may be adversely affected by current economic conditions; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the acquisition of Safeco Corporation ("Safeco") and its subsidiaries; 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 hurricanes, hail, tornados, 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 proposed Federal legislation related to natural catastrophe funds and financial services regulation 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 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, 2009 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2009 were \$7.916 billion, an increase of \$1.045 billion or 15.2% over the same period in 2008.
- Net written premium for the three months ended September 30, 2009 was \$7.207 billion, an increase of \$661 million or 10.1% over the same period in 2008.
- Pre-tax operating income before private equity (loss) income for the three months ended September 30, 2009 was \$263 million, an increase of \$114 million or 76.5% over the same period in 2008.
- Pre-tax operating income for the three months ended September 30, 2009 was \$258 million, an increase of \$99 million or 62.3% over the same period in 2008.
- Net income for the three months ended September 30, 2009 was \$265 million, an increase of \$259 million from the same period in 2008.
- Cash flow from operations for the three months ended September 30, 2009 was \$580 million, a decrease of \$300 million or 34.1% from the same period in 2008.
- The combined ratio before catastrophes¹ and net incurred losses attributable to prior years² for the three months ended September 30, 2009 was 97.9%, an increase of 3.0 points over the same period in 2008. 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, 2009 decreased 2.8 points to 100.6%.

Nine Months Ended September 30, 2009 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2009 were \$23.152 billion, an increase of \$2.448 billion or 11.8% over the same period in 2008.
- Net written premium for the nine months ended September 30, 2009 was \$21.139 billion, an increase of \$2.058 billion or 10.8% over the same period in 2008.
- Pre-tax operating income before private equity (loss) income for the nine months ended September 30, 2009 was \$1.094 billion, an increase of \$164 million or 17.6% over the same period in 2008.
- Pre-tax operating income for the nine months ended September 30, 2009 was \$696 million, a decrease of \$362 million or 34.2% from the same period in 2008.

¹ Catastrophes include all current and prior year catastrophe losses 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, 2009 was \$567 million, a decrease of \$99 million or 14.9% from the same period in 2008.
- Cash flow from operations for the nine months ended September 30, 2009 was \$1.568 billion, a decrease of \$1.004 billion or 39.0% from the same period in 2008.
- The combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2009 was 98.0%, an increase of 0.7 points from the same period in 2008. 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, 2009 decreased 1.9 points to 100.1%.

Financial Condition as of September 30, 2009

- Total assets were \$109.996 billion as of September 30, 2009, an increase of \$5.680 billion over December 31, 2008.
- Policyholders' equity was \$13.833 billion as of September 30, 2009, an increase of \$3.673 billion over December 31, 2008.
- Long-term debt, including current maturities of long-term debt, was \$5.885 billion as of September 30, 2009, a decrease of \$204 million from December 31, 2008. The decrease primarily reflects year-to-date debt repurchases of \$207 million.

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 an 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) and private equity income (loss) 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 and 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. 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:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Private passenger automobile	\$2,575	\$2,015	27.8%	\$7,338	\$5,583	31.4%
Workers compensation	992	1,148	(13.6)	3,078	3,764	(18.2)
Commercial multiple peril / fire	603	511	18.0	1,804	1,459	23.6
Homeowners	607	638	(4.9)	1,589	1,646	(3.5)
International local businesses	451	403	11.9	1,348	1,236	9.1
Commercial automobile	400	340	17.6	1,184	1,021	16.0
General liability	316	277	14.1	922	896	2.9
LIU ¹ reinsurance	199	233	(14.6)	789	766	3.0
Bond	201	111	81.1	538	293	83.6
LIU third party	199	223	(10.8)	513	553	(7.2)
LIU inland marine program	147	158	(7.0)	473	460	2.8
Group disability and life	155	140	10.7	453	417	8.6
Individual life	82	66	24.2	218	185	17.8
LIU first party	61	67	(9.0)	209	200	4.5
Assumed voluntary reinsurance	43	44	(2.3)	125	119	5.0
Other ²	176	172	2.3	558	483	15.5
Total net written premium³	\$7,207	\$6,546	10.1%	\$21,139	\$19,081	10.8%

¹ Liberty International Underwriters (“LIU”).

² Primarily includes net written premium from domestic inland marine and allied lines.

³ Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business.

Consolidated net written premium by SBU was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Agency Markets	\$2,800	\$1,685	66.2%	\$8,307	\$4,862	70.9%
International	1,737	1,744	(0.4)	5,131	5,026	2.1
Personal Markets	1,767	1,643	7.5	4,810	4,527	6.3
Commercial Markets	1,207	1,372	(12.0)	3,711	4,511	(17.7)
Corporate and Other ¹	(304)	102	NM	(820)	155	NM
Total net written premium (NWP)	\$7,207	\$6,546	10.1%	\$21,139	\$19,081	10.8%
Foreign exchange effect on growth			(1.3)			(2.4)
NWP growth excluding foreign exchange			11.4%			13.2%

¹ Includes internal and external reinsurance including a 31.725% homeowners quota share reinsurance treaty entered into in 2008.
NM = Not Meaningful

Major drivers of net written premium growth were as follows:

\$ in Millions	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009	2008	\$ Change	Pts. Attribution	2009	2008	\$ Change	Pts. Attribution
LMG NWP	\$7,207	\$6,546	\$661	10.1	\$21,139	\$19,081	\$2,058	10.8
Components of Growth:								
Safeco	\$1,283	\$134	\$1,149	17.6	\$3,883	\$134	\$3,749	19.6
International local businesses (excluding foreign exchange)	1,203	1,072	131	2.0	3,578	3,149	429	2.3
-Domestic homeowners ¹	712	617	95	1.5	1,810	1,625	185	1.0
-Homeowners quota share	(321)	-	(321)	(4.9)	(824)	-	(824)	(4.3)
Total Homeowners	391	617	(226)	(3.4)	986	1,625	(639)	(3.3)
Domestic personal auto ¹	1,340	1,286	54	0.8	3,684	3,614	70	0.4
Group disability and life	155	140	15	0.2	453	417	36	0.2
Individual life	82	66	16	0.2	218	185	33	0.2
Workers Compensation booked as billed adjustment	44	59	(15)	(0.2)	(6)	(30)	24	0.1
Bond ¹	96	99	(3)	-	250	281	(31)	(0.2)
Foreign exchange	(84)	-	(84)	(1.3)	(449)	-	(449)	(2.4)
Other commercial lines ¹	2,697	3,073	(376)	(5.8)	8,542	9,706	(1,164)	(6.1)
Total LMG NWP	\$7,207	\$6,546	\$661	10.1	\$21,139	\$19,081	\$2,058	10.8

¹ Excludes Safeco premium.

Net written premium for the three and nine months ended September 30, 2009 was \$7.207 billion and \$21.139 billion, respectively, increases of \$661 million and \$2.058 billion over the same periods in 2008. Significant changes by major line of business include:

- Private passenger automobile net written premium increased \$560 million and \$1.755 billion in the quarter and year-to-date, respectively. The increases in the quarter and year-to-date primarily reflect approximately \$488 million and \$1.702 billion of premium, respectively, related to the Safeco acquisition made on September 22, 2008, growth in International's local businesses in Latin America, inflation in Venezuela, and new business growth as well as rate increases in Personal Markets. The increases were partially offset by weaker foreign currencies versus the U.S. dollar (approximately \$40 million and \$197 million, respectively) and less new business

- writings in European operations primarily as a result of the region's general economic contraction and lower retention in Personal Markets.
- Workers compensation net written premium decreased \$156 million and \$686 million in the quarter and year-to-date, respectively. The decreases in the quarter and year-to-date primarily reflect lower retention and new business writings in Commercial Markets as a result of competitive market conditions and continued price discipline, reduced exposures due to economic contraction, the Middle Market change from direct distribution to third party, a decline in insureds in the state based involuntary market pools and a year-to-date reduction in premium in the National Market segment of Commercial Markets of \$45 million driven by a multi-year construction account written in 2008 that did not recur in 2009. Partially offsetting the decrease in the quarter and year-to-date was approximately \$23 million and \$79 million of premium, respectively, related to the Safeco acquisition. Both periods also include an adjustment to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium.
 - Commercial multiple peril / fire net written premium increased \$92 million and \$345 million in the quarter and year-to-date, respectively. The increases primarily reflect approximately \$121 million and \$380 million of premium, respectively, related to the Safeco acquisition and higher rates in Commercial Markets. Partially offsetting the year-to-date increase were lower retention levels and reduced exposures due to economic contraction.
 - Homeowners net written premium decreased \$31 million and \$57 million in the quarter and year-to-date, respectively. The decreases in the quarter and year-to-date reflect the impact of \$321 million and \$824 million, respectively, related to a homeowners quota share reinsurance treaty entered into in 2008. Partially offsetting the decrease in the quarter and year-to-date was approximately \$195 million and \$582 million of premium, respectively, related to the Safeco acquisition and strong customer retention, new business growth in non-coastal areas and rate increases in Personal Markets.
 - International local businesses net written premium (excluding private passenger automobile), increased \$48 million and \$112 million in the quarter and year-to-date, respectively. The increase in both periods was driven largely by growth in Latin America, inflation in Venezuela, and to a lesser extent, Asia. Partially offsetting the increase in the quarter and year-to-date was the impact of weaker foreign currencies versus the U.S. dollar (approximately \$26 million and \$139 million, respectively) and a decline in Europe due to the region's general economic contraction.
 - Commercial automobile net written premium increased \$60 million and \$163 million in the quarter and year-to-date, respectively. The increases in the quarter and year-to-date primarily reflect approximately \$87 million and \$284 million of premium, respectively, related to the Safeco acquisition, and rate increases in Commercial Markets. Partially offsetting the increases in both periods were lower retention and new business writings in Commercial Markets and Agency Markets due to a more competitive environment and the Middle Market change from direct distribution to third party in Commercial Markets.
 - General liability net written premium increased \$39 million and \$26 million in the quarter and year-to-date, respectively. The increases in the quarter and year-to-date primarily reflect approximately \$33 million and \$125 million of premium, respectively related to the Safeco acquisition. Partially offsetting the increases in both periods were lower new business writings in Commercial Markets. The year-to-date increase is also partially offset by a reduction in premium in the National Market segment of Commercial Markets of \$43 million driven by a multi-year construction account written in 2008 that did not recur in 2009.
 - LIU reinsurance net written premium decreased \$34 million in the quarter and increased \$23 million year-to-date. The decrease in the quarter is primarily driven by the non-renewal of a reinsurance program. The year-to-date increase reflects an improved rate environment. The quarter and year-to-date also reflect the impact of weaker foreign currencies versus the U.S. dollar (approximately \$6 million and \$43 million, respectively).
 - Bond net written premium increased \$90 million and \$245 million in the quarter and year-to-date, respectively. The increases in the quarter and year-to-date primarily reflect approximately \$93 million and \$276 million of premium, respectively, related to the Safeco acquisition. Partially offsetting the increase in both periods was reduced exposures due to economic conditions.

- LIU third party net written premium decreased \$24 million and \$40 million in the quarter and year-to-date, respectively. The decreases in the quarter and year-to-date primarily reflect an increase in ceded written premium due to a change in the structure of the specialty casualty reinsurance program, a more competitive environment in the U.S. and Europe, and the impact of weaker foreign currencies versus the U.S. dollar (approximately \$6 million and \$29 million, respectively).
- Other net written premium increased \$4 million and \$75 million in the quarter and year-to-date, respectively. The increases in the quarter and year-to-date primarily reflect higher allied lines net written premium of \$17 million and \$69 million, respectively, primarily related to the Safeco acquisition.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	\$7,916	\$6,871	15.2%	\$23,152	\$20,704	11.8%
PTOI before catastrophes, net incurred losses attributable to prior years and private equity (loss) income	\$575	\$661	(13.0%)	\$1,644	\$1,758	(6.5%)
Catastrophes ¹ :						
-September 2008 Hurricanes	(2)	(697)	(99.7%)	(16)	(697)	(97.7%)
-All other ²	(195)	(111)	75.7%	(760)	(590)	28.8%
Net incurred losses attributable to prior years:						
- Asbestos & environmental ³	(361)	(1)	NM	(364)	(5)	NM
- All other ⁴	246	297	(17.2%)	590	464	27.2%
Pre-tax operating income before private equity (loss) income	263	149	76.5%	1,094	930	17.6%
Private equity (loss) income ⁵	(5)	10	NM	(398)	128	NM
Pre-tax operating income	258	159	62.3%	696	1,058	(34.2%)
Realized gains (losses), net	35	(249)	NM	14	(256)	NM
Federal and foreign income tax (expense) benefit	(28)	96	NM	(143)	(136)	5.1%
Net income	\$265	\$6	NM	\$567	\$666	(14.9%)
Cash flow from operations	\$580	\$880	(34.1%)	\$1,568	\$2,572	(39.0%)

1 Catastrophes include all current and prior year catastrophe losses 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 Catastrophe losses ceded under the homeowners quota share treaty are included to the extent that the ceded combined ratio exceeds 100.0%.

3 Net of allowance for uncollectible reinsurance reduction of (\$70) million for the three and nine months ended September 30, 2009, and zero and \$7 million for the comparable periods of 2008.

4 Net of earned premium attributable to prior years of (\$73) million and (\$71) million for the three and nine months ended September 30, 2009, and \$14 million and \$11 million for the comparable periods of 2008. Net of amortization of deferred gains on retroactive reinsurance of \$17 million and \$52 million for the three and nine months ended September 30, 2009, and \$17 million and \$53 million for the comparable periods of 2008.

5 Private equity (loss) income is included in net investment income in the accompanying statements of income.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2009 was \$258 million and \$696 million, respectively, an increase of \$99 million and a decrease of \$362 million versus the same periods in 2008. The increase in the quarter reflects lower catastrophe related losses, favorable reserve development in Agency Markets liability lines and the involuntary market workers compensation pools and gains on early extinguishment of debt. Partially offsetting the increase in the quarter was an increase in asbestos reserves (refer also to the "Critical Accounting Policies" section for additional details), higher catastrophe reinsurance costs and a \$53 million write down of net recoverables due to the restructuring of the North Carolina Insurance Underwriting Association Beach Plan ("NC Beach Plan"). The year-to-date decrease was driven by lower net investment income due to reduced valuations for investments in limited partnerships and limited liability companies, an increase in asbestos reserves, higher corporate benefit expenses, the write down of net recoverables due to the NC Beach Plan, higher catastrophe reinsurance costs and the impact of a stronger U.S. dollar versus the prior year. Partially offsetting the year-to-date decrease were more favorable incurred losses attributable to prior years, a decrease in catastrophe related losses and gains on early extinguishment of debt

Revenues for the three and nine months ended September 30, 2009 were \$7.916 billion and \$23.152 billion respectively, increases of \$1.045 billion and \$2.448 billion over the same periods in 2008. The major components of revenues are net premium earned, net investment income, net realized investment gains (losses), and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2009 was \$6.942 billion and \$20.783 billion, respectively, increases of \$724 million and \$2.623 billion over the same periods in 2008. The increases in both periods primarily reflect approximately \$1.267 billion and \$3.867 billion, respectively, of premium related to the acquisition of Safeco and organic growth in Latin America. Partially offsetting the increases in the quarter and year-to-date were \$270 million and \$774 million, respectively, of ceded premium related to the homeowners quota share treaty, approximately \$79 million and \$394 million reflecting the impact of weaker foreign currencies versus the U.S. dollar, reduced exposures due to economic contraction, a competitive commercial lines market, and a decline in premium in the Middle Market segment of Commercial Markets primarily due to the change from direct distribution to third party distribution.

Net investment income for the three and nine months ended September 30, 2009 was \$710 million and \$1.744 billion, respectively, an increase of \$5 million and a decrease of \$472 million versus the same periods in 2008. Net investment income increased in both periods primarily due to a higher invested asset base resulting from the Safeco acquisition in the third quarter of 2008 and continued reinvestment of cash flows from operations. These increases were offset by decreases in limited partnership income reflecting reduced valuations, a decrease in dividend income reflecting a change in investment strategy to reduce the total equity portfolio exposure, and an increase in investment expenses due to the Safeco acquisition, strategic initiatives and variable compensation costs.

Net realized investment gains for the three and nine months ended September 30, 2009 were \$35 million and \$14 million, respectively, compared to losses of \$249 million and \$256 million from the same periods in 2008. The increase in both periods reflects impairment losses recorded in 2008 on fixed maturity and equity investments related to securities deemed to be other than temporarily impaired due to market conditions. Partially offsetting this were gains recorded in 2008 related to derivative contracts the Company used to hedge its equity exposure and a 2008 gain from the sale of an investment property.

Fee and other revenues for the three and nine months ended September 30, 2009 were \$229 million and \$611 million, respectively, increases of \$32 million and \$27 million over the same periods in 2008. The increase in both periods reflects gains of \$48 million and \$59 million on early extinguishment of debt and higher installment fees in Agency Markets due to the acquisition of Safeco. Partially offsetting the increases in both periods are lower oil and gas revenues from the Company's energy operations and lower fee revenues from the Company's servicing carrier operations due to lower involuntary market premium. 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, 2009 were \$7.623 billion and \$22.442 billion, respectively, increases of \$662 million and \$2.540 billion over the same periods in 2008. The increase in both periods primarily reflects the acquisition of Safeco, business growth and inflation, in particular International's Latin American operations, an increase in asbestos reserves, higher corporate benefit expenses, the write down of the NC Beach Plan net recoverables and general cost increases. Partially offsetting the increases in both periods were favorable incurred losses attributable to prior years primarily related to Agency Markets liability lines, lower workers compensation losses in Commercial Markets due to a decline in premium volume, ceded losses and expenses associated with the homeowners quota share reinsurance treaty, and the impact of weaker foreign currencies versus the U.S. dollar.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change (Points)	2009	2008	Change (Points)
CONSOLIDATED						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	69.5%	68.2%	1.3	69.6%	69.7%	(0.1)
Underwriting expense ratio	28.2	26.5	1.7	28.2	27.3	0.9
Dividend ratio	0.2	0.2	-	0.2	0.3	(0.1)
Subtotal	97.9	94.9	3.0	98.0	97.3	0.7
Catastrophes ¹ :						
-September 2008 Hurricanes	-	11.6	(11.6)	-	4.0	(4.0)
-All other	2.9	1.9	1.0	3.8	3.4	0.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	4.3	-	4.3	1.5	0.1	1.4
- All other	(4.5)	(5.0)	0.5	(3.2)	(2.8)	(0.4)
Total combined ratio²	100.6%	103.4%	(2.8)	100.1%	102.0%	(1.9)

- 1 Catastrophes include all current and prior year catastrophe losses 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 ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense 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, 2009 was 97.9% and 98.0% respectively, increases of 3.0 points and 0.7 points over the same periods in 2008. The increase in the claims and claim adjustment expense ratio in the quarter reflects an increase in loss activity in International's local business, LIU's reinsurance business resulting from several large loss events, increasing loss trends in Commercial Markets workers compensation and general liability lines of business, unfavorable loss trends in Personal Markets homeowners line of business and a higher loss ratio in Summit due to a decrease in rates. The year-to-date decrease reflects the impact of favorable Agency Markets results across property and liability lines and greater weighting of personal lines results from the acquired Safeco personal lines business. The increase in the underwriting expense ratio in both periods primarily reflects a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the involuntary pools, higher corporate benefit costs and variable 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, 2009 was 100.6% and 100.1%, respectively, decreases of 2.8 points and 1.9 points from the same periods in 2008. The decrease in the quarter reflects the changes in the combined ratio components previously discussed and lower catastrophe losses, partially offset by the higher asbestos reserve increase and lower favorable prior year development. The year-to-date decrease includes the combined ratio items previously discussed as well as increased favorable incurred loss development, partially offset by the higher asbestos reserve increase. The favorable loss development in both periods is primarily related to Agency Markets liability lines.

Federal and foreign income tax expense for the three and nine months ended September 30, 2009 was \$28 million and \$143 million, respectively, increases of \$124 million and \$7 million from the same periods in 2008. The Company's effective tax rate for the three and nine months ended September 30, 2009 was 10% and 20%, respectively, compared to (107%) and 17% for the same periods in 2008. 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 resulting in a tax refund claim. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-exempt investment income, goodwill, foreign taxes and prior years' taxes.

Net income for the three and nine months ended September 30, 2009 was \$265 million and \$567 million, respectively, an increase of \$259 million and a decrease of \$99 million versus the same periods in 2008.

Cash flow from operations for the three and nine months ended September 30, 2009 was \$580 million and \$1.568 billion, respectively, decreases of \$300 million and \$1.004 billion from the same periods in 2008. The decreases in both periods primarily reflect higher ceded premium associated with the homeowners quota share treaty and increased catastrophe reinsurance purchases, lower domestic commercial lines written premium (excluding Safeco), lower investment income collections, increases in catastrophe and non-catastrophe paid losses, and pension contributions in 2009 that did not occur in 2008. Partially offsetting these decreases are higher personal lines premium collections.

AGENCY MARKETS

Overview – Agency Markets

Agency Markets delivers personal and commercial insurance products and services to individuals and small businesses through independent agents throughout the United States. Commercial lines products are offered through eight regional insurance companies that combine their local underwriting, market knowledge and service orientation with the cost efficiencies of a national company. Personal lines products are distributed nationally using the Safeco brand, with a focus on product and pricing sophistication. Liberty Mutual Surety is a leading provider of nationwide contract and commercial surety bonds. Summit provides workers compensation in the Southeast (primarily Florida).

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009 ¹	2008 ¹	Change	2009 ¹	2008 ¹	Change
Personal Lines (Safeco)	\$1,289	\$467	176.0%	\$3,735	\$1,144	NM
Regional Companies Group	1,195	990	20.7%	3,523	2,811	25.3%
Liberty Mutual Surety	202	113	78.8%	538	296	81.8%
Summit	72	82	(12.2%)	389	510	(23.7%)
Other ²	42	33	27.3%	122	101	20.8%
Total net written premium	\$2,800	\$1,685	66.2%	\$8,307	\$4,862	70.9%

1 Effective in the first quarter 2009, net written premium of both legacy Safeco and Regional Companies Group have been reclassified as follows: a) commercial lines operations are reflected in the Regional Companies Group segment; this segment also includes excess casualty operations previously reflected in Other, b) personal lines results are reflected in the Personal Lines (Safeco) segment and c) surety and fidelity operations are reflected in the Liberty Mutual Surety segment. The prior periods have been restated to reflect these changes.

2 Includes run-off operations and internal reinsurance.

NM= Not Meaningful

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Commercial Lines						
Commercial multiple peril	\$501	\$395	26.8%	\$1,449	\$1,096	32.2%
Workers compensation total:	310	320	(3.1%)	1,082	1,204	(10.1%)
- Summit	72	82	(12.2%)	389	510	(23.7%)
- All other	238	238	-	693	694	(0.1%)
Commercial automobile	287	223	28.7%	864	640	35.0%
Bond	201	111	81.1%	538	294	83.0%
General liability	128	100	28.0%	389	290	34.1%
Other	76	60	26.7%	218	172	26.7%
Subtotal	\$1,503	\$1,209	24.3%	\$4,540	\$3,696	22.8%
Personal Lines						
Private passenger automobile	\$792	\$291	172.2%	\$2,382	\$712	NM
Homeowners	396	160	147.5%	1,067	386	176.4%
Other	109	25	NM	318	68	NM
Subtotal	\$1,297	\$476	172.5%	\$3,767	\$1,166	NM
Total net written premium	\$2,800	\$1,685	66.2%	\$8,307	\$4,862	70.9%

NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2009 was \$2.800 billion and \$8.307 billion, respectively, increases of \$1.115 billion and \$3.445 billion over the same periods in 2008. The increases reflect the impact of the Safeco acquisition, which contributed approximately \$1.283 billion and \$3.883 billion in the quarter and year-to-date, respectively. These increases represent additional net written premium of approximately \$862 million and \$2.622 billion for personal lines in the quarter and year-to-date, respectively, and approximately \$421 million and \$1.261 billion for commercial lines in the quarter and year-to-date, respectively. The increases in both periods were partially offset by exposure reductions due to economic contraction, lower retention and new business due to a more competitive environment, and state mandated rate decreases of 18.9% in Florida workers compensation.

Results of Operations – Agency Markets

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	\$2,936	\$1,824	61.0%	\$8,992	\$5,141	74.9%
PTOI before catastrophes and net incurred losses attributable to prior years	\$351	\$177	98.3%	\$965	\$412	134.2%
Catastrophes ¹ :						
-September 2008 Hurricanes	-	(92)	(100.0%)	(16)	(92)	(82.6%)
-All other	(95)	(46)	106.5%	(412)	(201)	105.0%
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other ²	293	177	65.5%	581	290	100.3%
Pre-tax operating income	\$549	\$216	154.2%	\$1,118	\$409	173.3%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. 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 (\$66) million and (\$68) million for the three and nine months ended September 30, 2009, respectively, and (\$6) million and (\$11) million for the comparable periods of 2008.

PTOI for the three and nine months ended September 30, 2009 was \$549 million and \$1.118 billion, respectively, increases of \$333 million and \$709 million over the same periods in 2008. The increases in PTOI are primarily attributable to earnings associated with the Safeco acquisition and favorable incurred losses attributable to prior years, partially offset in the year-to-date period by unfavorable catastrophe activity. Partially offsetting the increases in both periods was a \$29 million write down of net recoverables due to the restructuring of the NC Beach Plan.

Revenues for the three and nine months ended September 30, 2009 were \$2.936 billion and \$8.992 billion, respectively, increases of \$1.112 billion and \$3.851 billion over the same periods in 2008. The major components of revenues are net premium earned, net investment income, and fee and other income.

Net premiums earned for the three and nine months ended September 30, 2009 were \$2.685 billion and \$8.244 billion, respectively, increases of \$1.036 billion and \$3.587 billion over the same periods in 2008. The quarter and year-to-date increases reflect approximately \$1.267 billion and \$3.867 billion of premium, respectively, related to the Safeco acquisition, partially offset by lower audit premium and the earned premium associated with the changes in net written premium previously discussed.

Net investment income for the three and nine months ended September 30, 2009 was \$222 million and \$659 million, respectively, increases of \$64 million and \$223 million over the same periods in 2008. The increases in both periods reflect an increase in invested assets associated with the Safeco acquisition and the continued investment of cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and nine months ended September 30, 2009 were \$29 million and \$89 million, increases of \$12 million and \$41 million over the same periods in 2008. The increases reflect increased installment fees due to the Safeco acquisition.

Claims, benefits and expenses for the three and nine months ended September 30, 2009 were \$2.387 billion and \$7.874 billion, respectively, increases of \$779 million and \$3.142 billion over the same periods in 2008. The increases in both periods reflect the impact of the Safeco acquisition and general cost increases, partially offset by favorable incurred losses attributable to prior years primarily in liability lines due to better than expected frequency and severity trends across most commercial and personal lines. In addition, the quarter benefited from no hurricanes, while the year-to-date period results reflect higher catastrophe losses related to winter and Midwest storms.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change (Points)	2009	2008	Change (Points)
AGENCY MARKETS						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	62.8%	64.4%	(1.6)	64.2%	66.5%	(2.3)
Underwriting expense ratio ¹	31.1	32.8	(1.7)	30.7	32.6	(1.9)
Dividend ratio	0.3	0.3	-	0.3	0.6	(0.3)
Subtotal	94.2	97.5	(3.3)	95.2	99.7	(4.5)
Catastrophes: ²						
-September 2008 Hurricanes	-	5.5	(5.5)	0.2	2.0	(1.8)
-All other	3.4	2.8	0.6	5.0	4.3	0.7
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(12.0)	(10.7)	(1.3)	(7.5)	(6.2)	(1.3)
Total combined ratio	85.6%	95.1%	(9.5)	92.9%	99.8%	(6.9)

1 One-time Safeco integration costs have been excluded from the combined ratio.

2 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. 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, 2009 was 94.2% and 95.2%, respectively, decreases of 3.3 points and 4.5 points from the same periods in 2008. The decrease in the claims and claim adjustment expense ratio for the quarter and year-to-date reflects the change in business mix associated with the Safeco acquisition (higher percentage of personal lines) and favorable personal lines results across property and liability lines, partially offset by higher loss ratios in Summit due to the decrease in rates. The decrease in the underwriting expense ratio reflects the impact of writing more personal lines business, which typically has a lower expense ratio, and increased efficiencies resulting from the Safeco acquisition.

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, 2009 was 85.6% and 92.9%, respectively, decreases of 9.5 points and 6.9 points from the same periods in 2008. The decreases in both periods primarily reflect the changes in the combined ratio previously discussed as well as favorable net incurred losses attributable to prior years across most personal and commercial lines. The quarter also benefited from no hurricane losses, while the year-to-date results were partially offset by higher catastrophe losses from winter and Midwest storm activity.

INTERNATIONAL

Overview – International

International provides insurance products and services through two distinct approaches: local businesses, which sell personal and small commercial lines products, and Liberty International Underwriters (“LIU”) which sells specialty commercial lines worldwide. International's local business operations consist of local insurance operations selling property, casualty, health and life insurance products (primarily auto) to individuals and businesses in countries with a large and growing middle class. In Latin 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, International operates in Spain, Portugal, Turkey and Poland. LIU writes casualty, specialty casualty, marine, energy, construction, aviation and property coverages through offices in Asia, Australia, Europe, the Middle East, North America and Latin 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:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
International Local Businesses Total	\$1,137	\$1,071	6.2%	\$3,221	\$3,124	3.1%
- Latin America	751	672	11.8	2,107	1,874	12.4
- Europe	320	345	(7.2)	930	1,086	(14.4)
- Asia	66	54	22.2	184	164	12.2
Liberty International Underwriters	600	673	(10.8)	1,910	1,902	0.4
Total net written premium (NWP)	\$1,737	\$1,744	(0.4%)	\$5,131	\$5,026	2.1%
Foreign exchange effect on growth			(4.8%)			(8.9%)
NWP growth excluding foreign exchange			4.4%			11.0%

International's major product lines 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: handset protection coverage for lost or damaged devices;
- (4) LIU third party: includes casualty, excess casualty, D&O, E&O, environmental impairment liability, railroad and other;
- (5) LIU first party: includes marine, energy, construction, aviation and property; and
- (6) LIU other: includes workers compensation, commercial automobile, surety, trade credit and crisis management.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Local businesses – private passenger auto	\$686	\$668	2.7%	\$1,891	\$1,908	(0.9%)
Local businesses – all other ¹	451	403	11.9	1,330	1,216	9.4
LIU reinsurance	199	233	(14.6)	741	719	3.1
LIU inland marine program	147	158	(7.0)	473	460	2.8
LIU third party	199	211	(5.7)	496	517	(4.1)
LIU first party	55	59	(6.8)	178	168	6.0
LIU other	-	12	(100.0)	22	38	(42.1)
Total net written premium	\$1,737	\$1,744	(0.4%)	\$5,131	\$5,026	2.1%

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

Net written premium for the three and nine months ended September 30, 2009 was \$1.737 billion and \$5.131 billion, respectively, a decrease of \$7 million and an increase of \$105 million versus the same periods in 2008. While LIU has seen increased competition and declining exposures over the course of 2009, the slight decrease in the quarter reflects a decline in LIU across all lines of business, primarily driven by the non-renewal of a program within LIU's reinsurance business, as well as an increase in the amount of ceded written premium in LIU's inland marine and third party businesses due to a change in the structure of certain reinsurance programs. The increase in the local businesses was driven largely by organic growth in Latin America, primarily inflation in Venezuela, and to a lesser extent, Asia, partially offset by a decline in Europe as a result of the region's general economic contraction. The decrease in the quarter was also impacted by the weakening of foreign currencies versus the U.S. dollar (approximately \$83 million). The increase year-to-date reflects organic growth in both LIU and the local businesses. LIU's growth year-to-date was driven by the improved rating environment in LIU's reinsurance business and continued expansion of LIU's inland marine program. Organic growth within the local businesses occurred primarily in Latin America, largely driven by inflation in Venezuela, and to a lesser extent, Asia, partially offset by a decline in Europe. The increase year-to-date was largely offset by the weakening of foreign currencies versus the U.S. dollar (approximately \$446 million), as well as an increase in ceded written premium due to the previously mentioned change in the structure of the LIU third party reinsurance program and a more competitive environment in the U.S. and Europe within this line of business.

Results of Operations – International

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	\$1,924	\$1,727	11.4%	\$5,518	\$5,225	5.6%
PTOI before catastrophes and net incurred losses attributable to prior years	\$115	\$174	(33.9%)	\$342	\$436	(21.6%)
Catastrophes: ^{1, 2}						
-September 2008 Hurricanes	(3)	(101)	(97.0%)	(9)	(101)	(91.0%)
-All other	(3)	-	NM	(3)	-	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other ³	(8)	57	NM	22	96	(77.1%)
Pre-tax operating income	\$101	\$130	(22.3%)	\$352	\$431	(18.3%)

1 Catastrophes include all current and prior year catastrophe losses 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 Assumed catastrophe losses related to the September 2008 Hurricanes are reported net of estimated net catastrophe reinsurance premium earned of zero for three and nine months ended September 30, 2009, and \$7 million for the comparable periods of 2008.

3 Net of earned premium attributable to prior years of \$4 million and \$3 million for the three and nine months ended September 30, 2009, respectively, and (\$2) million for the comparable periods of 2008.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2009 was \$101 million and \$352 million, respectively, decreases of \$29 million and \$79 million from the comparable periods in 2008. The decrease in both periods mainly reflects the impact of a higher loss ratio in the local businesses, primarily in select countries within Latin America, and the impact of a stronger U.S. dollar versus the prior year (approximately \$2 million and \$26 million in the quarter and year-to-date, respectively).

Revenues for the three and nine months ended September 30, 2009 were \$1.924 billion and \$5.518 billion, respectively, increases of \$197 million and \$293 million over the same periods in 2008. The primary components of revenues are net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2009 was \$1.748 billion and \$4.960 billion, respectively, increases of \$177 million and \$244 million over the same periods in 2008. The increase in both periods reflects the organic growth in net written premium in 2008 and 2009, partially offset by the impact of weakening foreign currencies versus the U.S. dollar (approximately \$79 million and \$394 million in the quarter and year-to-date, respectively).

Net investment income for the three and nine months ended September 30, 2009 was \$150 million and \$445 million, respectively, decreases of \$6 million and \$10 million from the same periods in 2008. The decrease in both periods reflects the impact of weaker foreign currencies versus the U.S. dollar and a decline in yield, partially offset by an increase associated with a higher invested asset base.

Claims, benefits and expenses for the three and nine months ended September 30, 2009 were \$1.833 billion and \$5.161 billion, respectively, increases of \$200 million and \$314 million over the same periods in 2008. The increase in both periods reflects lower favorable incurred loss development attributable to prior years in 2009 versus 2008, more than offset by a decrease in catastrophe losses related to the September 2008 Hurricanes in LIU's first party and reinsurance lines of business. The increase in both periods also reflects growth in the local businesses, primarily in Latin America, Venezuelan inflation, and general cost

increases, partially offset by weaker foreign currencies versus the U.S. dollar. The year-to-date increase also reflects growth in LIU.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change (Points)	2009	2008	Change (Points)
INTERNATIONAL						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	71.1%	66.6%	4.5	70.6%	68.1%	2.5
Underwriting expense ratio	29.7	31.7	(2.0)	30.2	31.8	(1.6)
Dividend ratio	-	-	-	-	-	-
Subtotal	100.8	98.3	2.5	100.8	99.9	0.9
Catastrophes: ¹						
-September 2008 Hurricanes	0.2	6.5	(6.3)	0.2	2.2	(2.0)
-All other	0.2	-	0.2	0.1	-	0.1
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	0.4	(3.7)	4.1	(0.5)	(2.1)	1.6
Total combined ratio	101.6%	101.1	0.5	100.6%	100.0%	0.6

¹ Catastrophes include all current and prior year catastrophe losses 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 International combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2009 was 100.8%, increases of 2.5 points and 0.9 points over the same periods in 2008, respectively. The increase in the claims and claim adjustment expense ratio in both periods was primarily due to an increase in loss activity within the local businesses, primarily in certain countries within Latin America, and in LIU's reinsurance business resulting from several large loss events. The increase was partially offset in both periods by a lower underwriting expense ratio in the local businesses, primarily in Latin America and Europe, as a result of effective cost management. The year-to-date decrease in the underwriting expense ratio also reflects a lower commission expense ratio primarily due to a change in the structure of a reinsurance program in LIU's inland marine 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, 2009 was 101.6% and 100.6%, respectively, increases of 0.5 points and 0.6 points over the same periods in 2008. These movements reflect the previously mentioned changes in the combined ratio components, a decrease in the amount of favorable incurred loss development attributable to prior years in 2009 as compared to the same periods in 2008 and the impact of catastrophe loss development related to the September 2008 Hurricanes in LIU's first party and reinsurance businesses.

PERSONAL MARKETS

Overview – Personal Markets

Personal Markets sells 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 telesales counselors, third-party producers and the Internet. Personal Markets' largest source of new business is through its more than 11,850 sponsored affinity groups (including employers, professional associations and alumni associations, credit unions, and other partnerships).

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Private passenger automobile	\$1,097	\$1,054	4.1%	\$3,060	\$2,955	3.6%
Homeowners and other	588	523	12.4	1,532	1,387	10.5
Individual life	82	66	24.2	218	185	17.8
Total net written premium	\$1,767	\$1,643	7.5%	\$4,810	\$4,527	6.3%

Net written premium for the three and nine months ended September 30, 2009 was \$1.767 billion and \$4.810 billion, respectively, increases of \$124 million and \$283 million over the same periods in 2008. The increases in both periods reflect new business growth, strong customer retention, rate increases on both automobile and homeowners policies, and increases in structured settlement premium for individual life.

Private passenger automobile net written premium for the three and nine months ended September 30, 2009 was \$1.097 billion and \$3.060 billion, respectively, increases of \$43 million and \$105 million over the same periods in 2008. The increases in both periods reflect a 3.9% increase in voluntary policies in-force as compared to September 30, 2008 due to strong customer retention and new business growth, and positive rate action.

Homeowners and other net written premium for the three and nine months ended September 30, 2009 was \$588 million and \$1.532 billion, respectively, increases of \$65 million and \$145 million over the same periods in 2008. The increases in both periods reflect rate increases and a 5.9% increase in policies in-force (1.3 points related to renters policies) as compared to September 30, 2008 due to strong customer retention and new business growth, primarily in non-coastal areas. Approximately one point of the policies in-force growth is attributable to the relationship established with GEICO in late 2007, which allows GEICO to offer the Company's homeowners products to its automobile prospects and customers through the Internet and call centers.

Individual life net written premium for the three and nine months ended September 30, 2009 was \$82 million and \$218 million, respectively, increases of \$16 million and \$33 million over the same periods in 2008. The increases in both periods reflect higher structured settlement sales.

Results of Operations – Personal Markets

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	\$1,785	\$1,679	6.3%	\$5,187	\$4,965	4.5%
PTOI before catastrophes and net incurred losses attributable to prior years	\$253	\$222	14.0%	\$740	\$657	12.6%
Catastrophes: ¹						
-September 2008 Hurricanes	-	(268)	(100.0%)	21	(268)	NM
-All other	(93)	(52)	78.9%	(309)	(307)	0.7%
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(21)	45	NM	(7)	58	NM
Pre-tax operating income (loss)	\$139	(\$53)	NM	\$445	\$140	NM

¹ Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2009 was \$139 million and \$445 million, respectively, increases of \$192 million and \$305 million over the same periods in 2008. Both periods reflect increased revenue due to higher net premiums and decreased catastrophe losses. Additionally, both periods reflect a decrease in the amount of favorable prior year loss development on auto liability business as compared to 2008 and a \$24 million write down of net recoverables due to the restructuring of the NC Beach Plan.

Revenues for the three and nine months ended September 30, 2009 were \$1.785 billion and \$5.187 billion, respectively, increases of \$106 million and \$222 million over the same periods in 2008. 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, 2009 was \$1.563 billion and \$4.560 billion, respectively, increases of \$87 million and \$206 million over the same periods in 2008. 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 the last quarter of 2008 and the first three quarters of 2009, and an increase in sales of structured settlement products in individual life.

Net investment income for the three and nine months ended September 30, 2009 was \$183 million and \$540 million, respectively, increases of \$3 million and \$10 million versus the same periods in 2008. Both periods reflect a higher invested asset base due to the continued investment of cash flow from operations.

Claims, benefits and expenses for the three and nine months ended September 30, 2009 were \$1.641 billion and \$4.753 billion, respectively, decreases of \$101 million and \$91 million from the same periods in 2008. The decrease in both periods was primarily due to a decrease in catastrophe losses partially offset by business growth, the NC Beach Plan recoverable write off and general cost increases. Both periods reflect reduced overhead absorption due to the impact of the Safeco acquisition and a decrease in the amount of favorable prior year loss development on auto liability business as compared to 2008. The decrease year-to-date also includes a subrogation recovery related to the 2007 California wildfires, favorable development on the September 2008 Hurricanes, and lower profit share expense related to business acquired from Prudential Financial, Inc. (“PruPac”).

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change (Points)	2009	2008	Change (Points)
PERSONAL MARKETS						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	64.3%	62.1%	2.2	63.8%	63.3%	0.5
Underwriting expense ratio	24.5	27.0	(2.5)	25.1	26.5	(1.4)
Dividend ratio	-	-	-	-	-	-
Subtotal	88.8	89.1	(0.3)	88.9	89.8	(0.9)
Catastrophes ¹ :						
-September 2008 Hurricanes	-	19.0	(19.0)	(0.5)	6.4	(6.9)
-All other	6.3	3.7	2.6	7.1	7.4	(0.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(0.2)	(3.2)	3.0	(0.4)	(1.4)	1.0
Total combined ratio	94.9%	108.6%	(13.7)	95.1%	102.2%	(7.1)

¹ Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Personal Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2009 was 88.8% and 88.9%, respectively, decreases of 0.3 points and 0.9 points from the same periods in 2008. The increase in the claims and claim adjustment expense ratio in both periods is primarily related to unfavorable trends in the homeowners line of business as a result of higher severity (consistent with industry trends), modestly higher frequency (below industry trends), and reduced catastrophe exposed premium. Both periods also reflect higher variable compensation costs. The decrease in the underwriting expense ratio in the quarter resulted from lower spending on advertising and reduced overhead absorption due to the impact of the Safeco acquisition. The year-to-date underwriting expense ratio also benefited from lower profit share expense related to PruPac compared to 2008.

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, 2009 was 94.9% and 95.1%, respectively, decreases of 13.7 points and 7.1 points from the same periods in 2008. The decreases in both periods reflect the changes in the combined ratio previously discussed, lower catastrophe losses, and a decrease in the amount of favorable prior year loss development on automobile liability business as compared to 2008.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets offers a wide array of commercial insurance coverages to mid-sized and large businesses (with an annual cost of risk of \$150,000 or more) through independent agents, brokers and benefit consultants throughout the United States. The Commercial Markets business unit is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base or product grouping 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 involuntary market pools.

On January 22, 2009, Commercial Markets established Middle Market, a new market segment that combines the Business Market and Wausau Insurance market segments. As part of this change, Commercial Markets 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, 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 on February 27, 2009.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Middle Market ^{1,2}	\$485	\$602	(19.4%)	\$1,419	\$1,895	(25.1%)
National Market ²	298	344	(13.4)	963	1,261	(23.6)
Group Market	155	140	10.7	453	417	8.6
Specialty Lines ³	87	73	19.2	295	268	10.1
Liberty Mutual Property	73	89	(18.0)	267	297	(10.1)
Other Markets	109	124	(12.1)	314	373	(15.8)
Total net written premium	\$1,207	\$1,372	(12.0%)	\$3,711	\$4,511	(17.7%)

1 Effective in the fourth quarter 2008, net written premium associated with Business Markets and Wausau Insurance, previously reported separately, is now included in Middle Market. The prior periods have been restated to reflect this change.

2 Effective November 1, 2008, certain accounts with available premium and premium equivalents greater than \$1.5 million, previously reported as part of Middle Market, have been transferred upon renewal to National Market. The prior periods have been restated to reflect this change.

3 Effective in the fourth quarter 2008, net written premium associated with Commercial Affinity, previously reported as part of Wausau Insurance, is now included in Specialty Lines. The prior periods have been restated to reflect this change.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Workers compensation	\$626	\$761	(17.7%)	\$1,974	\$2,569	(23.2%)
Group disability and life	155	140	10.7	453	417	8.6
General liability	138	148	(6.8)	392	522	(24.9)
Commercial automobile	111	115	(3.5)	316	375	(15.7)
Commercial multiple peril / Fire	79	94	(16.0)	289	328	(11.9)
Assumed voluntary reinsurance	43	44	(2.3)	125	116	7.8
Other	55	70	(21.4)	162	184	(12.0)
Total net written premium	\$1,207	\$1,372	(12.0%)	\$3,711	\$4,511	(17.7%)

Net written premium for the three and nine months ended September 30, 2009 was \$1.207 billion and \$3.711 billion, respectively, decreases of \$165 million and \$800 million from the same periods in 2008. The decreases reflect a decrease in exposures due to economic contraction, lower retention levels and new business writings across most lines of business and market segments, most pronounced in the Middle Market segment due to the impact of a competitive rate environment and the change from direct distribution to third party, a reduction in audit premium driven by a decline in exposures and a decline in assumed workers compensation premium from the state based involuntary market pools included in the Other Markets segment. The decline in the involuntary market pools is due to shrinking pools as insureds have been able to find insurance in the voluntary market. In addition, workers compensation premium and general liability premium in the National Market segment decreased by \$45 million and \$43 million, respectively, on a year-to-date basis driven by a multi-year construction account written in 2008 that did not recur. Partially offsetting the decreases in both periods was an increase in group disability and life business due to a broader penetration of those markets and an increase in workers compensation, general liability and commercial automobile premium in the Specialty Lines segment due to lower ceded premium. Also partially offsetting the decrease on a year-to-date basis was an increase in assumed voluntary reinsurance included in the Other Markets segment.

Results of Operations – Commercial Markets

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	\$1,493	\$1,757	(15.0%)	\$4,627	\$5,143	(10.0%)
PTOI before catastrophes and net incurred losses attributable to prior years	\$68	\$103	(34.0%)	\$256	\$335	(23.6%)
Catastrophes ¹ :						
-September 2008 Hurricanes	-	(156)	NM	-	(156)	NM
-All other	(5)	(12)	(58.3%)	(39)	(71)	(45.1%)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other ²	13	25	(48.0%)	38	47	(19.1%)
Pre-tax operating income (loss)	\$76	(\$40)	NM	\$255	\$155	64.5%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's 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 (\$11) million and (\$6) million for the three and nine months ended September 30, 2009, and \$22 million and \$24 million for the comparable periods of 2008. Net of amortization of deferred gains on retroactive reinsurance of \$12 million and \$37 million for the three and nine months ended September 30, 2009, and \$12 million and \$38 million for the comparable periods of 2008.

PTOI for the three and nine months ended September 30, 2009 was \$76 million and \$255 million, respectively, increases of \$116 million and \$100 million over the same periods in 2008. The increases in both periods reflect lower catastrophe related property losses, higher net investment income, favorable results due to favorable reserve development from the involuntary market workers compensation pools, and lower fixed expenses, primarily as a result of the Middle Market reorganization, partially offset by declining earned premium and declining loss trends primarily in the workers compensation and general liability lines of business. In addition, the quarterly result was adversely impacted by an increase in non-catastrophe related property losses.

Revenues for the three and nine months ended September 30, 2009 were \$1.493 billion and \$4.627 billion, respectively, decreases of \$264 million and \$516 million from the same periods in 2008. 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, 2009 was \$1.215 billion and \$3.785 billion, respectively, decreases of \$256 million and \$507 million from the same periods in 2008. The decreases in both periods reflect the decrease in net written premium during the fourth quarter of 2008 and the first nine months of 2009.

Net investment income for the three and nine months ended September 30, 2009 was \$213 million and \$634 million, respectively, increases of \$3 million and \$13 million over the same periods in 2008. 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.

Fee and other revenues for the three and nine months ended September 30, 2009 were \$65 million and \$208 million, respectively, decreases of \$11 million and \$22 million from the same periods in 2008. The decreases in both periods 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, 2009 were \$1.417 billion and \$4.372 billion, respectively, decreases of \$380 million and \$616 million from the same periods in 2008. The decreases in both periods primarily reflect lower catastrophe related property losses, expense efficiencies and lower workers compensation losses, loss adjustment expenses and acquisition expenses due to the decline in premium volume. Additionally, both periods reflect favorable reserve development from the involuntary market workers compensation pools, partially offset by general cost increases. The quarterly results also include an increase in non-catastrophe related property losses.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change (Points)	2009	2008	Change (Points)
COMMERCIAL MARKETS						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	85.7%	84.2%	1.5	85.2%	83.4%	1.8
Underwriting expense ratio	22.4	20.2	2.2	21.6	20.8	0.8
Dividend ratio	0.5	0.4	0.1	0.5	0.6	(0.1)
Subtotal	108.6	104.8	3.8	107.3	104.8	2.5
Catastrophes ¹ :						
-September 2008 Hurricanes	0.1	11.9	(11.8)	-	4.1	(4.1)
-All other	0.5	0.9	(0.4)	1.1	1.8	(0.7)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(1.2)	(2.2)	1.0	(1.0)	(1.3)	0.3
Total combined ratio	108.0%	115.4%	(7.4)	107.4%	109.4%	(2.0)

¹ Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's 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 the three and nine months ended September 30, 2009 was 108.6% and 107.3%, respectively, increases of 3.8 points and 2.5 points over the same periods in 2008. The increase in the claims and claim adjustment expense ratio reflects a higher claims and claim adjustment expense ratio in the workers compensation and general liability lines of business due to increasing loss trends and discount accretion on prior year reserves, combined with declining earned premium. Contributing to the unfavorable variance in the quarter is an increase in non-catastrophe related property losses, partially offset by less discount accretion on the involuntary market pools' prior year reserves. The increase in the underwriting expense ratio is due to declining earned premium and a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the involuntary pools and general cost increases partially offset by reduced overhead absorption due to the impact of the Safeco acquisition and cost efficiencies.

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, 2009 was 108.0% and 107.4%, respectively, decreases of 7.4 points and 2.0 points from the same periods in 2008. The decreases in both periods reflect lower catastrophe losses, partially offset by lower favorable net incurred losses attributable to prior years and the changes in the combined ratio previously discussed. Net incurred losses attributable to prior years were impacted by a reduction in prior year earned premium due to a state workers compensation reinsurance association ceded premium assessment and a reduction in earned but not reported premium due to the economic downturn, partially offset by involuntary pool workers compensation reserve weakening.

CORPORATE AND OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Certain internal discontinued operations composed of: asbestos, environmental, and toxic tort exposures, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation, certain distribution channels related to PruPac, pre-2004 Commercial Markets assumed voluntary reinsurance business and Commercial Markets pre-2005 fully insured workers compensation business.
- Interest expense on the Company's outstanding debt.
- Certain risks of its SBUs that the Company reinsures as part of its risk management program.
- The Company reports its written premiums on workers compensation contracts on the "booked as billed" method. Commercial Markets and Agency Markets report workers compensation 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.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Reinsurance, net	(\$348)	\$40	NM	(\$816)	\$180	NM
Workers compensation ¹	44	59	(25.4%)	(6)	(30)	(80.0%)
Other	-	3	(100.0)	2	5	(60.0)
Total net written premium	(\$304)	\$102	NM	(\$820)	\$155	NM

¹Booked as billed adjustment
 NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2009 was (\$304) million and (\$820) million, respectively, decreases of \$406 million and \$975 million from the same periods in 2008. The decreases in both periods are primarily driven by an increase in externally ceded reinsurance. In the fourth quarter of 2008, the Company entered into a reinsurance contract where the Company cedes a pro rata portion of consolidated U.S. direct written homeowners premiums. The impact of this contract on net written premium was (\$321) million and (\$824) million in the quarter and year-to-date, respectively. The decrease in both periods also reflects a reduction in internal reinsurance and an increase in external reinsurance, excluding the previously mentioned treaty, of \$67 million and \$172 million, respectively. The quarter and year-to-date also reflect the impact of the Company's workers compensation "booked as billed" adjustment.

Results of Operations – Corporate and Other

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2009	2008	Change	2009	2008	Change
Revenues	(\$222)	(\$116)	(91.4%)	(\$1,172)	\$230	NM
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years and private equity (loss) income:	(\$212)	(\$15)	NM	(\$659)	(\$82)	NM
Catastrophes ¹ :						
-September 2008 Hurricanes	1	(80)	NM	(12)	(80)	(85.0%)
-All other ²	1	(1)	NM	3	(11)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental ³	(361)	(1)	NM	(364)	(5)	NM
- All other ⁴	(31)	(7)	NM	(44)	(27)	(63.0%)
Pre-tax operating loss before private equity (loss) income	(602)	(104)	NM	(1,076)	(205)	NM
Private equity (loss) income ⁵	(5)	10	NM	(398)	128	NM
Pre-tax operating loss	(\$607)	(\$94)	NM	(\$1,474)	(\$77)	NM

- Catastrophes include all current and prior year catastrophe losses 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 \$1 million and \$3 million for the three and nine months ended September 30, 2009 and \$5 million and \$6 million for the comparable periods of 2008.
- Catastrophe losses ceded under the homeowners quota share treaty are included to the extent that the ceded combined ratio exceeds 100.0%.
- Net of allowance for uncollectible reinsurance reduction of (\$70) million for the three and nine months ended September 30, 2009, and zero and \$7 million for the comparable periods of 2008.
- Net of amortization of deferred gains on retroactive reinsurance of \$5 million and \$15 million for the three and nine months ended September 30, 2009 and 2008, respectively.
- Private equity (loss) income is included in net investment income in the accompanying statements of income.

NM = Not Meaningful

Pre-tax operating loss for the three and nine months ended September 30, 2009 was \$607 million and \$1.474 billion, increases of \$513 million and \$1.397 billion over the same periods in 2008. The increases in both periods are driven by ceded premium (and losses and expenses) related to the restructuring of treaties in the Company's reinsurance program, lower net investment income due to reduced valuations for investments in limited partnerships and limited liability companies, an increase in asbestos reserves in the third quarter of 2009, higher employee benefit costs and interest expenses, partially offset by favorable variable annuity reserve development versus unfavorable development in prior periods and gains on early extinguishment of debt.

Revenues for the three and nine months ended September 30, 2009 were (\$222) million and (\$1.172) billion, respectively, compared to (\$116) million and \$230 million in the same periods in 2008. The major components of revenues include net premium earned, net investment income, and fee and other revenues.

Net (ceded) premium earned for the three and nine months ended September 30, 2009 was (\$269) million and (\$766) million, respectively, decreases of \$320 million and \$907 million from the same periods in 2008. The decreases in both periods primarily reflect ceded premium related to the homeowners quota share treaty and the restructuring of other treaties in the Company's reinsurance program.

Net investment loss for the three and nine months ended September 30, 2009 was \$58 million and \$534 million, respectively, compared to income of \$1 million and \$174 million in the same periods in 2008. The decrease in both periods primarily reflects decreases in limited partnership income reflecting reduced valuations, decrease in dividend income reflecting a change in investment strategy to reduce the total equity portfolio exposure, and an increase in investment expenses. These increases were partially offset by the impact of a higher invested asset base resulting from the Safeco acquisition in the third quarter of 2008 and continued reinvestment of cash flows from operations.

Fee and other revenues for the three and nine months ended September 30, 2009 were \$65 million and \$108 million, increases of \$30 million and \$9 million over the same periods in 2008. The increases in both periods primarily reflect gains on early extinguishment of debt of \$48 million and \$59 million, in the quarter and year-to-date, respectively, partially offset by a decrease in oil and gas revenues due to price declines.

Claims, benefits and expenses for the three and nine months ended September 30, 2009 were \$345 million and \$282 million, respectively, an increase of \$164 million and a decrease of \$209 million versus the same periods in 2008. The increase in the quarter is driven by an increase in asbestos reserves and other corporate expenses primarily related to employee benefits. Offsetting the increase in the quarter are higher ceded losses and expenses associated with the homeowners quota share treaty. The decrease year-to-date primarily reflects higher ceded losses and expenses associated with the restructuring of treaties in the Company's reinsurance program and favorable variable annuity reserve development versus unfavorable development in prior periods, partially offset by the previously mentioned increase in asbestos reserves, higher interest expense as a result of the Company's May 2008 debt offering and other corporate expenses primarily related to employee benefits.

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, 2009 and December 31, 2008:

\$ in Millions	As of September 30, 2009		As of December 31, 2008	
	Carrying Value	% of Total	Carrying Value	% of Total
Invested Assets by Type				
Fixed maturities, available for sale, at fair value	\$55,958	84.9%	\$47,731	79.9%
Equity securities, available for sale, at fair value	1,112	1.7	1,184	2.0
Trading securities, at fair value	1	-	1	-
Limited partnerships and LLCs	2,412	3.7	2,534	4.2
Commercial mortgage loans	1,053	1.6	1,090	1.8
Short-term investments	580	0.9	1,193	2.0
Other investments	168	0.3	194	0.3
Cash and cash equivalents	4,599	6.9	5,848	9.8
Total invested assets	\$65,883	100.0%	\$59,775	100.0%

Total invested assets as of September 30, 2009 were \$65.883 billion, an increase of \$6.108 billion or 10.2% over December 31, 2008. The increase reflects investment of cash from operations and an increase in unrealized gains primarily due to a decrease in credit spreads. Partially offsetting the increase was a decline in the valuations of private equity investments.

Fixed maturities as of September 30, 2009 were \$55.958 billion, an increase of \$8.227 billion or 17.2% over December 31, 2008. The increase reflects market value increases, foreign currency exchange rates, and additional purchases of fixed income securities.

Equity securities available for sale as of September 30, 2009 were \$1.112 billion (\$655 million common stock and \$457 million preferred stock versus \$694 million common stock and \$490 million preferred stock as of December 31, 2008), a decrease of \$72 million or 6.1% from December 31, 2008. Of the \$655

million of common stock at September 30, 2009, \$265 million 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 common equities in the first quarter, partially offset by market appreciation.

Investments in limited partnerships and LLCs as of September 30, 2009 were \$2.412 billion, a decrease of \$122 million or 4.8% from December 31, 2008. These investments consist of traditional private equity partnerships of \$1.456 billion, other partnerships (primarily energy) of \$544 million, and real estate partnerships of \$412 million. The decrease from December 31, 2008 primarily reflects a decline in market value recorded in the first quarter of 2009. 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, 2009 were \$1.053 billion (net of \$5.4 million of loan loss reserves or 0.5% of the outstanding loan portfolio), a decrease of \$37 million or 3.4% from December 31, 2008. The decrease primarily reflects \$32 million in principal repayments. The entire commercial loan portfolio is U.S. based. As of September 30, 2009, the average total loan size was \$1.5 million and the average loan participation size was \$0.5 million. The number of loans in the portfolio decreased from 2,257 at December 31, 2008 to 2,203 at September 30, 2009. Approximately 92% of the loans are full or partial recourse to borrowers.

Short term investments as of September 30, 2009 were \$580 million, a decrease of \$613 million or 51.4% from December 31, 2008. This decrease reflects a decline in short term assets held as collateral in connection with the Company's security lending program and the acquisition of longer duration securities.

Cash and cash equivalents as of September 30, 2009 were \$4.599 billion, a decrease of \$1.249 billion or 21.4% from December 31, 2008. This decrease reflects the purchase of long-term securities partially offset by cash generated from operations and the previously mentioned equity security sales.

Regarding fair value measurements, as of September 30, 2009, excluding separate accounts and other assets, the Company reflected \$2.066 billion as level 1 (quoted prices in active markets) primarily comprised of U.S. Treasuries and common equity securities. The majority of the Company's invested assets are reported as level 2 (quoted prices from other observable inputs). As of September 30, 2009, the Company reported \$54.542 billion as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported \$1.172 billion as level 3 (unobservable inputs), primarily comprised of international and privately held securities for which a market price is not readily available.

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

As of September 30, 2009, 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 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

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

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of September 30, 2009:

\$ in Millions	As of September 30, 2009							
	AAA	AA	A	BBB	BB	B or Lower	Total	% of Total
Mortgage & Asset-Backed Fixed Maturities by Credit Quality								
SBA loans	\$1,349	\$-	\$-	\$-	\$-	\$-	\$1,349	9.1%
GNMA residential mortgage	4,032	-	-	-	-	-	4,032	27.3
FNMA residential mortgage	2,439	-	-	-	-	-	2,439	16.5
FHLMC residential mortgage	3,675	-	-	-	-	-	3,675	24.9
Prime residential mortgage	211	-	19	24	17	143	414	2.8
Alt-A residential mortgage	62	-	3	3	11	106	185	1.3
Sub-prime residential mortgage	11	6	12	19	-	12	60	0.4
Commercial mortgage backed securities	2,036	119	54	10	-	-	2,219	15.0
Non-mortgage asset backed securities	287	32	36	24	19	7	405	2.7
Total	\$14,102	\$157	\$124	\$80	\$47	\$268	\$14,778	100.0%
% of Total	95.4%	1.1%	0.8%	0.5%	0.3%	1.9%	100.0%	

More than 77% 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). During 2009, the Company has moved some of its liquidity into longer-term mortgage backed securities. GNMA's increased \$3.129 billion, reflecting acquisitions in 2009 as part of the Company's overall strategy to improve liquidity and reduce credit risk. Over 95% of the mortgage & asset-backed holdings are rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with 97.1% rated AA or above, approximately 20% of the underlying collateral having been defeased with U.S. Treasuries, and less than 10% of the 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, 2009 and December 31, 2008:

\$ in Millions	As of September 30, 2009		As of December 31, 2008	
	Fair Value	% of Total	Fair Value	% of Total
Fixed Maturities by Credit Quality¹				
AAA	\$24,521	43.8%	\$21,786	45.6%
AA+, AA, AA-	10,040	18.0	9,162	19.2
A+, A, A-	10,524	18.8	9,156	19.2
BBB+, BBB, BBB-	6,455	11.5	4,776	10.0
BB+, BB, BB-	1,997	3.6	1,575	3.3
B+, B, B-	1,697	3.0	897	1.9
CCC or lower	724	1.3	379	0.8
Total fixed maturities	\$55,958	100.0%	\$ 47,731	100.0%

¹For purposes of this disclosure, credit quality is primarily based upon Standard & Poor's ratings.

The Company's allocation to investment grade securities decreased slightly to 92.1% at September 30, 2009 from 94.0% December 31, 2008. The Company had 7.9% of its fixed maturity securities invested in non-investment grade securities at September 30, 2009, an increase of 1.9% primarily due to significant tightening of non-investment grade credit spreads and downgrades on investment grade securities. Overall, the average credit quality rating stands at AA-.

The Company's holdings of below investment grade securities primarily consist of an actively managed diversified portfolio of high yield securities and loans within the domestic insurance portfolios and 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, 2009 and December 31, 2008:

\$ in Millions	As of September 30, 2009		As of December 31, 2008	
	Fair Value	% of Total	Fair Value	% of Total
Fixed Maturities by Maturity Date				
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%

During 2009, 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 duration 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, 2009 and 2008:

\$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net Investment Income				
Taxable interest income	\$572	\$580	\$1,697	\$1,729
Tax-exempt interest income	157	104	466	316
Dividends	9	18	32	73
Limited partnerships and limited liability companies	(5)	10	(398)	128
Commercial mortgage loans	17	14	50	36
Other investment income	2	7	8	18
Gross investment income	752	733	1,855	2,300
Investment expenses	(42)	(28)	(111)	(84)
Net investment income	\$710	\$705	\$1,744	\$2,216

Net investment income for the three and nine months ended September 30, 2009 was \$710 million and \$1.744 billion, respectively, an increase of \$5 million and a decrease of \$472 million versus the same periods in 2008. Net investment income increased in both periods primarily due to a higher invested asset base resulting from the Safeco acquisition in the third quarter of 2008 and continued reinvestment of cash flows from operations. These increases were offset by decreases in limited partnership income reflecting reduced valuations, a decrease in dividend income reflecting a change in investment strategy to reduce the total equity portfolio exposure, and an increase in investment expenses due to the Safeco acquisition, strategic initiatives and variable compensation costs.

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, 2009 and 2008:

\$ in Millions	Sales & Dispositions	Impairments	Change in Derivatives Value	Total
Net Realized Investment Gains (Losses)				
Three Months Ended September 30, 2009:				
Fixed maturities	\$56	(\$35)	\$-	\$21
Common and preferred stock	24	-	-	24
Other	(10)	-	-	(10)
Total	\$70	(\$35)	\$-	\$35
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)
Nine months ended September 30, 2009:				
Fixed maturities	\$53	(\$161)	\$-	(\$108)
Common and preferred stock	114	(44)	-	70
Other	32	(5)	25	52
Total	\$199	(\$210)	\$25	\$14
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)

\$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Components of Net Realized Investment Gains (Losses)				
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)

Net realized investment gains for the three and nine months ended September 30, 2009 were \$35 million and \$14 million, respectively, versus losses of \$249 million and \$256 million in the same periods in 2008. The increase in both periods reflects impairment losses recorded in 2008 on fixed maturity and equity investments related to securities deemed to be other than temporarily impaired due to the market conditions. Partially offsetting this were gains recorded in 2008 related to derivative contracts the Company used to hedge its equity exposure and a 2008 gain from the sale of an investment property.

Effective January 1, 2009, the Company adopted FASB Staff Position FAS 115-2 and 124-2 *Recognition and Presentation of Other-Than-Temporary Impairments*. See Footnote 1 to the Unaudited Financial Statements as of and for the three and nine months ended September 30, 2009 for details. In the first quarter of 2009, the Company recorded a cumulative effect adjustment, net of income taxes, in the amount of \$28 million. The adjustment was an increase to policyholders' unassigned equity and a corresponding decrease to accumulated other comprehensive income.

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

\$ in Millions	Three Months Ended September 30, 2009				
	Fixed Maturities	Preferred Stock	Common Stock	Other	Total by Issuer
American International Group	(\$14)	\$-	\$-	\$-	(\$14)
Hawker Beechcraft	(8)	-	-	-	(8)
Tenneco	(5)	-	-	-	(5)
Total other	(8)	-	-	-	(8)
Total by Security Type	(\$35)	\$	\$	\$	(\$35)

\$ in Millions	Nine Months Ended September 30, 2009				
	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)
Total 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:

\$ in Millions	Less Than 12 Months		Greater Than 12 Months	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
Unrealized Losses & Fair Value by Security Type				
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 billion as of December 31, 2008 to \$970 million as of September 30, 2009 primarily due to a decrease in credit spreads. Unrealized losses less than 12 months decreased from \$1.869 billion at December 31, 2008 to \$131 million as of September 30, 2009 and accounted for \$1.738 billion of the overall decrease in unrealized losses. Unrealized losses greater than 12 months decreased from \$1.686 billion to \$839 million at December 31, 2008 and September 30, 2009 respectively, a decrease of \$847 million. Included in the \$839 million of unrealized losses were \$513 million 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 that 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. The total impairment losses for the three and nine months ended September 30, 2009 were \$35 million and \$210 million, respectively, a decrease of \$392 million and \$312 million versus the same periods in 2008. Of the \$35 million and \$161 million of fixed maturity impairments recognized for the three and nine months ended September 30, 2009, respectively, (\$12) million and \$16 million were recognized as changes to non-credit impairments.

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 million and \$161 million, 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.

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 million 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.

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 while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. The Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of September 30, 2009 (including cash and cash equivalents) totaled \$65.883 billion.

Short-term debt outstanding as of September 30, 2009 and December 31, 2008 was as follows:

\$ in Millions	As of September 30, 2009	As of December 31, 2008
Commercial paper	\$-	\$-
Revolving credit facilities	-	-
Current maturities of long-term debt ¹	300	-
Total short-term debt obligations	\$300	\$-

¹ Reflects debt originally issued by Safeco. On December 29, 2008, \$281 million of the outstanding \$300 million 4.875% notes due 2010 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.

The increase in short-term debt reflects an increase in the current maturities of long-term debt related to the 4.875% notes maturing in February of 2010.

Long-term debt outstanding at September 30, 2009 and December 31, 2008 was as follows:

\$ in Millions	As of September 30, 2009	As of 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
Subtotal	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 million of the outstanding \$300 million, 4.875% notes due 2010 and \$187 million of the outstanding \$204 million, 7.25% notes due 2012 were exchanged for a like principal amount of newly issued LMGI notes.

² Reflects debt originally issued by Ohio Casualty Corporation ("Ohio Casualty"). On December 29, 2008, \$180 million of the outstanding \$200 million, 7.30% notes due 2014 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.

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

Debt Transactions and In-force Credit Facilities

On September 1, 2009, LMIC ("LMIC") renewed its existing \$750 million, 364-day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

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

The Company places commercial paper through a \$1 billion program issued by LMGI and guaranteed by LMIC. The program is backed by two revolving credit facilities totaling \$750 million. On February 24, 2009, LMGI entered into a \$30 million unsecured revolving credit facility, which terminates on July 25, 2010. On March 16, 2009, the five-year \$750 million credit facility, which also terminates on July 25,

2010, was amended to remove a lender with a \$30 million commitment in the facility. To date, no funds have been borrowed under either facility.

On December 29, 2008, the following transactions occurred:

- LMGI exchanged \$281 million of the outstanding \$300 million 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 million of the outstanding \$204 million 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 million of the outstanding \$200 million Ohio Casualty 7.30% Senior Notes due 2014 for a like principal amount of newly issued LMGI 7.30% Senior Notes due 2014.

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. In connection with the consents, LMGI paid approximately \$5.6 million in consideration to the noteholders. These costs were capitalized and will be amortized into income over the remaining term of the respective newly issued LMGI Senior Notes. The supplemental indenture eliminated substantially all restrictive covenants and eliminated or modified certain events of default.

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 Series C 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 Series C 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).

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.

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a \$20 million 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.

Interest Expense

Consolidated interest expense for the three and nine months ended September 30, 2009 was \$119 million and \$364 million, respectively, increases of \$5 million and \$74 million over the same periods in 2008. The increases were principally due to the Series C Notes and debt resulting from the Safeco acquisition partially offset by the previously mentioned debt repurchases occurring in 2009. As previously discussed, the Company continues to evaluate market conditions and may periodically effect transactions in its debt, subject to applicable limitations. Future debt repurchases may be done through open market or other appropriate transactions.

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, 2009, the Company, through its downstream subsidiary LMGI, had \$5.073 billion of debt outstanding, excluding discount.

The insurance subsidiaries' ability to pay dividends on preferred or common stock 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 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, 2008) and 2009 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

\$ in Millions	RBC Ratio¹		Dividend Capacity²
	2008	2007	2009
RBC Ratios and Dividend Capacity			
LMIC ³	402%	519%	\$1,363
LMFIC ³	501%	507%	\$86
EICOW ³	362%	516%	\$95

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 as of September 30, 2009.

³ Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group. Effective January 1, 2009, the LMIC pooling percentage decreased from 75.9% to 75.0%, the LMFIC pooling percentage increased from 10.0% to 12.9%, and the EICOW pooling percentage decreased from 10.0% to 8.0%.

As of January 1, 2009, LMGI also has access to the following sources of funding:

- A management services agreement with LMIC pursuant to which LMGI is entitled to collect certain costs plus a management fee for services rendered by LMGI employees, with annual fee estimated to be approximately \$50 million.
- Liberty Corporate Services LLC ("LCS"), which through its subsidiaries, collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three and nine months ended September 30, 2009, LCS recorded \$118 million and \$275 million in pre-tax income, respectively.
- Approximately \$80 million of annual dividends related to non-redeemable perpetual preferred stock issuances by LMIC and LMFIC.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was \$13.701 billion and \$12.330 billion at September 30, 2009, and December 31, 2008, respectively. The increase in surplus primarily reflects net income of \$338 million (the sum of earnings from the Company's 63 domestic insurance companies and dividends from subsidiaries), unrealized gains of \$725 million, and an increase in other changes in surplus of \$405 million primarily related to change in non-admitted goodwill from acquisitions and deferred tax assets, partially offset by surplus note repurchases of \$97 million.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP 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 2008 tables to conform to the 2009 tables.

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 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 in the Unaudited Consolidated Financial Statements as of and for the three and nine months ended September 30, 2009 for further detail.

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 million (net of tax) to policyholders' unassigned equity and a corresponding

decrease to accumulated comprehensive loss. See Note 1 in the Unaudited Consolidated Financial Statements as of and for the three and nine months ended September 30, 2009 for further detail.

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 in the Unaudited Consolidated Financial Statements as of and for the three and nine months ended September 30, 2009 for further detail.

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 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 million.

None of the other accounting standards adopted by the Company through the third quarter of 2009 had a material impact on the Company. See Note 1 in the Unaudited Consolidated Financial Statements as of and for the three and nine months ended September 30, 2009 for further detail.

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.

None of the other new accounting standards that will be adopted by the Company in 2009 are expected to have a material impact on the Company. See Note 1 in the 2009 Unaudited Consolidated Financial Statements for details.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were \$49.3 billion and \$48.7 billion at September 30, 2009 and December 31, 2008, 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 asbestos and environmental (A&E) reserves for unpaid claims and claim adjustment expenses, net of reinsurance and including uncollectible reinsurance, increased \$242 million from \$1.396 billion as of December 31, 2008 to \$1.638 billion as of September 30, 2009. The increase is primarily due to the completion of the Company's biennial ground-up asbestos reserve study and the settlement, subject to court approval, of the Company's remaining tier one or two exposure, partially offset by payments during the period.

In the third quarter of 2009, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal review, potential exposures of certain policyholders were individually evaluated using the company's proprietary stochastic model, which is consistent with 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.

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 acquired PruPac in 2003 and any increase in A&E reserves is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial Inc.

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties; the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding 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 \$15.414 billion and \$15.309 billion at September 30, 2009 and December 31, 2008, respectively, net of allowance for doubtful accounts. The increase is primarily due to the purchase of additional quota share protection for 2009.

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 94% 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, 2009. Collateral held against outstanding gross reinsurance recoverable balances was \$5.825 billion and \$5.418 billion at September 30, 2009 and December 31, 2008, respectively.

The remaining 6% 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, 2009.

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, 2009, and December 31, 2008, deferred gains related to these reinsurance arrangements were \$701 million and \$725 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, 2009 was \$29 million and \$87 million, respectively, as compared to \$30 million and \$89 million 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 million and \$50 million respectively, as compared to \$16 million and \$49 million 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 billion and \$2.165 billion as of 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 million 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 million of the original \$525 million of Mystic Re matured. As of May 31, 2009, the remaining \$200 million 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 million 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 million 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 million of collateral. The Company has not recorded any recoveries under these programs.

Impairment Losses on Investments

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 that 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. The total fixed income and equity impairment losses for the three and nine months ended September 30, 2009 were \$35 million and \$210 million, respectively, a decrease of \$392 million and \$312 million versus the same periods in 2008. Of the \$35 million and \$161 million of fixed maturity impairments recognized for the three and nine months ended September 30, 2009, respectively, (\$12) million and \$16 million were recognized as changes to non-credit impairments.

The Company reviews fixed income, public equity securities and private equity and private equity co-investment securities for impairment on a quarterly basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to: (a) the extent of the decline in fair value below book value, (b) the duration of the decline, (c) significant adverse changes in the financial condition or near term prospects of the investment or issuer, (d) significant change in the business climate or credit ratings of the issuer, (e) general market conditions and volatility, (f) industry factors, and (g) the past impairment of the security holding or the issuer. For fixed income securities where the Company does not expect to recover the entire amortized cost basis of the security, the Company will evaluate whether the other-than-temporary is a credit or a non-credit impairment based on the guidance outlined in FSP FAS 115-2. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the debt security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration, (e) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all debt securities and certain preferred equity securities) or the Company's intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in market value.

Subsequent to 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 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 variable interest entities ("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 million and \$623 million at September 30, 2009 and December 31, 2008, respectively. The Company's maximum exposure to losses from VIEs was \$1.208 billion and \$1.267 billion 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 million.

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 million. All futures contracts concluded in March 2008 and the Company realized gains of \$26 million on these transactions. Subsequent to the above transactions, the Company entered into a \$600

million notional equity swap agreement. For the nine months ended September 30, 2008 the Company recognized a \$90 million 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 million on this transaction. In August 2008, the Company entered into two additional equity swap agreements with a total notional amount of \$335 million. These contracts matured in January 2009 resulting in realized gains of \$25 million for the nine months ended September 30, 2009.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were \$2.607 billion and \$2.541 billion as of September 30, 2009 and December 31, 2008, 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 acquisitions of Ohio Casualty and Safeco that equal the fair value of in-force insurance contracts at the date of acquisition. Amortization of these assets will occur over the remaining policy term.

Goodwill

Goodwill assets were \$4.750 billion and \$4.645 billion at September 30, 2009 and December 31, 2008, respectively. Goodwill is tested for impairment at least annually (performed in the fourth quarter) using a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount is not recoverable from the discounted cash flows using a “market” rate and is measured as the difference between the carrying amount and the implied fair value. Other changes in the carrying amount of goodwill are primarily caused by foreign currency translation adjustments and adjustments to valuation allowances for acquired tax losses.

Deferred Income Taxes

The net deferred income tax asset was \$1.820 billion and \$3.166 billion as of September 30, 2009 and December 31, 2008, respectively, net of a valuation allowance of \$160 million and \$131 million, respectively. The net increase in the Company’s valuation allowance is primarily due to increases in foreign currency translation adjustments. 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 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 (amounts in millions):

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	<u>\$270</u>

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

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

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

On October 15, 2008, the Company prevailed in its suit for refund of overpaid federal income tax for the 1990 tax year, 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. On June 10, 2009, the United States Court of Appeals for the First Circuit entered a judgment that dismissed the Government's notice of appeal.

The IRS is currently reviewing the Company's federal tax returns for the 1999 through 2005 tax years. The IRS is also reviewing Safeco Corporation and subsidiaries' federal tax returns for the 2005 through 2007 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 fifth largest property and casualty insurer in the U.S. based on 2008 direct written premium. The Company also ranks 86th on the Fortune 500 list of largest corporations in the United States based on 2008 revenue. As of December 31, 2008, LMG had \$104.316 billion in consolidated assets, \$94.156 billion in consolidated liabilities, and \$28.855 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 substantially all of its business through four strategic business units: 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.