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

Quarter Ended September 30, 2010

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, 2010 and 2009. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2009 Annual Report, 2010 Unaudited Consolidated Financial Statements and Third Quarter 2010 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 principles ("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.

Some of the factors that could cause actual results to differ include, but are not limited to the following: the occurrence of catastrophic events (including terrorist acts, hurricanes, hail, tornados, snowfall and winter conditions); inadequacy of loss reserves; adverse developments involving asbestos, environmental or toxic tort claims and litigation; adverse developments in the cost, availability or ability to collect reinsurance; disruptions to the Company's relationships with its independent agents and brokers; financial disruption or a prolonged economic downturn; the performance of the Company's investment portfolios; a rise in interest rates; risks inherent in the Company's alternative investments in private limited partnerships and limited liability companies; difficulty in valuing certain of the Company's investments; subjectivity in the determination of the amount of impairments taken on the Company's investments; unfavorable outcomes from litigation and other legal proceedings, including the effects of emerging claim and coverage issues and investigations by state and federal authorities; the Company's exposure to credit risk in certain of its business operations; terrorist acts; the Company's inability to obtain price increases or maintain market share due to competition or otherwise; inadequacy of the Company's pricing models; changes to insurance laws and regulations; changes in the amount of statutory capital that the Company must hold to maintain its financial strength and credit ratings; regulatory restrictions on the Company's ability to change its methods of marketing and underwriting in certain areas; assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings; the ability of the Company's subsidiaries to pay dividends to the Company; inflation, including inflation in medical costs and automobile and home repair costs; the cyclicality of the property and casualty insurance industry; political, legal, operational and other risks faced by the Company's international business; potentially high severity losses involving the Company's surety products; loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of personal lines policies; inadequacy of the Company's controls to ensure compliance with legal and regulatory standards; changes in federal or state tax laws; risks arising out of the Company's securities lending program; the Company's utilization of information technology systems and its implementation of technology innovations; difficulties with technology or data security; insufficiency of the Company's business continuity plan in the event of a disaster; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions; insufficiency of the Company's enterprise risk management models and modeling techniques; and changing climate conditions. The Company's forward looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs. For a detailed discussion of these and other cautionary statements, visit the Company's Investor Relations website at www.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, 2010 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2010 were $8.387 billion, an increase of $471 million or 5.9% over the same period in 2009.
- Net written premium for the three months ended September 30, 2010 was $7.720 billion, an increase of $513 million or 7.1 % over the same period in 2009.
- Pre-tax operating income before private equity income for the three months ended September 30, 2010 was $513 million, an increase of $259 million or 102.0% over the same period in 2009.
- Pre-tax operating income for the three months ended September 30, 2010 was $658 million, an increase of $409 million or 164.3% over the same period in 2009.
- Net income for the three months ended September 30, 2010 was $567 million, an increase of $307 million or 118.1% over the same period in 2009.
- Cash flow from operations for the three months ended September 30, 2010 was $709 million, an increase of $129 million or 22.2% over the same period in 2009.
- The combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2] for the three months ended September 30, 2010 was 98.6%, an increase of 0.1 points over the same period in 2009. 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, 2010 decreased 1.6 points to 99.2%.

Nine Months Ended September 30, 2010 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2010 were $24.643 billion, an increase of $1.491 billion or 6.4 % over the same period in 2009.
- Net written premium for the nine months ended September 30, 2010 was $22.212 billion, an increase of $1.073 billion or 5.1% over the same period in 2009.
- Pre-tax operating income before private equity income for the nine months ended September 30, 2010 was $1.000 billion, a decrease of $67 million or 6.3% from the same period in 2009.
- Pre-tax operating income for the nine months ended September 30, 2010 was $1.234 billion, an increase of $565 million or 84.5% over the same period in 2009.

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[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, 2010 was $1.102 billion, an increase of $552 million or 100.4% over the same period in 2009.

- Cash flow from operations for the nine months ended September 30, 2010 was $1.754 billion, an increase of $186 million or 11.9% over the same period in 2009.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2010 was 98.1%, a decrease of 0.7 points from the same period in 2009. 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, 2010 increased 1.8 points to 102.0%.

Financial Condition as of September 30, 2010

- Total assets were $112.889 billion as of September 30, 2010, an increase of $3.414 billion over December 31, 2009.

- Policyholders' equity was $16.863 billion as of September 30, 2010, an increase of $2.349 billion over December 31, 2009.

- Total debt was $5.638 billion as of September 30, 2010, a decrease of $302 million from December 31, 2009.

Other 2010 3rd Quarter Highlights

- On September 29, 2010, the Company issued a press release announcing its decision to postpone the initial public offering of stock in Liberty Mutual Agency Corporation ("LMAC"). Effective in the third quarter of 2010, for financial reporting purposes, LMAC became a Strategic Business Unit of Liberty Mutual Group replacing the former Agency Markets Strategic Business Unit.

Subsequent Events

- On November 3, 2010, the Company and Videocon Industries Ltd. announced their mutual intent to establish a non-life insurance joint venture company in India to provide personal and commercial insurance products through a range of distribution channels. The two companies intend to begin the licensing application process for the new company before the end of this year.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI") and PTOI before private equity income (loss) 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 before private equity income (loss) is defined as PTOI excluding limited partnership results recognized on the equity method. PTOI before private equity income (loss) and PTOI are considered by the Company to be appropriate indicators of underwriting and operating results and are consistent with the way the Company internally evaluates performance. Net realized investment gains (losses) and limited partnership results are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results and the timing and amount of integration and other acquisition related costs are not connected to our management of the insurance and underwriting aspects of our business. 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.

Effective January 1, 2010, the Company's Venezuelan operations began applying hyper-inflationary accounting, utilizing the U.S. dollar as the functional currency, which had no impact on consolidated policyholders' equity at January 1, 2010. However, on January 8, 2010, the Venezuelan government devalued its currency, announcing that the fixed official exchange rate would be changed to a dual exchange rate system. This dual exchange rate system for the fixed official exchange rate includes a 2.60 Bolivar Fuerte (BsF) rate to 1 U.S. dollar for food and other items as mandated by the Venezuelan government, and a 4.30 BsF to 1 U.S. dollar rate for all other items. The impact of the devaluation accounting on pre-tax operating income in the quarter and year-to-date ended September 30, 2010 was an increase of $44 million and $124 million, respectively.

Additionally, while the devaluation has, in U.S. dollars, reduced net written premium and loss and loss adjustment expense reserves in 2010 compared to the prior period, the impact on consolidated policyholders' equity is not material.

On September 29, 2010, the Company issued a press release announcing its decision to postpone the initial public offering of stock in LMAC. Effective in the third quarter of 2010, for financial reporting purposes, LMAC became a Strategic Business Unit of Liberty Mutual Group replacing the former Agency Markets Strategic Business Unit. The financial results of LMAC differ from Agency Markets' results principally due to LMAC maintaining a dedicated investment portfolio, the inclusion of the impact of a homeowners quota share treaty effective December 31, 2008 through December 31, 2009, the results of which were previously shown in our Corporate and Other segment, and certain expenses incurred that are specific to LMAC. As such, results of LMAC are not directly comparable to the previously reported financial information for Agency Markets. All historical results have been restated to reflect this change.

Overview – Consolidated

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
Private passenger automobile	$2,710	$2,575	5.2%	$7,646	$7,338	4.2%
Workers compensation	1,003	992	1.1	2,964	3,078	(3.7)
Homeowners	826	607	36.1	2,207	1,589	38.9
Commercial multiple peril / fire	640	603	6.1	1,834	1,804	1.7
International local businesses	455	451	0.9	1,306	1,348	(3.1)
Commercial automobile	389	400	(2.8)	1,186	1,184	0.2
LIU[1] reinsurance	292	199	46.7	945	789	19.8
General liability	337	316	6.6	934	922	1.3
Surety	203	201	1.0	566	538	5.2
Group disability and life	173	155	11.6	515	453	13.7
LIU inland marine program	172	147	17.0	497	473	5.1
LIU third party	160	199	(19.6)	483	513	(5.8)
LIU first party	71	61	16.4	231	209	10.5
Individual life	54	82	(34.1)	194	218	(11.0)
Assumed voluntary reinsurance	45	43	4.7	138	125	10.4
Other[2]	190	176	8.0	566	558	1.4
Total NWP[3]	$7,720	$7,207	7.1%	$22,212	$21,139	5.1%

1 Liberty International Underwriters (“LIU”).
2 Primarily includes net written premium from allied lines and domestic inland marine.
3 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business.

Consolidated net written premium by Strategic Business Unit (“SBU”) was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
LMAC[1]	$2,821	$2,586	9.1%	$8,001	$7,561	5.8%
International	1,841	1,737	6.0	5,330	5,131	3.9
Personal Markets	1,848	1,767	4.6	5,159	4,810	7.3
Commercial Markets[1]	1,337	1,279	4.5	4,085	4,100	(0.4)
Corporate and Other[2]	(127)	(162)	(21.6)	(363)	(463)	(21.6)
Total net written premium (NWP)	$7,720	$7,207	7.1%	$22,212	$21,139	5.1%
Foreign exchange effect on growth, excluding Venezuelan devaluation			(0.1%)			0.7%
Venezuelan devaluation			(3.9)			(3.4)
Total foreign exchange effect on growth			(4.0)			(2.7)
NWP growth excluding foreign exchange and Venezuelan devaluation			11.1%			7.8%

1 Effective January 1, 2010, net written premium associated with Summit, previously included in LMAC, is included in Commercial Markets. The prior periods have been restated to reflect this change.
2 Includes internal and external reinsurance including Personal Markets homeowners quota share reinsurance treaties entered into in the fourth quarter of 2009 and 2008, respectively. Excludes LMAC portion of homeowners quota share reinsurance treaties in 2009.

Major drivers of net written premium growth were as follows:

$ in Millions	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010	2009	$ Change	Points Attribution	2010	2009	$ Change	Points Attribution
LMG NWP	$7,720	$7,207	$513	7.1	$22,212	$21,139	$1,073	5.1
Components of Growth:								
-Domestic homeowners	1,006	928	78	1.1	2,686	2,413	273	1.3
-Homeowners quota share	(180)	(321)	141	2.0	(479)	(824)	345	1.6
Total Homeowners	826	607	219	3.1	2,207	1,589	618	2.9
International local businesses (excluding foreign exchange)	1,435	1,137	298	4.1	3,868	3,243	625	3.0
Domestic personal auto	2,013	1,889	124	1.7	5,693	5,443	250	1.2
Group disability and life	173	155	18	0.2	515	453	62	0.3
Surety	203	201	2	-	566	538	28	0.1
Individual life	54	82	(28)	(0.4)	194	218	(24)	(0.1)
Foreign exchange and Venezuelan devaluation	(286)	-	(286)	(4.0)	(580)	-	(580)	(2.7)
Other commercial lines	3,302	3,136	166	2.4	9,749	9,655	94	0.4
Total LMG NWP	$7,720	$7,207	$513	7.1	$22,212	$21,139	$1,073	5.1

Consolidated net written premium by U.S. or foreign distribution channels were as follows:

$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Change	2010	2009	Change
U.S.	$6,158	$5,729	7.5%	$17,699	$16,792	5.4%
International[1]	1,562	1,478	5.7	4,513	4,347	3.8
Total NWP	$7,720	$7,207	7.1%	$22,212	$21,139	5.1%

1 Excludes domestically written business in the International SBU.

Net written premium for the three and nine months ended September 30, 2010 was $7.720 billion and $22.212 billion, increases of $513 million and $1.073 billion over the same periods in 2009. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $135 million and $308 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect policies in-force growth and rate increases in Personal Markets, the introduction of an annual auto product in 2010 and rate increases in LMAC, as well as organic growth in International's local businesses in Latin America mainly due to inflation in Venezuela. The increases were partially offset by a decline in Europe as a result of Spain's continuing economic contraction and the net impact of foreign exchange, approximately $143 million and $271 in the quarter and year-to-date, respectively.
- Workers compensation net written premium increased $11 million and decreased $114 million in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects premium adjustments on retrospectively rated policies in Commercial Markets, partially offset by a decrease in exposures and negative audit premium due to weak economic conditions and state mandated rate decreases in Florida. The year-to-date decrease primarily reflects the previously mentioned decrease in exposures, negative audit premium and the impact of competitive market conditions.

- Homeowners net written premium increased $219 million and $618 million in the quarter and year-to-date, respectively. The increases in both periods were primarily driven by the non-renewal of LMAC's portion of the homeowners quota share reinsurance treaty of $141 million and $357 million in the quarter and year-to-date, respectively, as well as higher premiums in Personal Markets due to policies in-force growth and rate increases, and in LMAC due to new business policy growth and rate increases.
- International local businesses net written premium (excluding private passenger automobile) increased $4 million and decreased $42 million in the quarter and year-to-date, respectively. The year-to-date decrease is attributable to foreign exchange decline driven by the Venezuelan devaluation (approximately $380 million) and the weakening of the Euro versus the U.S. dollar, partially offset by the weakening of the U.S. dollar versus other foreign currencies, and a decline in Europe due to Spain's continued economic contraction. The decrease was largely offset by premium growth in Venezuela, primarily due to inflation, and Brazil.
- LIU reinsurance net written premium increased $93 million and $156 million in the quarter and year-to-date, respectively. The increases primarily reflect growth in certain worldwide reinsurance and contingent lines.
- Group disability and life net written premium increased $18 million and $62 million in the quarter and year-to-date, respectively. The increases reflect broader penetration of those markets.
- LIU third party net written premium decreased $39 million and $30 million in the quarter and year-to-date, respectively. The decreases were attributable to an increase in ceded premium primarily due to a change in the structure of a reinsurance program, partially offset by growth in certain lines of business.
- LIU first party net written premium increased $10 million and $22 million in the quarter and year-to-date respectively. The increases were primarily driven by new business in the energy and construction lines in Asia and the U.S.

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

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

Results of Operations – Consolidated

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[2]**	**Change**	**2010[1]**	**2009[2]**	**Change**
Revenues	$8,387	$7,916	5.9%	$24,643	$23,152	6.4%
PTOI before catastrophes, net incurred losses attributable to prior years and private equity income	554	529	4.7	1,793	1,463	22.6
Catastrophes[3,4]	(127)	(160)	(20.6)	(945)	(622)	51.9
Net incurred losses attributable to prior years:						
- Asbestos & environmental[5]	(2)	(361)	(99.4)	(5)	(364)	(98.6)
- All other[6]	88	246	(64.2)	157	590	(73.4)
Pre-tax operating income before private equity income	513	254	102.0	1,000	1,067	(6.3)
Private equity income (loss) [7]	145	(5)	NM	234	(398)	NM
Pre-tax operating income	658	249	164.3%	1,234	669	84.5 %
Realized gains, net	86	35	145.7%	292	14	NM
Income tax expense	(177)	(24)	NM	(424)	(133)	NM
Net income	$567	$260	118.1%	$1,102	$550	100.4 %
Cash flow from operations	$709	$580	22.2%	$1,754	$1,568	11.9%

1 Effective January 1, 2010, the Venezuelan operations of the Company's International SBU began applying hyper-inflationary accounting, utilizing the U.S. dollar as the functional currency.
2 2009 results have been restated for the retrospective accounting change related to the change in the discount rate applied to the long-term indemnity portion of the settled unpaid workers compensation claims.
3 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.
4 Catastrophes exclude the catastrophe losses ceded under the homeowners quota share agreement.
5 Net of allowance for uncollectible reinsurance increase of zero and $2 million for the three and nine months ended September 30, 2010 and an increase of $70 million for the three and nine months ended September 30, 2009.
6 Net of earned premium attributable to prior years of ($9) million and ($103) million for the three and nine months ended September 30, 2010 and ($73) million and ($71) million for the comparable periods of 2009. Net of amortization of deferred gains on retroactive reinsurance of $18 million and $53 million for the three and nine months ended September 30, 2010 and $17 million and $52 million for the three and nine months ended September 30, 2009.
7 Private equity income (loss) 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, 2010 was $658 million and $1.234 billion, respectively, increases of $409 million and $565 million over the same periods in 2009. The increases in both periods are driven by private equity income as a result of improved market valuations, an increase in asbestos reserves in 2009 that did not recur and the impact of the Venezuelan devaluation. Offsetting the increases were less favorable development in net incurred losses attributable to prior years and year- to-date catastrophe losses.

Revenues for the three and nine months ended September 30, 2010 were $8.387 billion and $24.643 billion, respectively, increases of $471 million and $1.491 billion over the same periods in 2009. The major components of revenues are net premium earned, net investment income, net realized investment gains, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2010 was $7.232 billion and $21.356 billion, respectively, increases of $290 million and $573 million over the same periods in 2009. The increases in both periods reflect decreased ceded premium of approximately $115 million and $315 million in the quarter and year-to-date, respectively, due to the non-renewal of LMAC's portion of the homeowners quota share treaty and earned premium associated with the other changes in net written premium previously discussed. The increases in both periods were partially offset by foreign exchange decline driven by the Venezuelan devaluation and the weakening of the Euro versus the U.S. dollar, partially offset by the weakening of the U.S. dollar versus other foreign currencies, and a decrease in Commercial Markets in the estimate of prior year earned premium on loss sensitive business recorded in the three months ended September 30, 2010.

Net investment income for the three and nine months ended September 30, 2010 was $884 million and $2.431 billion, respectively, increases of $174 million and $687 million over the same periods in 2009. The increases in both periods reflect increases in limited partnerships' and limited liability companies' income of $150 million and $632 million, respectively, as a result of improved valuations. In addition, continued investment of cash flows from operations contributed to the overall increase. The increase in taxable interest income and the decrease in tax exempt income reflect a continued shift in the Company's tactical allocation.

Net realized investment gains for the three and nine months ended September 30, 2010 were $86 million and $292 million, respectively, increases of $51 million and $278 million over the same periods in 2009. The increases primarily reflect a decrease in impairment losses recorded in 2010 due to the improving market conditions. Fixed maturity gains for the three and nine months ended September 30, 2010 reflect gains recognized from the sale of securities related to the shift in the Company's tactical allocation versus equity gains recognized for the three and nine months ended September 30, 2009 related to the Company's decision to reduce its equity exposure. Gains on common and preferred stock for the three and nine months ended September 30, 2010 include $29 million related to the sale of Verisk Analytics Inc. common stock. Other realized gains for nine months ended September 30, 2009 that did not recur in 2010 include $25 million related to equity swap derivative contracts that terminated in January 2009.

Fee and other revenues for the three and nine months ended September 30, 2010 were $185 million and $564 million, respectively, decreases of $44 million and $47 million from the same periods in 2009. The decreases in both periods are driven by the gains on the early extinguishment of debt in 2009 that did not recur, and lower commission revenue 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. Partially offsetting the year-to-date decrease is an increase driven by higher oil and gas revenues due to increases in price and production from the Company's energy operations.

Claims, benefits and expenses for the three and nine months ended September 30, 2010 were $7.643 billion and $23.117 billion, respectively, increases of $11 million and $648 million over the same periods in 2009. The increases in both periods reflect a decrease in ceded losses and expenses associated with the homeowners quota share reinsurance treaty, business growth in Personal Markets and International's Latin American operations and the net impact of prior year incurred, partially offset by the Venezuelan devaluation. Also contributing to the year-to-date increase were higher losses and expenses associated with catastrophes and a one-time remeasurement loss due to the Venezuelan devaluation.

Income tax expense for the three and nine months ended September 30, 2010 was $177 million and $424 million, respectively, an increase of $153 million and an increase of $291 million versus the same periods in 2009. The Company's effective tax rate for the three and nine months ended September 30, 2010 was 24% and 28%, compared to 8% and 19% for the same periods in 2009. The increase in effective tax rate from 2009 to 2010 was due to a $55 million one-time charge related to the recently enacted federal health care legislation which eliminated the tax benefit associated with Medicare Part D subsidies and increased pre-tax income. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-exempt investment income and foreign taxes, partially offset by the impact of the tax charge associated with Medicare Part D subsidies.

Net income for the three and nine months ended September 30, 2010 was $567 million and $1.102 billion, respectively, increases of $307 million and $552 million over the same periods in 2009.

Cash flow from operations for the three and nine months ended September 30, 2010 was $709 million and $1.754 billion, respectively, increases of $129 million and $186 million over the same periods in 2009. The increase in the quarter is attributable to a decrease in expenses, lower catastrophe paid losses and higher premium collections. The increase is offset by lower premium collections in Commercial Markets and also in International due to the Venezuelan devaluation. The year-to-date increase reflects a decrease in ceded premium payments associated with the homeowners quota share treaty, and lower catastrophe paid losses partially offset by a large loss payment related to an asbestos claim recorded in the prior year and higher premium collections in Personal Markets. The increase also reflects lower expenses and higher investment income in LMAC, partially offset by lower premium collections in Commercial Markets and also in International due to the Venezuelan devaluation.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
CONSOLIDATED	**2010[1]**	**2009**	**Change (Points)**	**2010[1]**	**2009**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	69.6%	70.1%	(0.5)	69.5 %	70.4%	(0.9)
Underwriting expense ratio	28.8	28.2	0.6	28.4	28.2	0.2
Dividend ratio	0.2	0.2	-	0.2	0.2	-
Subtotal	98.6	98.5	0.1	98.1	98.8	(0.7)
Catastrophes[2]	1.9	2.4	(0.5)	4.7	3.1	1.6
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	4.3	(4.3)	-	1.5	(1.5)
- All other	(1.3)	(4.4)	3.1	(0.8)	(3.2)	2.4
Total combined ratio[3]	99.2%	100.8%	(1.6)	102.0%	100.2%	1.8

1 2010 combined ratio has been adjusted to exclude the impact of the Venezuelan devaluation for comparative purposes.

2 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 LIU 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.

3 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. One-time integration costs related to the acquisition of Safeco, 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, 2010 was 98.6% and 98.1%, respectively, an increase of 0.1 points and a decrease of 0.7 points versus the same periods in 2009. The decrease in the claims and claim adjustment expense ratio in the quarter reflects favorable trends in select Latin American countries in International and a decrease in non-catastrophe property losses in Commercial Markets partially offset by higher commercial lines liability and property loss ratios in LMAC. The year-to-date decrease in the claims and claim adjustment expense ratio is driven by favorable personal lines property and liability results in LMAC partially offset by unfavorable trends in commercial lines and the impact of several large loss events including the Chilean and New Zealand earthquakes on the LIU reinsurance business. The increase in the underwriting expense ratio in both periods is driven by higher Commercial Markets' commission expense due to the change in the Middle Market distribution structure, higher underwriting expenses in select countries in Latin America primarily Venezuela due to inflation and a one-time charge for the settlement of a cash balance plan, partially offset by lower net commission expense resulting from a change in the structure of a reinsurance program within LIU's third party businesses and lower variable compensation costs in LMAC.

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, 2010 was 99.2% and 102.0%, respectively, a decrease of 1.6 points and an increase of 1.8 points versus the same periods in 2009. The decrease in the quarter reflects the changes in the combined ratio previously discussed, an increase in asbestos reserves in 2009 that did not recur and lower catastrophes, partially offset by a decrease in the amount of favorable net incurred losses attributable to prior years primarily in LMAC and Commercial Markets. The year-to-date increase is driven by less favorable net incurred losses attributable to prior years in 2010 compared to 2009 primarily in LMAC and Commercial Markets and unfavorable prior year development related to LMAC run-off business in Corporate. The increase also reflects higher catastrophe losses, partially offset by an increase in asbestos reserves in 2009 that did not recur.

LIBERTY MUTUAL AGENCY CORPORATION

Liberty Mutual Agency Corporation delivers personal and commercial insurance products and services to individuals and small to mid-sized 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 scale advantages of a national company. Personal lines products are distributed nationally under the Safeco brand, with an emphasis on service, and product and pricing sophistication. Liberty Mutual Surety is a leading provider of nationwide contract and commercial surety bonds to businesses of all sizes.

Effective in the third quarter of 2010, the Company's subsidiary, Liberty Mutual Agency Corporation ("LMAC"), became a SBU replacing the former Agency Markets SBU. The financial results of LMAC differ from Agency Markets' results principally due to LMAC maintaining a dedicated investment portfolio, the inclusion of the impact of a homeowners quota share treaty effective December 31, 2008 through December 31, 2009, the results of which were previously reflected in our Corporate and Other segment, and certain expenses incurred that are specific to LMAC. As such, results of LMAC are not directly comparable to the previously reported financial information for Agency Markets. All prior periods have been restated to reflect this change.

Liberty Mutual Agency Corporation net written premium by segment was as follows:

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Personal	$1,400	$1,148	22.0%	$3,895	$3,379	15.3%
Commercial	1,190	1,194	(0.3%)	3,447	3,522	(2.1%)
Surety	203	201	1.0%	566	538	5.2%
Corporate and Other[1]	28	43	(34.9%)	93	122	(23.8%)
Total net written premium	$2,821	$2,586	9.1%	$8,001	$7,561	5.8%

1 Includes run-off operations and internal reinsurance.

Liberty Mutual Agency Corporation net written premium by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Commercial Lines						
Commercial multiple peril	$498	$501	(0.6%)	$1,413	$1,449	(2.5%)
Commercial automobile	278	287	(3.1%)	831	864	(3.8%)
Workers compensation	242	238	1.7%	694	693	0.1%
Surety[1]	203	201	1.0%	566	538	5.2%
General liability	123	128	(3.9%)	373	389	(4.1%)
Other	71	75	(5.3%)	215	218	(1.4%)
Subtotal	$1,415	$1,430	(1.0)%	$4,092	$4,151	(1.4%)
Personal Lines						
Private passenger automobile	$863	$792	9.0%	$2,425	$2,382	1.8%
Homeowners	422	255	65.5%	1,146	710	61.4%
Other	121	109	11.0%	338	318	6.3%
Subtotal	$1,406	$1,156	21.6%	$3,909	$3,410	14.6%
Total net written premium	$2,821	$2,586	9.1%	$8,001	$7,561	5.8%

1 Included as part of the Surety segment

Net written premium for the three and nine months ended September 30, 2010 was $2.821 billion and $8.001 billion, respectively, increases of $235 million and $440 million over the same periods in 2009. The increases in both periods reflect additional retained premium in 2010 of $141 million and $357 million in the quarter and year-to-date periods, respectively, due to the discontinuation of a homeowners quota share reinsurance treaty, the introduction of an annual private passenger automobile product in 2010, rate increases across most lines of business, higher contract and commercial surety bond premium, and increased new business in both periods for personal lines and in the year-to-date period for commercial lines (excluding surety). These items were partially offset by a decline in commercial lines renewal premium (excluding surety) due to a reduction in insured exposures and the impact of negative audit premiums and lower private passenger automobile premium (excluding the annual automobile product) driven by declining retention over the last six months of 2009 and a shift towards writing higher quality risks (resulting in lower average premium per policy).

Results of Operations – Liberty Mutual Agency Corporation

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Revenues	$2,969	$2,706	9.7%	$8,822	$8,221	7.3%
PTOI before catastrophes and net incurred losses attributable to prior years	$346	$388	(10.8%)	$1,140	$1,024	11.3%
Catastrophes[1, 2]	(63)	(82)	(23.2%)	(473)	(367)	28.9%
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	40	238	(83.2%)	82	510	(83.9%)
Pre-tax operating income before private equity income	323	544	(40.6%)	749	1,167	(35.8%)
Private equity income (loss)[4]	1	(1)	NM	(4)	(36)	(88.9%)
Pre-tax operating income[5]	$324	$543	(40.3%)	$745	$1,131	(34.1%)

1 Catastrophes include all current and prior year catastrophe losses. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Catastrophes exclude the catastrophe losses ceded under the homeowners quota share agreement.
3 Net of earned premium attributable to prior years.
4 Private equity income (loss) is included in net investment income in the accompanying statements of income.
5 LMAC PTOI excludes a certain intercompany reinsurance agreement related to our run-off business which eliminates in consolidation
NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2010 was $324 million and $745 million, respectively, decreases of $219 million and $386 million from the same periods in 2009. The decreases in both periods reflect less favorable net incurred losses attributable to prior years and higher commercial lines liability loss ratios, partially offset by favorable loss trends across the personal property product lines, and lower variable compensation costs. The quarter also includes lower net investment income, unfavorable loss development associated with a re-estimation of current accident year commercial lines liability losses, and higher losses across the commercial property product lines, partially offset by lower catastrophe losses primarily driven by more severe hail storm activity in 2009. The year-to-date period also reflects higher catastrophe losses due to hail and other severe weather in the Northwest and Midwest regions as well as winter storms in the Mid Atlantic and Northeast regions, partially offset by favorable personal lines liability results.

Revenues for the three and nine months ended September 30, 2010 were $2.969 billion and $8.822 billion, respectively, increases of $263 million and $601 million over the same periods in 2009. The major components of revenues are net premium earned, net investment income, and net realized gains/(losses).

Net premiums earned for the three and nine months ended September 30, 2010 were $2.612 billion and $7.725 billion, respectively, increases of $164 million and $197 million over the same periods in 2009. The increases are primarily associated with additional retained premium in 2010 of $121 million and $335 million in the quarter and year-to-date periods, respectively, due to the discontinuation of a homeowners quota share reinsurance treaty and the changes in written premium in 2009 and 2010.

Net investment income for the three and nine months ended September 30, 2010 was $215 million and $678 million, respectively, a decrease of $22 million and an increase of $2 million versus the same periods in 2009. The decrease in the quarter is primarily driven by a lower invested asset base due to the intercompany dividend payment. The increase in the year-to-date period is largely due to an improvement in equity earnings on limited partnerships.

Net realized gains for the three and nine months ended September 30, 2010 were $117 million and $344 million, respectively, increases of $120 million and $400 million over the same periods in 2009. The increases in both periods reflect gains on sales of fixed maturities as part of the intercompany dividend payment as well as a decrease in impairment losses due to improved market conditions.

Claims, benefits and expenses for the three and nine months ended September 30, 2010 were $2.528 billion and $7.856 billion, respectively, increases of $356 million and $688 million over the same periods in 2009. The increases in both periods reflect less favorable net incurred losses attributable to prior years, additional retained losses and expenses of $84 million and $251 million (excluding catastrophes) in the quarter and year-to-date periods, respectively, due to the discontinuation of a homeowners quota share reinsurance treaty, unfavorable commercial lines liability results, and general cost increases. These items were partially offset by favorable loss trends across the personal property product lines and lower variable compensation costs. The quarter also includes unfavorable loss development associated with a re-estimation of current accident year commercial lines liability losses and higher losses across the commercial property product lines, partially offset by lower catastrophe losses. The year-to-date period also reflects additional expenses associated with a certain intercompany reinsurance agreement related to our run-off reserves which eliminates in consolidation, and higher catastrophe losses, partially offset by favorable personal lines liability results.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
LIBERTY MUTUAL AGENCY CORPORATION	**2010[1]**	**2009[1]**	**Change (Points)**	**2010[1]**	**2009[1]**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	63.4%	61.4%	2.0	62.0%	63.4%	(1.4)
Underwriting expense ratio	30.1	31.5	(1.4)	30.6	31.3	(0.7)
Dividend ratio	0.3	0.2	0.1	0.2	0.2	-
Subtotal	93.8	93.1	0.7	92.8	94.9	(2.1)
Catastrophes[1]	2.4	3.2	(0.8)	6.1	4.9	1.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(1.5)	(9.8)	8.3	(1.1)	(6.8)	5.7
Total combined ratio	94.7%	86.5%	8.2	97.8%	93.0%	4.8

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

The combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2010 was 93.8% and 92.8%, respectively, an increase of 0.7 points and a decrease of 2.1 points versus the same periods in 2009. The increase in the claims and claim adjustment expense ratio in the quarter reflects 0.8 points of unfavorable loss development associated with a re-estimation of current accident year commercial lines liability losses and unfavorable commercial lines liability and property results, partially offset by favorable loss trends across the personal property product lines. The decrease in the claims and claim adjustment expense ratio in the year-to-date period is driven by favorable personal lines property and liability results, partially offset by unfavorable trends in the commercial liability lines. The decrease in the underwriting expense ratio in both periods is primarily due to lower variable compensation costs.

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, 2010 was 94.7% and 97.8%, respectively, increases of 8.2 points and 4.8 points over the same periods in 2009. The increase in the quarter is driven by less favorable incurred losses attributable to prior years and the changes in the combined ratio previously discussed, partially offset by lower catastrophe losses primarily related to adverse hail storm activity in 2009. The increase in the year–to-date period is due to less favorable incurred losses attributable to prior years and higher catastrophe losses due to hail and other severe weather in the Northwest and Midwest regions as well as winter storms in the Mid Atlantic and Northeast regions, partially offset by the changes in the combined ratio previously discussed.

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:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
International Local Businesses Total	$1,149	$1,137	1.1%	$3,228	$3,221	0.2%
- Latin America	769	751	2.4%	2,110	2,107	0.1%
- Europe	299	320	(6.6%)	899	930	(3.3%)
- Asia	81	66	22.7%	219	184	19.0%
Liberty International Underwriters	692	600	15.3%	2,102	1,910	10.1%
Total net written premium (NWP)	$1,841	$1,737	6.0%	$5,330	$5,131	3.9%
Foreign exchange effect on growth, excluding Venezuelan devaluation			(0.3%)			2.9%
Venezuelan devaluation			(16.3%)			(14.2%)
Total foreign exchange effect on growth			(16.6%)			(11.3%)
NWP growth excluding foreign exchange and Venezuelan devaluation			22.6%			15.2%

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:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	2010	2009	Change	2010	2009	Change
Local businesses – private passenger auto	$696	$686	1.5%	$1,948	$1,891	3.0%
Local businesses – all other[1]	453	451	0.4%	1,280	1,330	(3.8%)
LIU reinsurance	290	199	45.7%	899	741	21.3%
LIU inland marine program	172	147	17.0%	497	473	5.1%
LIU third party	156	199	(21.6%)	475	496	(4.2%)
LIU first party	60	55	9.1%	194	178	9.0%
LIU other	14	-	NM	37	22	68.2%
Total net written premium	$1,841	$1,737	6.0%	$5,330	$5,131	3.9%

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, 2010 was $1.841 billion and $5.330 billion, increases of $104 million and $199 million over the same periods in 2009. The increases in both periods reflect organic growth in the local businesses, primarily in Latin America, led by Venezuela primarily due to inflation, Brazil, and to a lesser extent, Asia. Europe also contributed to the organic growth in both periods, across all operations, with the exception of Spain as a result of the country's continuing economic contraction. The increases in both periods also reflect growth in certain lines of LIU's reinsurance business, partially offset by an increase in the amount of ceded written premium in LIU third party primarily due to a change in the structure of a reinsurance program. Largely offsetting the increases in both periods was foreign exchange decline (approximately $289 million and $582 million in the quarter and year-to-date, respectively) driven by the Venezuelan devaluation and the weakening of the Euro versus the U.S. dollar partially offset by the weakening of the U.S. dollar versus other foreign currencies.

Results of Operations – International

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	2010[1]	2009	Change	2010[1]	2009	Change
Revenues	$2,007	$1,924	4.3%	$5,917	$5,518	7.2%
PTOI before catastrophes and net incurred losses attributable to prior years	$194	$115	68.7%	$493	$342	44.2%
Catastrophes[2]	8	(6)	NM	(12)	(12)	-
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	15	(8)	NM	72	22	NM
Pre-tax operating income	$217	$101	114.9%	$553	$352	57.1%

1 Effective January 1, 2010, the Venezuelan operations began applying hyper-inflationary accounting, utilizing the U.S. dollar as the functional currency.

2 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.

3 Net of earned premium attributable to prior years of zero and ($1) million for the three and nine months ended September 30, 2010, respectively, and $4 million and $3 million for the comparable periods of 2009.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2010 was $217 million and $553 million, respectively, increases of $116 million and $201 million over the same periods in 2009. The increases in both periods reflect the impact of the Venezuelan devaluation (approximately $44 million and $124 million in the quarter and year-to-date, respectively) as well as favorable net incurred loss development attributable to prior years, primarily within LIU's reinsurance business.

Revenues for the three and nine months ended September 30, 2010 were $2.007 billion and $5.917 billion, respectively, increases of $83 million and $399 million over the same periods in 2009. 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, 2010 was $1.814 billion and $5.346 billion, respectively, increases of $66 million and $386 million over the same periods in 2009. The increases in both periods reflect the previously mentioned growth in net written premium in 2010 and in the latter half of 2009, partially offset by foreign exchange decline (approximately $169 million and $253 million in the quarter and year-to-date, respectively) driven by the Venezuelan devaluation and the weakening of the Euro versus the U.S. dollar, partially offset by the weakening of the U.S. dollar versus other foreign currencies.

Net investment income for the three and nine months ended September 30, 2010 was $144 million and $426 million, respectively, decreases of $6 million and $19 million from the same periods in 2009. The decreases were primarily due to the Venezuelan devaluation and, to a lesser extent, the impact of 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, 2010 were $1.773 billion and $5.312 billion, respectively, a decrease of $60 million and an increase of $151 million versus the same periods in 2009. The decrease in the quarter was primarily the result of the Venezuelan devaluation and an increase in favorable net incurred loss development attributable to prior years within LIU's reinsurance business, partially offset by higher current year claims and claims adjustment expenses primarily driven by the organic growth in Latin America, and an increase in loss activity within LIU's reinsurance business resulting from several large loss events, including the New Zealand earthquake. The year-to-date increase is driven by higher current year claims and claims adjustment expenses primarily as a result of the organic growth in Latin America, the previously mentioned increase in loss activity within LIU's reinsurance business resulting from several large loss events, and the Chilean earthquake. The increase is partially offset by the Venezuelan devaluation and favorable net incurred loss development attributable to prior years within LIU's reinsurance business. The foreign exchange loss, primarily the result of the Venezuelan devaluation, contributed approximately $100 million to the increase year-to-date.

	Three Months Ended September 30,			Nine Months Ended September 30,		
INTERNATIONAL	**2010[1]**	**2009**	**Change (Points)**	**2010[1]**	**2009**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	69.0%	71.1%	(2.1)	71.1%	70.6%	0.5
Underwriting expense ratio	30.9	29.7	1.2	30.5	30.2	0.3
Dividend ratio	-	-	-	-	-	-
Subtotal	99.9	100.8	(0.9)	101.6	100.8	0.8
Catastrophes[2]	(0.5)	0.4	(0.9)	0.2	0.3	(0.1)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(0.9)	0.4	(1.3)	(1.4)	(0.5)	(0.9)
Total combined ratio	98.5%	101.6%	(3.1)	100.4%	100.6%	(0.2)

1 2010 combined ratio has been adjusted to exclude the impact of the Venezuelan devaluation for comparative purposes.
2 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, 2010 was 99.9% and 101.6%, respectively, a decrease of 0.9 points and an increase of 0.8 points versus the same periods in 2009. The decrease in the quarter reflects favorable claims and claims adjustment expense ratios in select countries in Latin America, partially offset by an increase in underwriting expense ratio in select countries in Latin America, led by Venezuela due to inflation. The year-to-date increase in the claims and claims adjustment expense ratio reflects the impact of several large loss events within LIU's reinsurance business including the Chilean and New Zealand earthquakes. The increase in the underwriting expense ratio reflects unfavorable underwriting expense in select countries in Latin America, led by Venezuela due to inflation, partially offset by lower net commission expense within LIU's inland marine and third party businesses resulting from a change in the structure of certain reinsurance programs, as well as the recognition of additional profit commission from certain reinsurance programs within LIU's third party 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, 2010 was 98.5% and 100.4%, respectively, decreases of 3.1 points and 0.2 points from the same periods in 2009. The changes in both periods reflect the previously mentioned changes in the combined ratio, an increase in the amount of favorable net incurred loss development attributable to prior years and the impact of catastrophe loss development related to the September 2008 Hurricanes within LIU's reinsurance business. The year-to-date change also reflects an increase in catastrophe losses associated with the Chilean earthquake on the local 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 2,000 licensed captive sales representatives, more than 500 licensed telesales counselors, third-party producers and the Internet. Personal Markets' largest source of new business is through its more than 12,500 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:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
Private passenger automobile	$1,150	$1,097	4.8%	$3,266	$3,060	6.7%
Homeowners and other	644	588	9.5%	1,699	1,532	10.9%
Individual life	54	82	(34.1%)	194	218	(11.0%)
Total net written premium	$1,848	$1,767	4.6%	$5,159	$4,810	7.3%

Net written premium for the three and nine months ended September 30, 2010 was $1.848 billion and $5.159 billion, respectively, increases of $81 million and $349 million over the same periods in 2009.

Private passenger automobile net written premium for the three and nine months ended September 30, 2010 was $1.150 billion and $3.266 billion, respectively, increases of $53 million and $206 million over the same periods in 2009. The increases in both periods reflect 4.1% policies in-force growth as compared to September 30, 2009 and positive rate action.

Homeowners and other net written premium for the three and nine months ended September 30, 2010 was $644 million and $1.699 billion, respectively, increases of $56 million and $167 million over the same periods in 2009. The increases in both periods reflect 5.6% homeowners policies in-force growth as compared to September 30, 2009 and positive rate action. Approximately one point of the net written premium growth in each period is attributable to the ongoing GEICO relationship, which allows GEICO to offer the Company’s homeowners products to its automobile prospects and customers. These strong results were achieved while coastal management initiatives reduced the business unit’s coastal exposure from the prior year.

Individual life net written premium for the three and nine months ended September 30, 2010 was $54 million and $194 million, respectively, decreases of $28 million and $24 million from the same periods in 2009. The decreases in both periods reflect lower structured settlements sales.

Results of Operations – Personal Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
Revenues	$1,891	$1,785	5.9%	$5,566	$5,187	7.3%
PTOI before catastrophes, net incurred losses attributable to prior years and private equity (loss) income	$280	$253	10.7%	$832	$740	12.4%
Catastrophes[1]	(66)	(93)	(29.0%)	(404)	(288)	40.3%
Net incurred losses attributable to prior years:						
- Asbestos & environmental						
- All other	3	(21)	NM	9	(7)	NM
Pre-tax operating income	$217	$139	56.1%	$437	$445	(1.8%)

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.

PTOI for the three and nine months ended September 30, 2010 was $217 million and $437 million, respectively, an increase of $78 million and a decrease of $8 million versus the same periods in 2009. The increase in the quarter was primarily attributable to decreased catastrophe losses. The decrease in the year-to-date period was primarily attributable to increased catastrophe losses, partially offset by increased revenue due to higher net premiums earned.

Revenues for the three and nine months ended September 30, 2010 were $1.891 billion and $5.566 billion, respectively, increases of $106 million and $379 million over the same periods in 2009. 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, 2010 was $1.659 billion and $4.867 billion, respectively, increases of $96 million and $307 million over the same periods in 2009. The increases in both periods reflect 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, 2010 was $203 million and $591 million, respectively, increases of $20 million and $51 million over the same periods in 2009. The increases 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, 2010 were $1.680 billion and $5.135 billion, respectively, increases of $39 million and $382 million over the same periods in 2009. The increases in both periods reflect higher non-catastrophe losses and general cost increases from business growth. The increase in the year-to-date period was also due to increased catastrophe losses, which resulted from increased severity of non-hurricane weather, favorable catastrophe development in 2009 that did not recur, and a 2009 subrogation recovery related to the 2007 California wildfires.

PERSONAL MARKETS	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Change (Points)	2010	2009	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	64.4%	64.3%	0.1	63.9%	63.8%	0.1
Underwriting expense ratio	24.3	24.5	(0.2)	24.8	25.1	(0.3)
Dividend ratio	-	-	-	-	-	-
Subtotal	88.7	88.8	(0.1)	88.7	88.9	(0.2)
Catastrophes[1]:	4.1	6.3	(2.2)	8.6	6.6	2.0
Net incurred losses attributable to prior years:						
- Asbestos & environmental						
- All other	(0.2)	(0.2)	-	(0.2)	(0.4)	0.2
Total combined ratio	92.6%	94.9%	(2.3)	97.1%	95.1%	2.0

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 both the three and nine months ended September 30, 2010 was 88.7%, decreases of 0.1 points and 0.2 points from the same periods in 2009. The decrease in the underwriting expense ratio drives the decrease in both periods. The decrease in the quarter is due to lower advertising expenditures. For the year-to-date period, the decrease is due to a lower PruPac profit share expense as a result of the non-recurring favorable prior year catastrophe activity from 2009 partially offset by higher advertising expenditures.

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, 2010 was 92.6% and 97.1%, respectively, a decrease of 2.3 points and an increase of 2.0 points versus the same periods in 2009. The decrease in the quarter reflects changes previously discussed and lower catastrophe losses from less severe hail storms. The increase for the year-to-date period reflects changes previously discussed and increased catastrophe losses from the first half of 2010 as well as favorable catastrophe activity in 2009 that did not recur.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets offers a wide array of property & casualty and group benefits insurance coverages through independent agents, brokers and benefit consultants throughout the United States. Commercial Markets P&C provides commercial lines products and services to mid-sized and large businesses (with an annual cost of risk of $150,000 or more). Group Benefits provides mid-sized and large businesses with short- and long-term disability insurance products and administrative services and group life insurance through Liberty Life Assurance Company of Boston, a subsidiary of the Company. Summit provides workers compensation in the Southeast (mainly Florida) primarily to small businesses. Liberty Mutual Reinsurance provides reinsurance programs to domestic and foreign insurance and reinsurance companies. 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 combined 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 directly distributed Business Market and Wausau Insurance policyholders in various portions to three nationally recognized brokerage firms on February 27, 2009.

On July 14, 2010, Commercial Markets established a new distribution and service organization, Commercial Markets P&C, combining Middle Market, National Market, Specialty Lines and Liberty Mutual Property. This operating model provides agents and brokers a single point of entry for accessing Commercial Markets' property, casualty and specialty lines insurance as well as claims and loss control services for national accounts and mid-sized business clients.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Commercial Markets P&C[2]	$1,005	$973	3.3%	$2,995	$3,028	(1.1%)
Group Benefits	173	155	11.6%	515	453	13.7%
Summit[1]	76	72	5.6%	351	389	(9.8%)
Liberty Mutual Reinsurance	83	79	5.1%	223	229	(2.6%)
Other Markets[3]	-	-	-	1	1	-
Total net written premium	$1,337	$1,279	4.5 %	$4,085	$4,100	(0.4%)

1 Effective January 1, 2010, net written premium associated with Summit, previously included in LMAC, is included in Commercial Markets. The prior periods have been restated to reflect this change.
2 Effective July 14, 2010, net written premium associated with Middle Market, National Market, Specialty Lines and Liberty Mutual Property were combined into Commercial Markets P&C. The prior periods have been restated to reflect this change.
3 Includes internal reinsurance.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Workers compensation	$710	$700	1.4%	$2,256	$2,364	(4.6%)
Group disability and life	173	155	11.6%	515	453	13.7%
General liability	162	138	17.4 %	412	392	5.1%
Commercial automobile	107	111	(3.6%)	342	316	8.2%
Commercial multiple peril / fire	98	79	24.1%	297	289	2.8%
Assumed voluntary reinsurance	52	43	20.9%	145	125	16.0%
Other	35	53	(34.0%)	118	161	(26.7%)
Total net written premium	$1,337	$1,279	4.5%	$4,085	$4,100	(0.4%)

1 Effective January 1, 2010, net written premium associated with Summit, previously included in LMAC, is included in Commercial Markets. The prior periods have been restated to reflect this change.

Net written premium for the three and nine months ended September 30, 2010 was $1.337 billion and $4.085 billion, an increase of $58 million and a decrease of $15 million versus the same periods in 2009. Both periods reflect declines in exposures and audit premium in the Commercial Markets P&C and Summit segments due to weak economic conditions and a mandatory rate decrease in Florida, primarily impacting Summit. Continued competitive market conditions contributed to declining rates across all property and casualty lines. In addition, Other lines net written premium decreased in both periods due in part to the non-renewal of an assumed facultative reinsurance program in October 2009. These decreases on a year-to-date basis were partially offset by continued penetration of the group disability and life markets, growth in general liability premium due to new business writings along with increases in the construction segment of Commercial Markets P&C, and favorable premium adjustments on retrospectively rated workers compensation policies. Commercial automobile net written premium also increased year-to-date due to new business growth within Commercial Markets P&C. In addition, Assumed voluntary reinsurance net written premium increased due to Liberty Mutual Reinsurance new business growth. In the quarter, the increases as mentioned above, when combined with growth in Commercial multiple peril/fire net written premium, offset the decreases as mentioned above.

Results of Operations – Commercial Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010[1]**	**2009[1]**	**Change**	**2010[1]**	**2009[1]**	**Change**
Revenues	$1,571	$1,630	(3.6%)	$4,665	$5,073	(8.0%)
PTOI before catastrophes and net incurred losses attributable to prior years	$59	$59	-	$223	$261	(14.6%)
Catastrophes[2]	(11)	(5)	120.0%	(61)	(39)	56.4%
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	16	31	(48.4%)	40	71	(43.7%)
Pre-tax operating income	$64	$85	(24.7%)	$202	$293	(31.1%)

1 Effective January 1, 2010, the Summit results of operations, previously included in LMAC, are included in Commercial Markets. The prior periods have been restated to reflect this change.

2 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.

3 Net of earned premium attributable to prior years of ($8) million and ($112) million for the three and nine months ended September 30, 2010, and ($13) million and ($11) million for the comparable periods in 2009. Net of amortization of deferred gains on retroactive reinsurance of $13 million and $38 million for the three and nine months ended September 30, 2010 and $12 million and $37 million for the comparable periods in 2009.

PTOI for the three and nine months ended September 30, 2010 was $64 million and $202 million, respectively, decreases of $21 million and $91 million from the same periods in 2009. The decreases in both periods reflect a decline in earned premium that outpaced expense reductions, deteriorating loss trends, primarily in workers compensation, and increased catastrophe losses, partially offset by a decrease in non-catastrophe related property losses and higher net investment income. The quarter also includes unfavorable loss development associated with a re-estimation of current accident year workers compensation losses in the Commercial Markets P&C segment.

Revenues for the three and nine months ended September 30, 2010 were $1.571 billion and $4.665 billion, respectively, decreases of $59 million and $408 million from the same periods in 2009. 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, 2010 was $1.275 billion and $3.776 billion, respectively, decreases of $56 million and $392 million from the same periods in 2009. The decreases in both periods reflect the decrease in net written premium during 2009 and the first nine months of 2010. In addition, a reduction in the estimate of prior year earned premium on loss sensitive business contributed to the year-to-date decrease.

Net investment income for the three and nine months ended September 30, 2010 was $231 million and $691 million, respectively, increases of $3 million and $11 million over the same periods in 2009. The increases primarily reflect a higher invested asset base due to the continued investment of cash flow from operations.

Fee and other revenues for the three and nine months ended September 30, 2010 were $65 million and $199 million, respectively, decreases of $6 million and $26 million from the same periods in 2009. The decreases primarily reflect lower commission 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. Also contributing to the decreases was lower fee revenue from Helmsman Insurance Agency as a result of the Middle Market re-organization.

Claims, benefits, and expenses for the three and nine months ended September 30, 2010 were $1.507 billion and $4.464 billion, respectively, decreases of $38 million and $316 million from the same periods in 2009. The decreases in both periods primarily reflect declines in non-catastrophe losses due to lower earned premiums and reduced compensation-related expenses mainly as a result of the change in the Middle Market distribution structure. Contributing to the decreases on a year-to-date basis were reductions in premium taxes and claim adjustment expenses due to declines in exposure and net written premium and a reduction of net incurred losses attributable to prior years. Partially offsetting the decreases in both periods were increases in commission expenses due to the change in the Middle Market distribution structure and increases in property-related catastrophe losses.

COMMERCIAL MARKETS	Three Months Ended September 30, 2010[1]	2009[1]	Change (Points)	Nine Months Ended September 30, 2010[1]	2009[1]	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	85.3%	86.5%	(1.2)	84.7%	84.9%	(0.2)
Underwriting expense ratio	25.0	22.7	2.3	24.5	22.0	2.5
Dividend ratio	0.5	0.7	(0.2)	0.6	0.8	(0.2)
Subtotal	110.8	109.9	0.9	109.8	107.7	2.1
Catastrophes[2]	1.0	0.4	0.6	1.8	1.0	0.8
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(1.4)	(2.4)	1.0	(0.8)	(1.8)	1.0
Total combined ratio	110.4%	107.9%	2.5	110.8%	106.9%	3.9

1 Effective January 1, 2010, results associated with Summit, previously included in LMAC, are included in Commercial Markets. The prior periods have been restated to reflect this change.

2 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, 2010 was 110.8% and 109.8%, respectively, increases of 0.9 points and 2.1 points over the same periods in 2009. Both periods reflect the impact of deteriorating loss trends, primarily in workers compensation. Additionally, impacting both periods is an increase in assumed voluntary reinsurance losses in 2010 related to the New Zealand earthquake and U.S hailstorms in the third quarter and the Chilean earthquake and European winter storm Xynthia in the first quarter. Partially offsetting these increases in both periods were decreases in non-catastrophe property losses. The increase in the underwriting expense ratio in both periods primarily reflects an increase in the commission ratio due to the change in the Middle Market distribution structure, partially offset by a decrease in loss based assessments on a year-to-date basis.

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, 2010 was 110.4% and 110.8%, respectively, increases of 2.5 points and 3.9 points over the same periods in 2009. The increases in both periods reflect the changes in the combined ratio previously discussed as well as higher catastrophe losses and less favorable net incurred losses attributable to prior years driven by favorable development in 2009 related to the involuntary market workers compensation pools and Summit workers compensation that did not recur.

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 certain LMAC business, 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 long–term 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 reports workers compensation written premiums on the "booked at inception" method. Corporate and Other results reflect the difference between these two methods.

- The Company discounts the long-term indemnity portion of its settled unpaid workers compensation claims. In the fourth quarter of 2009, the Company changed its method of accounting for discounting from tabular discount rates based on insurance regulations as approved by the respective jurisdictions to a risk-free discount rate. Commercial Markets reports their discount based on a tabular rate of 4%. Corporate and Other results reflect the difference between the tabular and risk-free rate.

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

- For presentation in this MD&A, excluding LMAC, 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:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009**	**Change**	**2010**	**2009**	**Change**
Reinsurance, net	($165)	($205)	(19.5%)	($363)	($458)	(20.7%)
Workers compensation[1]	36	43	(16.3%)	(11)	(6)	83.3%
Other	2	-	NM	11	1	NM
Total net written premium	($127)	($162)	(21.6%)	($363)	($463)	(21.6%)

[1] Booked as billed adjustment
NM = Not Meaningful

Net written premium for the three and nine months ended September 30, 2010 was ($127) million and ($363) million, respectively, increases of $35 million and $100 million over the same periods in 2009. The increases in both periods were primarily due to a decrease in externally ceded reinsurance, partially offset by a decrease in assumed premium related to internal reinsurance.

Results of Operations – Corporate and Other

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2010**	**2009[1]**	**Change**	**2010**	**2009[1]**	**Change**
Revenues	($51)	($129)	(60.5%)	($327)	($847)	(61.4%)
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years and private equity income (loss):	($325)	($286)	13.6%	($895)	($904)	(1.0%)
Catastrophes[2,3]	5	26	(80.8%)	5	84	(94.0%)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[4]	(2)	(361)	(99.4%)	(5)	(364)	(98.6%)
- All other[5, 6]	14	6	133.3%	(46)	(6)	NM
Pre-tax operating loss before private equity income (loss) [7]	(308)	(615)	(49.9%)	(941)	(1,190)	(20.9%)
Private equity income (loss) [8]	144	(4)	NM	238	(362)	(165.7%)
Pre-tax operating loss	($164)	($619)	(73.5%)	($703)	($1,552)	(54.7%)

1 2009 results have been restated for the retrospective accounting change related to the change in the discount rate applied to the long-term indemnity portion of the settled unpaid workers compensation claims.
2 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 zero and $6 million for the three and nine months ended September 30, 2010 and $1 and $3 million for the comparable periods of 2009.
3 Catastrophes exclude the catastrophe losses ceded under the homeowners quota share agreement.
4 Net of allowance for uncollectible reinsurance increase of zero and $2 million for the three and nine months ended September 30, 2010, and $70 million for the comparable periods of 2009.
5 Net of amortization of deferred gains on retroactive reinsurance of $5 million and $15 million for the three and nine months ended September 30, 2010 and 2009, respectively.
6 Corporate and Other net incurred losses attributable to prior years includes presentational adjustments for results previously reported in the former Agency Markets SBU.
7 PTOI excludes a certain intercompany reinsurance agreement related to LMAC run-off business which eliminates in consolidation.
8 Private equity income (loss) 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, 2010 was $164 million and $703 million, respectively, decreases of $455 million and $849 million from the same periods in 2009. The decreases in both periods were primarily driven by an increase in asbestos reserves in 2009 that did not recur, an increase in limited partnerships' and limited liability companies' income as a result of improved equity valuations over the same periods in 2009, higher oil and gas revenues, and the restructuring of internal and external treaties in the Company's reinsurance program. Partially offsetting the decreases in both periods were gains on the early extinguishment of debt in 2009 that did not recur and unfavorable variable annuity reserve development in 2010 versus favorable development in 2009. Partially offsetting the decrease in year-to-date were unfavorable prior year development related to LMAC run-off business and internally assumed losses on the Company's reinsurance program related to the Chilean earthquake.

Revenues for the three and nine months ended September 30, 2010 were ($51) million and ($327) million, respectively, increases of $78 million and $520 million over the same periods in 2009. The major components of revenues include net premium earned, net investment income, net realized gains (losses) and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2010 was ($128) million and ($358) million, respectively, increases of $20 million and $75 million over the same periods in 2009. The increases in the quarter and year-to-date reflect 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, 2010 was $91 million and $45 million, respectively, increases of $179 million and $642 million over the same periods in 2009. The increases in both periods reflect increases in limited partnerships' and limited liability companies' income of $148 million and $600 million, respectively, as a result of improved equity valuations and continued investment of cash flows from operations, partially offset by lower investment yields on taxable securities.

Net realized investment losses for the three and nine months ended September 30, 2010 were $42 million and $97 million, respectively, decreases of $85 million and $173 million from the same periods in 2009. The decreases represent gains related to intercompany dividends between LMAC and affiliates, which are eliminated in consolidation through Corporate and Other.

Fee and other revenues for the three and nine months ended September 30, 2010 were $28 million and $83 million, respectively, decreases of $36 million and $24 million from the same periods in 2009. The decreases primarily reflect the gains on the early extinguishment of debt in 2009 that did not recur, partially offset by higher oil and gas revenues due to higher prices and increased production.

Claims, benefits and expenses for the three and nine months ended September 30, 2010 were $155 million and $350 million, respectively, decreases of $286 million and $257 million from the same periods in 2009. The decreases in both periods primarily reflect an increase in asbestos reserves in 2009 that did not recur, partially offset by unfavorable prior year development related to LMAC run-off business, internally assumed losses on the Company's reinsurance program related to the Chilean earthquake, and unfavorable variable annuity reserve development versus favorable development in 2009.

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, 2010 and December 31, 2009:

$ in Millions	**As of September 30, 2010**		**As of December 31, 2009**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$59,218	84.6%	$56,439	84.5%
Equity securities, available for sale, at fair value	1,207	1.7	1,188	1.7
Limited partnerships and limited liability companies	2,820	4.0	2,455	3.7
Commercial mortgage loans	1,172	1.7	1,121	1.7
Short-term investments	453	0.6	575	0.9
Other investments	177	0.3	164	0.2
Cash and cash equivalents	4,975	7.1	4,847	7.3
Total Invested Assets	$70,022	100.0%	$66,789	100.0%

Total invested assets as of September 30, 2010 were $70.022 billion, an increase of $3.233 billion or 4.8% over December 31, 2009. The increase reflects an increase in unrealized gains due to a decrease in interest rates and credit spreads, an increase in the valuations of private limited partnerships, and continued investment of cash flows from operations. Partially offsetting these increases were decreases attributable to a valuation decline from foreign exchange largely driven by the Venezuelan devaluation.

Fixed maturities as of September 30, 2010 were $59.218 billion, an increase of $2.779 billion or 4.9% over December 31, 2009. The increase reflects fair value increases due to a decrease in interest rates and credit spreads and continued investment of cash flows from operations. These increases were partially offset by valuation declines from foreign exchange as previously discussed.

Equity securities available for sale as of September 30, 2010 were $1.207 billion ($696 million common stock and $511 million preferred stock) versus $1.188 billion as of December 31, 2009 ($688 million common stock and $500 million preferred stock), an increase of $19 million or 1.6% over December 31, 2009. Of the $696 million of common stock at September 30, 2010, $286 million relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The increase in total equity securities available for sale is consistent with the broader equity market performance.

Investments in limited partnerships and limited liability companies as of September 30, 2010 were $2.820 billion, an increase of $365 million or 14.9% over December 31, 2009. These investments consist of traditional private equity partnerships of $1.736 billion, other partnerships (primarily energy) of $691 million, and real estate partnerships of $393 million. The increase primarily reflects an increase in value and new investments. 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, 2010 were $1.172 billion (net of $12 million of loan loss reserves or 1% of the outstanding loan portfolio), an increase of $51 million or 4.5% over December 31, 2009. The increase primarily reflects $88 million of new loans, $31 million in principal repayments and an increase of $6 million to the loan loss reserves. The entire commercial loan portfolio is U.S. based. As of September 30, 2010, the average total loan size was $1.4 million and the average loan participation size was $0.4 million. The number of loans in the portfolio increased from 2,469 at December 31, 2009 to 2,801 at September 30, 2010. Approximately 91% of the loans are full or partial recourse to borrowers.

Short-term investments as of September 30, 2010 were $453 million, a decrease of $122 million or 21.2% from December 31, 2009. This decrease reflects a decline in short-term assets held as collateral in connection with the Company's security lending program and the maturity of assets re-invested in cash equivalents and fixed maturity assets.

Cash and cash equivalents as of September 30, 2010 were $4.975 billion, an increase of $128 million or 2.6% over December 31, 2009.

Regarding fair value measurements, as of September 30, 2010, excluding separate accounts and other assets, the Company reflected $2.773 billion as level 1 (quoted prices in active markets) primarily consisting of U.S. Treasuries and common equity securities. The majority of the Company's invested assets are reported as level 2 (quoted prices from other observable inputs). As of September 30, 2010, the Company reported $57.153 billion as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported $1.093 billion as level 3 (unobservable inputs), primarily consisting of international and privately held securities for which a market price is not readily observable.

As of September 30, 2010, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of $993 million, $431 million and $1.219 billion, respectively. As of September 30, 2010, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair value of $18 million and various corporate and municipal securities at a cost and fair value of $698 million.

As of September 30, 2010, 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, 2010 and December 31, 2009:

September 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,808	$275	($-)	$3,083
Mortgage and asset-backed securities:				
Residential	9,242	560	(41)	9,761
Commercial	2,391	129	(3)	2,517
Other mortgage and ABS	1,691	136	(7)	1,820
U.S. state and municipal	12,701	1,022	(27)	13,696
Corporate and other	22,525	1,743	(120)	24,148
Foreign government securities	4,104	157	(68)	4,193
Total fixed maturities	55,462	4,022	(266)	59,218
Common stock	538	185	(27)	696
Preferred stock	555	37	(81)	511
Total equity securities	1,093	222	(108)	1,207
Total securities available for sale	$56,555	$4,244	($374)	$60,425

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

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of September 30, 2010:

$ in Millions	As of September 30, 2010							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$1,501	$-	$-	$-	$-	$-	$1,501	10.7%
GNMA residential mortgage	2,950	-	-	-	-	-	2,950	20.9
FNMA residential mortgage	2,804	-	-	-	-	-	2,804	19.9
FHLMC residential mortgage	3,290	-	-	-	-	-	3,290	23.3
Prime residential mortgage	173	49	-	-	-	246	468	3.3
Alt-A residential mortgage	65	4	-	4	-	130	203	1.4
Sub-prime residential mortgage	6	4	10	8	6	12	46	0.3
Commercial mortgage backed securities	2,327	159	16	11	4	-	2,517	17.9
Non-mortgage asset backed securities	211	24	33	32	15	4	319	2.3
Total	$13,327	$240	$59	$55	$25	$392	$14,098	100%
% of Total	94.5%	1.7%	0.4%	0.4%	0.2%	2.8%	100%	

Approximately 75% 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). Over 94% of the mortgage and asset-backed holdings are rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with over 98% rated AA or above with approximately 18% of the underlying collateral having been defeased with U.S. Treasuries.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of September 30, 2010 and December 31, 2009:

$ in Millions	As of September 30, 2010		As of December 31, 2009	
Fixed Maturities by Credit Quality[1]	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
AAA	$23,749	40.1%	$24,896	44.2%
AA+, AA, AA-	9,407	15.9	10,185	18.0
A+, A, A-	11,164	18.8	10,206	18.1
BBB+, BBB, BBB-	8,889	15.0	6,599	11.7
BB+, BB, BB-	2,737	4.6	2,089	3.7
B+, B, B-	2,343	4.0	1,767	3.1
CCC or lower	929	1.6	697	1.2
Total fixed maturities	$59,218	100%	$56,439	100%

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

The Company's allocation to investment grade securities decreased to 90% at September 30, 2010 from 92% at December 31, 2009. The decrease in investment grade bonds was related to the tactical decision to shorten the average duration of the investment portfolio. In order to mitigate the potential impact of the duration shortening on investment income, management increased the allocation to non-investment grade securities. The Company had 10% of its fixed maturity securities invested in non-investment grade securities at September 30, 2010, an increase of 2% primarily due to a shift in the Company's tactical allocation. Overall, the average credit quality rating stands at A+ as of September 30, 2010. 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, 2010 and December 31, 2009:

$ in Millions	As of September 30, 2010		As of December 31, 2009	
Fixed Maturities by Maturity Date	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
1 year or less	$2,454	4.1%	$2,556	4.5%
Over 1 year through 5 years	15,914	26.9	12,678	22.5
Over 5 years through 10 years	13,373	22.6	10,633	18.8
Over 10 years	13,379	22.6	15,521	27.5
Mortgage and asset-backed securities	14,098	23.8	15,051	26.7
Total fixed maturities	$59,218	100%	$56,439	100%

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

Net Investment Income

The following table summarizes the Company's net investment income for the three and nine months ended September 30, 2010 and 2009:

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Net Investment Income	**2010**	**2009**	**2010**	**2009**
Taxable interest income	$618	$572	$1,804	$1,697
Tax-exempt interest income	129	157	421	466
Dividends	9	9	31	32
Limited partnerships and limited liability companies	145	(5)	234	(398)
Commercial mortgage loans	18	17	54	50
Other investment income	1	2	2	8
Gross investment income	920	752	2,546	1,855
Investment expenses	(36)	(42)	(115)	(111)
Net investment income	$884	$710	$2,431	$1,744

Net investment income for the three and nine months ended September 30, 2010 was $884 million and $2.431 billion, respectively, increases of $174 million and $687 million over the same periods in 2009. The increases in both periods reflect increases in limited partnerships' and limited liability companies' income of $150 million and $632 million, respectively, as a result of improved valuations. In addition, continued investment of cash flows from operations contributed to the overall increase. The increase in taxable interest income and the decrease in tax exempt income reflect a continued shift in the Company's tactical allocation.

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, 2010 and 2009:

$ in Millions Net Realized Investment Gains (Losses)	Sales & Dispositions	Impairments	Change in Derivatives Value	Total
Three Months Ended September 30, 2010:				
Fixed maturities	$85	($27)	$-	$58
Common and preferred stock	31	(1)	-	30
Other	(1)	(1)	-	(2)
Total	$115	($29)	$-	$86
Three Months Ended September 30, 2009:				
Fixed maturities	$56	($35)	$-	$21
Common and preferred stock	24	-	-	24
Other	(10)	-	-	(10)
Total	$70	($35)	$-	$35

$ in Millions Net Realized Investment Gains (Losses)	Sales & Dispositions	Impairments	Change in Derivatives Value	Total
Nine Months Ended September 30, 2010:				
Fixed maturities	$298	($34)	$-	$264
Common and preferred stock	41	(1)	-	40
Other	(3)	(9)	-	(12)
Total	$336	($44)	$-	$292
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

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Components of Net Realized Investment Gains (Losses)	**2010**	**2009**	**2010**	**2009**
Fixed maturities:				
Gross realized gains	$90	$73	$317	$128
Gross realized losses	(32)	(52)	(53)	(236)
Equities:				
Gross realized gains	31	25	43	133
Gross realized losses	(1)	(1)	(3)	(63)
Other:				
Gross realized gains	3	8	11	78
Gross realized losses	(5)	(18)	(23)	(26)
Total net realized investment gains	$86	$35	$292	$14

Net realized investment gains for the three and nine months ended September 30, 2010 were $86 million and $292 million, respectively, increases of $51 million and $278 million over the same periods in 2009. The increases primarily reflect a decrease in impairment losses recorded in 2010 due to the improving market conditions. Fixed maturity gains for the three and nine months ended September 30, 2010 reflect gains recognized from the sale of securities related to the shift in the Company's tactical allocation versus equity gains recognized for the three and nine months ended September 30, 2009 related to the Company's decision to reduce its equity exposure. Gains on common and preferred stock for the three and nine months ended September 30, 2010 include $29 million related to the sale of Verisk Analytics Inc. common stock. Other realized gains for nine months ended September 30, 2009 that did not recur in 2010 include $25 million related to equity swap derivative contracts that terminated in January 2009.

Effective January 1, 2009, the Company adopted new guidance for accounting for other-than-temporary impairments, as codified in FASB Accounting Standards Codification ("ASC") 320, *Investments – Debt and Equity Securities.* See Footnote 1 to the Unaudited Financial Statements as of and for the three and nine months ended September 30, 2010 for details. In the first quarter of 2009, the Company recorded a cumulative effect adjustment, net of income taxes, 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 unrealized losses and fair value by security type and by duration that individual securities have been in an unrealized loss position as of September 30, 2010, that are not deemed to be other-than-temporarily impaired:

$ in Millions	**Less Than 12 Months**		**12 Months and Greater**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency Securities	($-)	$47	($-)	$-
Mortgage and asset-backed securities:				
Residential	(2)	197	(39)	371
Commercial	(-)	14	(3)	53
Other mortgage and ABS	(1)	1	(6)	37
U.S. state and municipal	(2)	129	(25)	262
Corporate and other	(23)	1,102	(97)	1,033
Foreign government securities	(33)	792	(35)	210
Total fixed maturities	(61)	2,282	(205)	1,966
Common stock	(3)	58	(24)	109
Preferred stock	(1)	35	(80)	319
Total equities	(4)	93	(104)	428
Total	($65)	$2,375	($309)	$2,394

Unrealized losses decreased from $821 million as of December 31, 2009 to $374 million as of September 30, 2010 primarily due to declining Treasury yields and a decrease in credit spreads. Unrealized losses less than 12 months decreased from $147 million at December 31, 2009 to $65 million as of September 30, 2010, a decrease of $82 million. Unrealized losses 12 months and greater decreased from $674 million as of December 31, 2009 to $309 million as of September 30, 2010 and accounted for $365 million of the overall decrease in unrealized losses. The Company monitors the difference between the amortized cost and estimated fair value of debt securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed income securities before they recover their fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be other-than-temporary, and the Company believes 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. For the three and nine months ended September 30, 2010, the Company recorded $27 million and $34 million, respectively, of fixed maturity impairment losses. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of September 30, 2010 are temporary.

For equity securities, if the decline is believed to be other-than-temporary, the carrying value of the investment is written down to fair value and a realized loss is recorded. The gross unrealized losses recorded on equity securities at September 30, 2010 resulted primarily from decreases in quoted fair values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. As of September 30, 2010, the Company has concluded that the gross unrealized losses of equity securities as of September 30, 2010 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, 2010 (including cash and cash equivalents) totaled $70.022 billion.

Short-term debt and current maturities of long-term debt outstanding as of September 30, 2010 and December 31, 2009 were as follows:

$ in Millions	**As of September 30, 2010**	**As of December 31, 2009**
Commercial paper	$-	$-
Revolving credit facilities	2	4
Current maturities of long-term debt	1	301
Total short-term debt and current maturities of long-term debt obligations	$3	$305

The decrease in short-term debt primarily reflects a decrease in current maturities of long-term debt related to the redemption of the 4.875% notes that matured in February 2010.

Long-term debt outstanding as of September 30, 2010 and December 31, 2009 was as follows:

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

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

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. 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 May 12, 2010, Liberty Mutual Agency Corporation ("LMAC") entered into a $200 million unsecured revolving credit facility for general corporate purposes with a syndicate of lenders led by Bank of America, N.A. that terminates three years following the date the facility first becomes available. On November 5, 2010, LMAC and the Ohio Casualty Corporation (OCC) entered into an Amended and Restated Revolving Credit Agreement to allow both LMAC and OCC to be joint and several co-borrowers under the facility, as well as, to change certain covenants to reflect the combined financials of the co-borrowers. The co-borrowers have the ability to trigger the availability of the facility and establish the specific terms of the financial covenants based on then-current combined financials (after giving effect to certain reorganization transactions) at any time before December 31, 2010.

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

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

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

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

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

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

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

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a $20 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, 2010, $2 million was outstanding under the facility.

Interest Expense

Consolidated interest expense for the three and nine months ended September 30, 2010 was $115 million and $345 million, decreases of $4 million and $19 million from the same periods in 2009. The decreases reflect the redemption of the 4.875% notes at maturity and debt repurchases that occurred 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, 2010, the Company, through its downstream subsidiary LMGI, had $4.792 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 and may be paid only from unassigned surplus. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards policyholders, following such dividend, is reasonable in relation to its outstanding liabilities, is adequate to its financial needs and does not exceed the insurer's unassigned surplus. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. 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, 2009) and 2010 available dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio[1]**		**Dividend Capacity[2]**	**Dividends Paid[3]**
RBC Ratios and Dividend Capacity	**2009**	**2008**	**2010**	**2010**
LMIC [4]	479%	402%	$831	$124
LMFIC	451%	501%	$92	$11
EICOW	467%	362%	$108	-

[1] Authorized control level risk-based capital as defined by the NAIC.
[2] Represents maximum allowable dividend without prior regulatory approval in the state of domicile.
[3] Dividends paid represent amounts paid during the nine months ended September 30, 2010. Available dividend capacity as of September 30, 2010 is calculated as 2010 dividend capacity less dividends paid for the preceding 12 months. Dividends paid October 1, 2009 through September 30, 2010 for LMIC, LMFIC and EICOW were $300 million, $15 million and zero, respectively.
[4] Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group. Effective January 1, 2010, the LMIC pooling percentage decreased from 75.0% to 73.8%.

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 fees estimated to be approximately $50 million.
- Investment management agreements with affiliated entities pursuant to which LMGI is entitled to recover approximately $54 million in annual expenses for investment management services performed by LMGI employees.
- Liberty Corporate Services LLC ("LCS"), which through its subsidiaries collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three and nine months ended September 30, 2010, LCS recorded $129 million and $279 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 $14.969 billion and $14.704 billion at September 30, 2010, and December 31, 2009, respectively. The increase in surplus primarily reflects net income of $504 million (the sum of earnings from the Company's 59 domestic insurance companies and dividends from subsidiaries) and unrealized gains of $475 million, partially offset by non-admitted goodwill and goodwill amortization of $479 million, dividends to stockholders of $135 million and non-admitted deferred tax assets of $112 million.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

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

- 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 of the investment portfolio;
- deferred acquisition costs;
- valuation of goodwill and intangible assets; and
- deferred income tax valuation allowance.

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

Certain reclassifications have been made to the 2009 amounts to conform with the 2010 presentation.

Adoption of New Accounting Standards

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

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

Future Adoption of New Accounting Standards

In October 2010, the FASB issued Accounting Standards Update 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* ("ASU 2010-26"). This guidance, as codified in ASC 944, *Financial Services - Insurance,* specifies that acquisition costs should include only those costs that are directly related to the acquisition or renewal of insurance contracts. All other acquisition related costs, including market research, training, administration, unsuccessful acquisition or renewal efforts, and product development, should be charged to expense as incurred. The Company is required to adopt ASU 2010-26 effective January 1, 2012. The Company is in the process of evaluating the impact of adoption.

None of the other accounting standards issued through the third quarter of 2010 will have 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, 2010 for further discussion of the Company's policies.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $48.164 billion and $48.355 billion as of September 30, 2010 and December 31, 2009, respectively. The decrease was due to a the ongoing settlement of claims and the impact of foreign exchange partially offset by business growth.

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

Establishing loss reserves, including loss reserves for catastrophic events that have occurred, is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the necessary reserve. Changes in the law, results of litigation, medical costs, the costs of repair materials, and labor rates can all affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement can be. Accordingly, "short-tail" claims, such as property damage claims, tend to be easier to estimate than "long-tail" claims, such as workers compensation or general liability claims.

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

Asbestos and Environmental

The Company's asbestos and environmental ("A&E") reserves for unpaid claims and claim adjustment expenses, net of reinsurance and including uncollectible reinsurance decreased $306 million from $1.580 billion as of December 31, 2009 to $1.274 billion as of September 30, 2010. The decrease is primarily due to a payment on a large settlement during the period.

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

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 $14.560 billion and $14.749 billion at September 30, 2010 and December 31, 2009, respectively, net of allowance for doubtful accounts. The decrease is primarily due to significant cash collections and liquidation of certain contracts, partially offset by increases in recoverables due to the Chilean earthquake.

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, 2010. Collateral held against outstanding gross reinsurance recoverable balances was $5.371 billion and $5.774 billion at September 30, 2010 and December 31, 2009, 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, 2010.

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. As of September 30, 2010, and December 31, 2009,

deferred gains related to these reinsurance arrangements were $555 million and $592 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, 2010 was $30 million and $89 million, respectively, as compared to $29 million and $87 million for the three months and nine months ended September 30, 2009, respectively. Deferred gain amortization for the three months and nine months ended September 30, 2010 was $16 million and $50 million, respectively, as compared to $17 million and $50 million for the three and nine months ended September 30, 2009, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $1.974 billion and $2.019 billion as of September 30, 2010 and December 31, 2009, respectively.

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

In 2007, the Company entered into a multi-year property catastrophe reinsurance agreement with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 million of reinsurance coverage for the Company and its affiliates in the event of a Northeast and/or Florida hurricane event. In the first quarter 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 along with company specific losses on the event. The Company has not recorded any recoveries under these programs. Mystic Re II does not have any other reinsurance in force.

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 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 impairment is a credit or a non-credit impairment. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the debt security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration, (e) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded

when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all debt securities and certain preferred equity securities) or the Company's intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in fair value.

Subsequent to quarter end, the Company has not recognized any additional material other-than-temporary impairments.

Variable Interest Entities

The Company invests in energy, private equity and real estate limited partnerships and other entities subject to variable interest entity (VIE) analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of December 31, 2009, the Company determined that it was the primary beneficiary of two VIEs in the energy investment sector, and as such, these VIEs were consolidated in the Company's 2009 financial statements. The carrying value of assets and liabilities, and the Company's maximum exposure to loss of the consolidated VIEs were immaterial to the Company. These entities were deconsolidated in 2010 upon adoption of the revised guidance in ASC 810 when the Company determined that it did not have a controlling financial interest in the VIEs.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. For these VIEs, the Company absorbs a portion, but not majority, of this variability. The carrying value of assets was $90 million and $87 million as of September 30, 2010 and December 31, 2009, respectively and the Company's maximum exposure to loss was $119 million and $99 million as of September 30, 2010 and December 31, 2009, respectively for unconsolidated VIEs in which the Company has a significant variable interest. The assets are included in Other Investments on the consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. There is no recourse provision to the general credit of the Company for any VIE beyond the full amount of the Company's loss exposure.

Derivatives

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

Total deferred policy acquisition costs were $2.760 billion and $2.636 billion as of September 30, 2010 and December 31, 2009, 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.

Goodwill

Goodwill assets were $4.756 billion and $4.748 billion as of September 30, 2010 and December 31, 2009, 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. No impairments were recorded in 2010 or 2009. 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 $564 million and $1.691 billion as of September 30, 2010 and December 31, 2009, respectively, net of a valuation allowance of $154 million and $160 million, respectively. The net decrease in the Company's net deferred income tax asset is primarily due to the change in net unrealized capital gains and losses on certain investments and a non-recurring charge due to a tax law change. The net decrease in the Company's valuation allowance is primarily due to foreign currency translation adjustments and the dissolution of a subsidiary. 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 December 31, 2009	$221
Additions based on tax positions related to current year	6
Additions for tax positions of prior years	24
Reductions for tax positions of prior years	-
Settlements	(1)
Balance at September 30, 2010	$250

Included in the tabular roll forward of unrecognized tax benefits is interest in the amount of $90 million and $85 million as of September 30, 2010 and December 31, 2009, respectively.

Included in the balance at September 30, 2010 is $150 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, 2010 and 2009, respectively, the Company recognized approximately $5 million and $15 million of interest and penalties, respectively. The Company had approximately $88 million and $82 million of interest and penalties accrued at September 30, 2010 and December 31, 2009, respectively.

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

The IRS has completed its review of the Company's Federal income tax returns through the 1998 tax year and is currently reviewing income tax returns for the 1999 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 2009 direct written premium. The Company also ranks 71st on the Fortune 500 list of largest corporations in the United States based on 2009 revenue. As of December 31, 2009, LMG had $109.475 billion in consolidated assets, $94.961 billion in consolidated liabilities, and $31.094 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: LMAC, International, Personal Markets and Commercial Markets. 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.