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

Quarter Ended September 30, 2012

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 Insurance group of entities (the "Company" or "LMHC"), for the three and nine months ended September 30, 2012 and 2011. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's December 31, 2011 Audited Consolidated Financial Statements, September 30, 2012 Unaudited Consolidated Financial Statements and Third Quarter 2012 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. Further, the Company notes that it may make material information regarding the Company available to the public, from time to time, via the Company's Investor Relations website at www.libertymutual.com/investors (or any successor site).

Index

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, tornadoes, tsunamis, earthquakes, floods, 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 ("LP") and limited liability companies ("LLC"); 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 Consolidated Financial Statements.

Three Months Ended September 30, 2012 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2012 were $9.278 billion, an increase of $511 million or 5.8% over the same period in 2011.
- Net written premium ("NWP") for the three months ended September 30, 2012 was $8.651 billion, an increase of $515 million or 6.3% over the same period in 2011.
- Pre-tax operating income ("PTOI") before LP and LLC income for the three months ended September 30, 2012 was $469 million versus a pre-tax operating loss before LP and LLC income of $340 million in the same period in 2011.
- PTOI for the three months ended September 30, 2012 was $511 million versus a pre-tax operating loss of $202 million in the same period in 2011.
- Loss on extinguishment of debt for the three months ended September 30, 2012 was zero versus $37 million in the same period in 2011. No debt was repurchased in the quarter, $500 million of senior debt was issued with a weighted average interest rate of 5.73%, and $204 million of debt matured.
- Net income attributable to LMHC for the three months ended September 30, 2012 was $465 million versus a $112 million net loss attributable to LMHC in the same period in 2011.
- Cash flow from operations for the three months ended September 30, 2012 was $1.019 billion, an increase of $434 million or 74.2% over the same period in 2011.
- The consolidated combined ratio before catastrophes[1], net incurred losses attributable to prior years[2] and current accident year re-estimation[3] for the three months ended September 30, 2012 was 96.6%, a decrease of 1.4 points from the same period in 2011. Including the impact of catastrophes, net incurred losses attributable to prior years and current accident year re-estimation, the Company's combined ratio for the three months ended September 30, 2012 decreased 12.2 points to 98.5%.

Nine Months Ended September 30, 2012 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2012 were $27.316 billion, an increase of $1.608 billion or 6.3% over the same period in 2011.
- NWP for the nine months ended September 30, 2012 was $25.064 billion, an increase of $1.577 billion or 6.7% over the same period in 2011.

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[1]Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. 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) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains.

[3]Re-estimation of the current accident year loss reserves for the six months ended June 30, 2012 and June 30, 2011.

- PTOI before LP and LLC income for the nine months ended September 30, 2012 was $973 million versus $501 million of pre-tax operating loss before LP and LLC income in the same period in 2011.

- PTOI for the nine months ended September 30, 2012 was $1.227 billion versus $25 million of pre-tax operating loss in the same period in 2011.

- Loss on extinguishment of debt for the nine months ended September 30, 2012 was $163 million, an increase of $86 million over the same period in 2011. $837 million of debt with a weighted average interest rate of 8.16% was repurchased year-to-date, $1.500 billion of senior debt was issued with a weighted average interest rate of 5.73%, and $204 million of debt matured.

- Net income attributable to LMHC for the nine months ended September 30, 2012 was $1.063 billion, versus net income of $73 million in the same period in 2011, an increase of $990 million.

- Cash flow from operations for the nine months ended September 30, 2012 was $2.244 billion, an increase of $722 million or 47.4% over the same period in 2011.

- The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2012 was 96.9%, an increase of 0.1 points over the same period in 2011. 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, 2012 decreased 6.9 points to 101.7%.

Financial Condition as of September 30, 2012

- Total assets were $119.341 billion as of September 30, 2012, an increase of $2.490 billion over December 31, 2011.

- Total equity was $19.624 billion as of September 30, 2012, an increase of $2.025 billion over December 31, 2011.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated PTOI and PTOI before LP and LLC income as non-GAAP financial measures. PTOI is defined by the Company as pre-tax income excluding net realized gains, loss on extinguishment of debt, extraordinary items, discontinued operations, integration and other acquisition and realignment related costs and cumulative effects of changes in accounting principles. PTOI before LP and LLC income is defined as PTOI excluding LP and LLC results recognized on the equity method. PTOI before LP and LLC income 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 gains and LP and LLC 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 and realignment related costs and the extinguishment of debt are not connected to the management of the insurance and underwriting aspects of the Company's 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 NWP 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 and Other segment. The Company believes that NWP 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.

On July 24, 2012, the Company announced the realignment of its four Strategic Business Units ("SBUs"). The four new SBUs are as follows:

- Personal Insurance includes all domestic personal lines business. Liberty Mutual and Safeco brands and products are being maintained, and distribution channels continue to be managed separately. Personal Insurance also includes Individual Life.

- Commercial Insurance serves traditional domestic commercial property and casualty accounts of all sizes and includes Summit and Group Benefits. As part of the realignment, the brands for the regional companies will no longer be used and are being replaced by a regional operating model under the Liberty Mutual Insurance brand.

- Liberty International comprises local country operations.

- Global Specialty includes Liberty International Underwriters ("LIU") including Liberty's Lloyd's Syndicate 4472 ("Syndicate 4472"), Liberty Mutual Surety ("LMS"), and Liberty Mutual Reinsurance ("LMR").

All historical results have been restated to reflect this change.

Overview – Consolidated

Consolidated NWP by significant line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Private passenger automobile	$3,076	$2,897	6.2%	$8,603	$8,060	6.7%
Homeowners	1,084	968	12.0	2,918	2,594	12.5
Workers compensation	951	909	4.6	2,872	2,825	1.7
Commercial multiple-peril / fire	686	676	1.5	1,969	1,919	2.6
Commercial automobile	480	453	6.0	1,412	1,359	3.9
Syndicate 4472	381	355	7.3	1,299	1,184	9.7
General liability	338	315	7.3	980	961	2.0
Group disability and life	293	273	7.3	860	826	4.1
LIU third party	223	209	6.7	708	628	12.7
Individual life and health	200	191	4.7	640	536	19.4
Surety	192	196	(2.0)	549	578	(5.0)
LIU inland marine program	135	104	29.8	376	299	25.8
LIU first party	81	76	6.6	282	276	2.2
Other[1] (including AVR)	531	514	3.3	1,596	1,442	10.7
Total NWP[2]	$8,651	$8,136	6.3%	$25,064	$23,487	6.7%

1 Primarily includes NWP from assumed voluntary reinsurance ("AVR"), allied lines and domestic inland marine.
2 NWP associated with internal reinsurance has been re-allocated to the appropriate lines of business.

Consolidated NWP by SBU was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Personal Insurance	$3,764	$3,473	8.4%	$10,392	$9,515	9.2%
Commercial Insurance	2,544	2,504	1.6	7,511	7,553	(0.6)
International	1,421	1,342	5.9	4,122	3,809	8.2
Global Specialty	1,078	1,006	7.2	3,338	3,098	7.7
Corporate and Other	(156)	(189)	(17.5)	(299)	(488)	(38.7)
Total NWP	$8,651	$8,136	6.3%	$25,064	$23,487	6.7%
Foreign exchange effect on growth			(1.5%)			(1.2%)
NWP growth excluding foreign exchange			7.8%			7.9%

Major drivers of NWP growth were as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
$ in Millions	**2012**	**2011**	**$ Change**	**Points Attribution**	**2012**	**2011**	**$ Change**	**Points Attribution**
Total NWP	$8,651	$8,136	$515	6.3	$25,064	$23,487	$1,577	6.7
Components of Growth:								
International local businesses (ex foreign exchange)	1,534	1,342	192	2.4	4,379	3,809	570	2.4
Domestic personal automobile	2,226	2,080	146	1.8	6,212	5,790	422	1.8
-Domestic homeowners	1,248	1,112	136	1.7	3,334	2,963	371	1.6
-Homeowners quota share	(221)	(199)	(22)	(0.3)	(588)	(525)	(63)	(0.3)
Total domestic homeowners	1,027	913	114	1.4	2,746	2,438	308	1.3
LIU (ex foreign exchange)	469	401	68	0.8	1,449	1,254	195	0.8
Syndicate 4472 (ex foreign exchange)	386	355	31	0.4	1,317	1,184	133	0.6
Domestic individual life	87	94	(7)	(0.1)	289	241	48	0.2
Domestic group disability and life	197	193	4	-	591	595	(4)	-
Surety	192	196	(4)	-	549	578	(29)	(0.1)
Other commercial lines	2,657	2,562	95	1.1	7,825	7,598	227	0.9
Foreign exchange	(124)	-	(124)	(1.5)	(293)	-	(293)	(1.2)
Total NWP	$8,651	$8,136	$515	6.3	$25,064	$23,487	$1,577	6.7

Consolidated NWP by geographic distribution channels was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
U.S.	$6,715	$6,306	6.5%	$19,230	$18,077	6.4%
International[1]	1,936	1,830	5.8	5,834	5,410	7.8
Total NWP	$8,651	$8,136	6.3%	$25,064	$23,487	6.7%

1 Excludes domestically written business in Global Specialty's LIU segment.

NWP for the three and nine months ended September 30, 2012 was $8.651 billion and $25.064 billion, respectively, increases of $515 million and $1.577 billion over the same periods in 2011. Significant changes by major line of business include:

- Private passenger automobile NWP increased $179 million and $543 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect growth of policies in-force (4.4%) and rate increases in Personal Insurance, organic growth in International, primarily in Latin America (Venezuela), and the acquisition of Quinn Insurance Limited ("QIL") in Ireland in November 2011.
- Homeowners NWP increased $116 million and $324 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect growth of policies in-force (6.5%) and rate increases in Personal Insurance.
- Workers compensation NWP increased $42 million and $47 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect rate increases, audit premiums and the "booked as billed" adjustment in Corporate and Other, substantially offset by exposure reductions.

- Syndicate 4472 NWP increased $26 million and $115 million in the quarter and year-to-date, respectively. The increases in both periods were largely due to favorable rates and new business.
- LIU third party NWP increased $14 million and $80 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect new business from casualty and specialty casualty lines.
- Individual life and health NWP increased $9 million and $104 million in the quarter and year-to-date, respectively. The year-to-date increase was primarily driven by organic growth including higher renewal premium in Venezuela and strong structured settlement sales in Personal Insurance in 2012 compared to 2011.
- LIU inland marine program NWP increased $31 million and $77 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect subscriber growth, pricing mix and the inception of a program in Japan in 2012.

More detailed explanations of the changes in NWP 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, and other material information, 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	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$9,278	$8,767	5.8%	$27,316	$25,708	6.3%
PTOI before catastrophes, net incurred losses attributable to prior years, current accident year re-estimation and LP and LLC income	$641	$568	12.9%	$2,042	$1,984	2.9%
Catastrophes[1]	(45)	(596)	(92.4)	(1,017)	(2,447)	(58.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(53)	(339)	(84.4)	(57)	(341)	(83.3)
- All other[3]	(21)	76	NM	5	303	(98.3)
Current accident year re-estimation[4]	(53)	(49)	8.2	-	-	-
Pre-tax operating income (loss) before LP and LLC income	469	(340)	NM	973	(501)	NM
LP and LLC income[5]	42	138	(69.6)	254	476	(46.6)
Pre-tax operating income (loss)	511	(202)	NM	1,227	(25)	NM
Net realized gains	128	41	NM	349	168	107.7
SBU realignment expenses	(42)	-	NM	(42)	-	NM
Loss on extinguishment of debt	-	(37)	(100.0)	(163)	(77)	111.7
Pre-tax income (loss)	597	(198)	NM	1,371	66	NM
Income tax (expense) benefit	(132)	88	NM	(315)	12	NM
Consolidated net income (loss)	465	(110)	NM	1,056	78	NM
Less: Net income (loss) attributable to non-controlling interest	-	2	(100.0)	(7)	5	NM
Net income (loss) attributable to LMHC	$465	($112)	NM	$1,063	$73	NM
Cash flow from operations	$1,019	$585	74.2%	$2,244	$1,522	47.4%

1 Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 2011 includes $294 million of strengthening of asbestos related reserves in connection with a ground-up reserve study.
3 Net of earned premium attributable to prior years of $19 million and $52 million for the three and nine months ended September 30, 2012 and zero and $16 million for the same periods in 2011. Net of amortization of deferred gains on retroactive reinsurance of $11 million and $32 million for the three and nine months ended September 30, 2012 and $16 million and $129 million for the same periods in 2011. 2011 reflects a gain on commutation of two retroactive reinsurance contracts during the first quarter.
4 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2012 and June 30, 2011.
5 LP and LLC income is included in net investment income in the accompanying consolidated statements of operations.
NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2012 was $511 million and $1.227 billion, respectively, increases of $713 million and $1.252 billion over the same periods in 2011. The increases in both periods primarily reflect earned premium growth, significantly lower catastrophes, favorable non-catastrophe losses in homeowners and commercial multiple-peril lines of business, partially offset by lower LP and LLC income and increases in current accident year losses in workers compensation, property, and surety lines of business. In addition, the quarter was impacted by lower prior year loss development. In 2011, approximately $300 million in asbestos reserves were recorded.

Revenues for the three and nine months ended September 30, 2012 were $9.278 billion and $27.316 billion, respectively, increases of $511 million and $1.608 billion over the same periods in 2011. The major components of revenues are net premium earned, net investment income, net realized gains, and fee and other revenues.

Net premium earned for the three months and nine months ended September 30, 2012 was $8.147 billion and $23.776 billion, respectively, increases of $518 million and $1.544 billion over the same periods in 2011. The increases in both periods primarily reflect strong written premium growth in the prior twelve months, including rate increases, audit premiums and the acquisition of QIL, partially offset by the impact of foreign exchange.

Net investment income for the three and nine months ended September 30, 2012 was $755 million and $2.449 billion, respectively, decreases of $126 million and $221 million from the same periods in 2011. The decreases in both periods primarily reflect lower valuation increases in LP and LLC investments. In addition, the quarter also reflects a decrease in taxable interest income due to lower investment yields primarily attributable to a tactical portfolio re-alignment.

Net realized gains for the three and nine months ended September 30, 2012 were $128 million and $349 million, respectively, increases of $87 million and $181 million over the same periods in 2011. The increase in the quarter and year-to-date primarily relates to gains recognized from security sales as part of a tactical portfolio re-alignment. Additionally, year-to-date is impacted by a gain on the sale of investments in the energy sector, a gain recognized from the sale of a business segment in Argentina and contingent consideration recognized in connection with the prior sale of certain Commercial Insurance policy renewal rights in 2009, partially offset by increased impairments due to market volatility.

Fee and other revenues for the three and nine months ended September 30, 2012 were $248 million and $742 million, respectively, increases of $32 million and $104 million over the same periods in 2011. The increases in both periods primarily reflect higher oil and gas revenues in Corporate and Other due to increased production, increases in Commercial Insurance revenues from servicing carrier operations due to higher involuntary market premium volume, and third-party administrator fee income. The year-to-date increase was also due to higher premium finance revenues in International and Personal Insurance.

Claims, benefits and expenses for the three and nine months ended September 30, 2012 were $8.639 billion and $25.740 billion, respectively, a decrease of $289 million and an increase of $175 million versus the same periods in 2011. The quarter and year-to-date reflect significantly lower catastrophe losses and favorable non-catastrophe losses in homeowners and commercial multiple-peril, offset by workers compensation and property lines' current accident year losses, and increases in losses and expenses consistent with business growth and higher variable compensation costs due to improved earnings. Both periods also reflect lower asbestos and environmental reserve increases versus 2011, partially offset by favorable loss development in 2011.

Loss on extinguishment of debt for the three and nine months ended September 30, 2012 was zero and $163 million, respectively, versus $37 million and $77 million in the same periods in 2011, primarily resulting from two tender offers completed in the second quarter of 2012. For the nine months ended September 30, 2012, $837 million of debt with a weighted average interest rate of 8.16% was repurchased and $1.500 billion was issued with a weighted average interest rate of 5.73%.

Expenses related to the Company's realignment of its SBUs include a $33 million impairment of an intangible asset related to the decision to discontinue the regional company brands.

Income tax (expense) benefit for the three and nine months ended September 30, 2012 was ($132) million and ($315) million, respectively, versus $88 million and $12 million for the same periods in 2011. The Company's effective tax rate for the three and nine months ended September 30, 2012 was 22% and 23% compared to 44% and (18%) for the same periods in 2011. For the three months ended September 30, 2012 the Company reported an income tax provision on pre-tax income as compared to reporting an income tax benefit on a pre-tax loss for the three months ended September 30, 2011. The effective tax rate for the nine months ended September 30, 2012 increased over the effective tax rate for the same period in 2011 primarily due to increased pre-tax income and reductions in tax-exempt income, offset by increased general business credits and favorable developments in revisions to prior-year estimates. The Company's effective tax rate differs from the federal statutory rate of 35% principally due to tax-exempt investment income, foreign taxes, and general business credits.

Net income (loss) attributable to LMHC for the three and nine months ended September 30, 2012 was $465 million and $1.063 billion, respectively, versus ($112) million and $73 million in the same periods in 2011.

Cash flow from operations for the three and nine months ended September 30, 2012 was $1.019 billion and $2.244 billion, increases of $434 million and $722 million over the same periods in 2011. The increases in both periods reflect higher premium collections and lower catastrophe losses partially offset by the impact of QIL cash outflow due to loss reserve liquidation and higher non-catastrophe paid losses and expenses consistent with business growth. In addition, the current year-to-date was also impacted by a federal income tax refund.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
	2012	**2011**	**Change (Points)**	**2012**	**2011**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	67.5%	69.1%	(1.6)	67.5%	68.1%	(0.6)
Underwriting expense ratio	29.0	28.8	0.2	29.2	28.5	0.7
Dividend ratio	0.1	0.1	-	0.2	0.2	-
Subtotal	96.6	98.0	(1.4)	96.9	96.8	0.1
Catastrophes[1]	0.5	8.2	(7.7)	4.5	11.5	(7.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	0.4	4.8	(4.4)	0.4	1.8	(1.4)
- All other	0.3	(1.0)	1.3	(0.1)	(1.5)	1.4
Current accident year re-estimation[2]	0.7	0.7	-	-	-	-
Total combined ratio[3]	98.5%	110.7%	(12.2)	101.7%	108.6%	(6.9)

1 Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2012 and June 30, 2011.

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. Provisions for uncollectible premium and reinsurance are not included in the combined ratio unless related to an asbestos and environmental commutation and certain other run off.

The consolidated combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and nine months ended September 30, 2012 was 96.6% and 96.9%, a decrease of 1.4 points and an increase of 0.1 points versus the same periods in 2011. The claims and claim adjustment expense ratio for both periods reflects favorable non-catastrophe losses in homeowners and commercial multiple-peril lines of business, partially offset by current accident year losses in workers compensation, property and surety lines of business. The increases in the underwriting expense ratio in both periods reflect increased investment in growth-related items, primarily captive sales representatives and advertising, increased variable compensation due to improved operating results, higher benefit costs and increased investment in technology, partially offset by earned premium growth and higher servicing carrier revenue.

Including the impact of catastrophes, net incurred losses attributable to prior years and current accident year re-estimation, the total combined ratio for the three and nine months ended September 30, 2012 was 98.5% and 101.7%, respectively, decreases of 12.2 points and 6.9 points from the same periods in 2011. The decreases in both periods primarily reflect lower catastrophes, as well as the changes in the combined ratio previously discussed. In addition, the quarter was impacted by prior year development for asbestos reserves recorded in 2011.

PERSONAL INSURANCE

Overview – Personal Insurance

Personal Insurance sells automobile, homeowners and other types of property-casualty insurance coverage, as well as life and annuity products, to individuals in the U.S. Personal Insurance comprises two segments: Personal Lines and Safeco. Personal Lines products are distributed through more than 2,300 licensed captive sales representatives, approximately 500 licensed telesales counselors, third-party producers (including banks for life products) and the Internet. Personal Lines' largest source of new business is through its 14,000 sponsored affinity groups (including employers, professional and alumni associations, credit unions, and other partnerships). Safeco products are distributed nationally through independent agents.

Effective in the third quarter of 2012, Personal Insurance became a new SBU replacing the former Personal Markets SBU. The financial results of Personal Insurance differ from Personal Markets results principally due to the addition of Safeco. As such, results of Personal Insurance are not directly comparable to the previously reported financial information for Personal Markets. All prior periods have been restated to reflect this change.

Personal Insurance NWP by segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Personal Lines	$2,197	$2,024	8.5%	$6,118	$5,579	9.7%
Safeco	1,567	1,449	8.1	4,274	3,936	8.6
Total NWP	$3,764	$3,473	8.4%	$10,392	$9,515	9.2%

Personal Insurance NWP by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Private passenger automobile	$2,226	$2,079	7.1%	$6,208	$5,787	7.3%
Homeowners and other	1,453	1,301	11.7	3,904	3,492	11.8
Individual life	85	93	(8.6)	280	236	18.6
Total NWP	$3,764	$3,473	8.4%	$10,392	$9,515	9.2%

NWP for the three and nine months ended September 30, 2012 was $3.764 billion and $10.392 billion, respectively, increases of $291 million and $877 million over the same periods in 2011.

Private passenger automobile NWP for the three and nine months ended September 30, 2012 was $2.226 billion and $6.208 billion, respectively, increases of $147 million and $421 million over the same periods in 2011. The increases reflect 4.4% growth in auto policies in-force as compared to September 30, 2011 as well as rate increases.

Homeowners and other NWP for the three and nine months ended September 30, 2012 was $1.453 billion and $3.904 billion, respectively, increases of $152 million and $412 million over the same periods in 2011. The increases reflect 6.5% growth in homeowners policies in-force as compared to September 30, 2011 as well as rate increases.

Individual life NWP for the three and nine months ended September 30, 2012 was $85 million and $280 million, respectively, a decrease of $8 million and an increase of $44 million versus the same periods in

2011. The changes in both periods were driven by structured settlements. Sales declined in the quarter but remained higher year-to-date compared to 2011.

Results of Operations – Personal Insurance

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$3,677	$3,420	7.5%	$10,725	$9,959	7.7%
PTOI before catastrophes and net incurred losses attributable to prior years	$543	$484	12.2%	$1,663	$1,454	14.4%
Catastrophes[1]	21	(482)	NM	(793)	(1,629)	(51.3)
Net incurred losses attributable to prior years	128	38	NM	148	123	20.3
Pre-tax operating income (loss)	$692	$40	NM	$1,018	($52)	NM

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.

NM=Not Meaningful

Pre-tax operating income (loss) for the three and nine months ended September 30, 2012 was $692 million and $1.018 billion, respectively, versus $40 million and ($52) million in the same periods in 2011. Both periods are impacted by favorable non-catastrophe loss trends in the homeowners line primarily due to the mild winter and the impact of growth in net premiums earned versus the prior year partially offset by an increase in expenses as a result of an investment in information technology and growth related items such as higher advertising and captive agents. Both periods were also positively impacted by lower catastrophe due to Hurricane Irene and significant tornado, hail and other severe storms occurring in 2011 as well as favorable catastrophe prior period development recognized in 2012. The quarter was also significantly impacted by favorable non-catastrophe incurred losses attributable to prior years.

Revenues for the three and nine months ended September 30, 2012 were $3.677 billion and $10.725 billion, respectively, increases of $257 million and $766 million over the same periods in 2011. 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, 2012 was $3.345 billion and $9.743 billion, respectively, increases of $243 million and $722 million over the same periods in 2011. The increases in both periods reflect the premium earned associated with the changes in NWP previously discussed.

Net investment income for the three and nine months ended September 30, 2012 was $271 million and $803 million, respectively, increases of $10 million and $30 million over the same periods in 2011. The increases were driven by a higher average invested asset base partially offset by a lower yield environment.

Claims, benefits and expenses for the three and nine months ended September 30, 2012 were $2.981 billion and $9.703 billion, respectively, decreases of $399 million and $302 million from the same periods in 2011. The decreases in both periods reflect lower catastrophe losses, an increase in the amount of favorable incurred losses attributable to prior years, and favorable non-catastrophe loss trends in the homeowners line of business. These items are partially offset by an increase in losses and expenses consistent with business growth as well as higher variable compensation costs due to improved earnings.

	Three Months Ended September 30,			Nine Months Ended September 30,		
			Change			Change
PERSONAL INSURANCE	**2012**	**2011**	**(Points)**	**2012**	**2011**	**(Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	62.1%	63.4%	(1.3)	61.3%	62.9%	(1.6)
Underwriting expense ratio	25.9	25.2	0.7	25.9	25.5	0.4
Subtotal	88.0	88.6	(0.6)	87.2	88.4	(1.2)
Catastrophes[1]	(0.6)	16.1	(16.7)	8.4	18.5	(10.1)
Net incurred losses attributable to prior years	(3.9)	(1.3)	(2.6)	(1.6)	(1.4)	(0.2)
Total combined ratio	83.5%	103.4%	(19.9)	94.0%	105.5%	(11.5)

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 Personal Insurance combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2012 was 88.0% and 87.2%, respectively, decreases of 0.6 points and 1.2 points from the same periods in 2011. The decreases in the claims and claim adjustment expense ratio primarily reflect favorable non-catastrophe loss trends in the homeowners line of business. The increases in the underwriting expense ratio are the result of an investment in information technology and growth-related items, such as increased captive sales representatives and higher advertising expenditures as well as higher variable compensation costs due to improved earnings.

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, 2012 was 83.5% and 94.0%, respectively, decreases of 19.9 points and 11.5 points from the same periods in 2011. The decreases in both periods primarily reflect lower catastrophe losses, an increase in favorable net incurred losses attributable to prior years in 2012 compared to 2011 as well as the changes in the combined ratio previously discussed.

COMMERCIAL INSURANCE

Overview – Commercial Insurance

Commercial Insurance offers a wide array of property-casualty and group benefits insurance coverages through independent agents, brokers and benefit consultants throughout the U.S. Commercial Insurance is organized into the following four markets: National Insurance, Business Insurance, Group Benefits, and Other Commercial Insurance. National Insurance provides commercial lines products and services, including third-party administration, to large businesses. Business Insurance serves the small and middle market segments through a regional operating model that combines local underwriting, market knowledge, and service orientation with the scale advantages of a national company. Group Benefits provides mid-sized and large businesses with short- and long-term disability insurance products and group life insurance. Other Commercial Insurance primarily consists of internal reinsurance and assumed business from state based workers compensation involuntary market pools. The Company is also a servicing carrier for state based workers compensation involuntary market pools.

On July 24, 2012, Commercial Insurance was formed by combining the Regional Companies Group, which was previously part of the Liberty Mutual Agency Corporation ("LMAC") strategic business unit, and the Commercial Markets strategic business unit, excluding LMR, which is now part of Global Specialty. All prior periods have been restated to reflect the realignment.

The "booked as billed" adjustment and other treaties between the former Commercial Markets SBU and Corporate and Other are still booked through Corporate and Other and relate to the former Commercial Markets business.

Commercial Insurance NWP by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Business Insurance	$1,636	$1,698	(3.7%)	$4,872	$4,981	(2.2%)
National Insurance	637	547	16.5	1,878	1,788	5.0
Group Benefits	197	193	2.1	590	595	(0.8)
Other Commercial Insurance	74	66	12.1	171	189	(9.5)
Total NWP	$2,544	$2,504	1.6%	$7,511	$7,553	(0.6%)

Commercial Insurance NWP by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Workers compensation	$962	$939	2.4%	$2,882	$2,953	(2.4%)
Commercial automobile	374	388	(3.6)	1,110	1,131	(1.9)
Commercial multiple-peril	551	556	(0.9)	1,566	1,581	(0.9)
General liability	274	259	5.8	801	801	-
Group disability and life	197	193	2.1	590	595	(0.8)
Other Lines	186	169	10.1	562	492	14.2
Total NWP	$2,544	$2,504	1.6%	$7,511	$7,553	(0.6%)

NWP for the three and nine months ended September 30, 2012 was $2.544 billion and $7.511 billion, respectively, an increase of $40 million and a decrease of $42 million versus the same periods in 2011. Both periods reflect increased rate and exposures on renewal business across all property and casualty lines of business, increased audit premium, and higher involuntary market premium due to pool growth, partially offset by a decline in new business premium within Business Insurance due to disciplined underwriting in a continued competitive marketplace. Both periods also reflect a reduction in workers compensation exposures, offset by increasing rate and audit premium. On a year-to-date basis, the decrease reflects two large 2011 events which did not recur, a multi-year policy written in 2011 and a large disability account transfer in Group Benefits.

Results of Operations – Commercial Insurance

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$2,891	$2,789	3.7%	$8,491	$8,321	2.0%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$155	$136	14.0%	$477	$465	2.6%
Catastrophes[1]	(27)	(195)	(86.2)	(299)	(666)	(55.1)
Net incurred losses attributable to prior years[2]	25	(2)	NM	89	15	NM
Current accident year re-estimation[3]	(53)	(49)	8.2	-	-	-
Pre-tax operating income (loss)	$100	($110)	NM	$267	($186)	NM

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

2 Net of earned premium attributable to prior years of $18 million and $40 million for the three and nine months ended September 30, 2012 and $5 million and $6 million for the same periods in 2011. Net of amortization of deferred gains on assumed retroactive reinsurance of $1 million and $2 million for the three and nine months ended September 30, 2012 and $1 million and $5 million for the same periods in 2011.

3 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2012 and June 30, 2011.

NM = Not Meaningful

Pre-tax operating income (loss) for the three and nine months ended September 30, 2012 was $100 million and $267 million, respectively, versus ($110) million and ($186) million in the same periods in 2011. The increases in both periods reflect non-catastrophe losses in the commercial multiple-peril line of business and growth in net earned premiums, partially offset by increased current accident year losses in the workers compensation and property lines of business. Both periods were also positively impacted by lower catastrophe losses and favorable net incurred losses attributable to prior years. The year-to-date was favorably impacted by an improvement in long-term disability results.

Revenues for the three and nine months ended September 30, 2012 were $2.891 billion and $8.491 billion, respectively, increases of $102 million and $170 million over the same periods in 2011. 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, 2012 was $2.490 billion and $7.291 billion, respectively, increases of $91 million and $149 million over the same periods in 2011. The increases in both periods reflect increased National Insurance net written premium, primarily due to rate increases, higher involuntary market premium primarily due to pool growth and higher audit premiums. The increase in the year was partially offset by a large disability account transfer in Group Benefits from 2011 that did not recur.

Net investment income for the three and nine months ended September 30, 2012 was $321 million and $961 million, respectively, increases of $1 million over the same periods in 2011.

Fee and other revenues for the three and nine months ended September 30, 2012 were $80 million and $239 million, respectively, increases of $10 million and $20 million over the same periods in 2011. The increases in both periods reflect higher commission revenue from servicing carrier operations due to higher involuntary market premium volume, and third-party administrator fee income. As a servicing carrier, the

Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits, and expenses for the three and nine months ended September 30, 2012 were \$2.791 billion and \$8.224 billion, respectively, decreases of \$108 million and \$283 million from the same periods in 2011. The decreases in both periods reflect lower catastrophe losses, favorable incurred losses attributable to prior years and favorable non-catastrophe losses in the commercial multiple-peril line of business. The year was favorably impacted by an improvement in long-term disability losses and the costs associated with a large disability account written in 2011 that did not recur. The decreases in both periods were partially offset by increased current accident year losses in the workers compensation and property lines of business.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
			Change			**Change**
COMMERCIAL INSURANCE	**2012**	**2011**	**(Points)**	**2012**	**2011**	**(Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	77.9%	78.3%	(0.4)	77.9%	77.2%	0.7
Underwriting expense ratio	28.3	29.1	(0.8)	28.7	29.2	(0.5)
Dividend ratio	0.4	0.4	-	0.4	0.4	-
Subtotal	106.6	107.8	(1.2)	107.0	106.8	0.2
Catastrophes[1]	1.2	8.9	(7.7)	4.5	10.2	(5.7)
Net incurred losses attributable to prior years[2]	(1.2)	-	(1.2)	(1.4)	(0.3)	(1.1)
Current accident year re-estimation[3]	2.3	2.2	0.1	-	-	-
Total combined ratio	108.9%	118.9%	(10.0)	110.1%	116.7%	(6.6)

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

2 Net of earned premium attributable to prior years.

3 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2012 and June 30, 2011.

The Commercial Insurance combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and nine months ended September 30, 2012 was 106.6% and 107.0%, respectively, a decrease of 1.2 points and an increase of 0.2 points versus the same periods in 2011. The claims and claim adjustment expense ratio in both periods was impacted by increased workers compensation and property losses and lower commercial multiple-peril losses. The decreases in the underwriting expense ratio in both periods reflect higher 2012 earned premium and increased servicing carrier commission revenue.

Including the impact of catastrophes, net incurred losses attributable to prior years and current accident year re-estimation, the total combined ratio for the three and nine months ended September 30, 2012 was 108.9% and 110.1%, respectively, decreases of 10.0 points and 6.6 points from the same periods in 2011. The decreases in both periods reflect lower catastrophe losses attributable to the tornadoes and severe storms during 2011. The decreases in both periods also reflect favorable net incurred losses attributable to prior years.

INTERNATIONAL

Overview – International

International sells property, casualty, health and life insurance products and services to individuals and businesses in three geographic regions: Latin America, including Venezuela, Brazil, Colombia, Argentina (Liberty ART S.A., a workers compensation business, was sold in June 2012), Chile and Ecuador (as a result of the Panamericana de Seguros del Ecuador S.A. and Cervantes S.A. Compania de Seguros y Reaseguros acquisitions in August 2012); Europe, including Spain, Portugal, Turkey, Poland, Ireland (as a result of the Quinn Insurance Limited acquisition in November 2011) and Russia (as a result of the KIT Finance Insurance acquisition in March 2012); and Asia, including Thailand, Singapore, China (including Hong Kong) and Vietnam. Private passenger automobile insurance is the single largest line of business.

The International SBU was realigned effective in the third quarter of 2012. The financial results differ principally due to the removal of the results of operation of LIU, including its Syndicate 4472. As such, the results of International are not directly comparable to the previously reported financial information for the International SBU. All prior periods have been restated to reflect this change.

International NWP by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Latin America	$936	$916	2.2%	$2,709	$2,564	5.7%
Europe	373	327	14.1	1,093	962	13.6
Asia	112	99	13.1	320	283	13.1
Total NWP	$1,421	$1,342	5.9%	$4,122	$3,809	8.2%
Foreign exchange effect on growth			(8.4%)			(6.8%)
NWP growth excluding foreign exchange			14.3%			15.0%

International NWP by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Private passenger automobile	$850	$817	4.0%	$2,391	$2,270	5.3%
Commercial automobile	106	67	58.2	302	232	30.2
Homeowners	57	55	3.6	172	156	10.3
Life and health	209	177	18.1	620	526	17.9
Other commercial[1]	199	226	(11.9)	637	625	1.9
Total NWP	$1,421	$1,342	5.9%	$4,122	$3,809	8.2%

1 Premium related to other commercial lines including bonds, workers compensation, property and fire, small and medium enterprise and marine and cargo lines of business.

NWP for the three and nine months ended September 30, 2012 was $1.421 billion and $4.122 billion, respectively, increases of $79 million and $313 million over the same periods in 2011. The increases in both periods reflect organic growth across all the regions, primarily in Latin America, led by the impact of inflation in Venezuela, followed by Europe, mainly attributable to the acquisitions in Ireland (primarily in the private passenger auto line of business) and Russia, and to a lesser extent, Asia, led by China. The increases were partially offset by the impact of foreign exchange (approximately $113 million and $257 million in the quarter and year-to-date, respectively, primarily driven by a weakened real and euro).

Results of Operations – International

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$1,468	$1,404	4.6%	$4,449	$4,046	10.0%
PTOI before catastrophes and net incurred losses attributable to prior years	$61	$74	(17.6%)	$188	$213	(11.7%)
Catastrophes[1]	2	-	NM	-	-	-
Net incurred losses attributable to prior years[2]	(6)	(8)	(25.0%)	(15)	(16)	(6.3%)
PTOI	$57	$66	(13.6%)	$173	$197	(12.2%)

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

2 Net of earned premium attributable to prior years of zero and ($1) million for the three months and nine months ended September 30, 2012, respectively, and zero for the same periods in 2011.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2012 was $57 million and $173 million, respectively, decreases of $9 million and $24 million from the same periods in 2011. The decreases in both periods were primarily driven by an increase in expenses in 2012 related to enhancements to global technology infrastructure, as well as the impact of foreign exchange (approximately $6 million and $10 million in the quarter and year-to-date, respectively). The decrease year-to-date was partially offset by an increase in net investment income.

Revenues for the three and nine months ended September 30, 2012 were $1.468 billion and $4.449 billion, respectively, increases of $64 million and $403 million over the same periods in 2011. 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, 2012 was $1.325 billion and $3.980 billion, respectively, increases of $54 million and $309 million over the same periods in 2011. The increases in both periods reflect the previously mentioned growth in NWP in 2012, partially offset by the impact of foreign exchange.

Net investment income for the three and nine months ended September 30, 2012 was $109 million and $334 million, respectively, increases of $6 million and $42 million over the same periods in 2011. The increases in both periods reflect the acquisition in Ireland. The year-to-date increase also reflects a higher invested asset base due to the reinvestment of cash flow from operations driven by the growth in NWP, partially offset by a decrease in overall investment yield primarily due to lower reinvestment rates.

Claims, benefits and expenses for the three and nine months ended September 30, 2012 were $1.414 billion and $4.262 billion, respectively, increases of $69 million and $391 million over the same periods in 2011. The increases in both periods were primarily driven by the acquisition in Ireland. The year-to-date increase also reflects the organic growth in Latin America led by Venezuela primarily due to inflation.

	Three Months Ended September 30,			Nine Months Ended September 30,		
INTERNATIONAL	**2012**	**2011**	**Change (Points)**	**2012**	**2011**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	65.8%	65.9%	(0.1)	66.8%	66.1%	0.7
Underwriting expense ratio	37.1	35.4	1.7	36.4	34.8	1.6
Subtotal	102.9	101.3	1.6	103.2	100.9	2.3
Catastrophes[1]	(0.1)	-	(0.1)	-	-	-
Net incurred losses attributable to prior years	0.4	0.6	(0.2)	0.4	0.5	(0.1)
Total combined ratio	103.2%	101.9%	1.3	103.6%	101.4%	2.2

1 Catastrophes include all current and prior accident 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, 2012 was 102.9% and 103.2%, respectively, increases of 1.6 points and 2.3 points over the same periods in 2011. The increases in both periods reflect higher underwriting expenses primarily related to investments in global technology infrastructure, and the impact of the acquisition in Ireland. The increase year-to-date also reflects higher non-catastrophe and current accident year claims and claim adjustment expenses, primarily driven by the acquisition in Ireland.

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, 2012 was 103.2% and 103.6%, respectively, increases of 1.3 points and 2.2 points over the same periods in 2011. The increases primarily reflect the changes in the combined ratio previously discussed.

GLOBAL SPECIALTY

Overview – Global Specialty

Global Specialty is composed of a wide array of products and services offered through three segments: LIU, LMS, and LMR. LIU, which sells specialty commercial insurance and reinsurance worldwide, writes casualty, specialty casualty, marine, energy, construction, aviation, property, crisis management and trade credit coverage and other specialty programs through offices in Asia, Australia, Europe, the Middle East, North America and Latin America. LIU, through its Syndicate 4472, also provides multi-line insurance and reinsurance worldwide written through the Lloyds' platform. LMS is a leading provider of nationwide contracts and commercial surety bonds to businesses of all sizes. LMR provides reinsurance programs to domestic and foreign insurance and reinsurance companies.

The Global Specialty SBU was formed during the third quarter of 2012. The SBU is the sum of: LIU, formerly part of International; LMS, formerly part of LMAC and LMR, formerly part of Commercial Markets. All prior periods have been restated to reflect this change.

Global Specialty NWP by market segment was as follow:

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
LIU	$785	$722	8.7%	$2,512	$2,294	9.5%
LMS	192	194	(1.0)	548	571	(4.0)
LMR	101	90	12.2	278	233	19.3
Total NWP	$1,078	$1,006	7.2%	$3,338	$3,098	7.7%
Foreign exchange effect on growth			(1.1%)			(1.2%)
NWP growth excluding foreign exchange			8.3%			8.9%

Global Specialty's major product lines are as follows:

(1) Syndicate 4472: multi-line insurance and reinsurance with an emphasis on property, contingent lines, marine reinsurance and property and casualty reinsurance;
(2) LIU inland marine program: handset protection coverage for lost or damaged devices;
(3) LIU third party: includes casualty, excess casualty, directors and officers, errors and omissions, environmental impairment liability, commercial automobile, railroad and other;
(4) LIU first party: includes marine, energy, construction, aviation and property;
(5) LIU other: includes workers compensation, surety, trade credit, excess and surplus property and crisis management;
(6) LMS: includes contracts and commercial surety bonds; and
(7) LMR: reinsurance programs through both domestic and foreign insurance and reinsurance companies.

Global Specialty NWP by line of business was as follow:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Syndicate 4472	$349	$343	1.7%	$1,189	$1,116	6.5%
LIU inland marine program	135	104	29.8	376	299	25.8
LIU third party	207	198	4.5	651	599	8.7
LIU first party	70	65	7.7	233	229	1.7
LIU other	24	12	100.0	63	51	23.5
LMS	192	194	(1.0)	548	571	(4.0)
LMR	101	90	12.2	278	233	19.3
Total NWP	$1,078	$1,006	7.2%	$3,338	$3,098	7.7%

NWP for the three and nine months ended September 30, 2012 was $1.078 billion and $3.338 billion, respectively, increases of $72 million and $240 million over the same periods in 2011. The increases in both periods reflect growth driven by the LIU inland marine business due to subscriber growth, pricing mix and the inception of a program in Japan in 2012, LMR as a result of price increases and higher line sizes on existing contracts and Syndicate 4472 due to favorable rates and new business. For the nine months ended September 30, 2012, growth was also driven by LIU third party due to new business from its casualty and specialty casualty lines. The increases in both periods were partially offset by a decline in surety lines premium largely due to a decline in the volume of bonded construction projects.

Results of Operations – Global Specialty

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$1,187	$1,066	11.4%	$3,365	$3,021	11.4%
PTOI before catastrophes and net incurred losses attributable to prior years	187	160	16.9	525	522	0.6
Catastrophes [1]	(13)	12	NM	4	(345)	NM
Net incurred losses attributable to prior years [2]	73	46	58.7	12	209	(94.3)
Pre-tax operating income	$247	$218	13.3%	$541	$386	40.2%

1 Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of $1 million and $14 million for the three months and nine months ended September 30, 2012 and $2 million and $17 million for the comparative periods in 2011.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2012 was $247 million and $541 million, respectively, increases of $29 million and $155 million over the same periods in 2011. The increase in both periods was attributable to higher earned premiums. In addition, impacting the quarter was favorable non-catastrophe results for Syndicate 4472, increased catastrophes due to Hurricane Isaac and higher favorable net incurred losses attributable to prior years for LMS. Impacting year-to-date was unfavorable loss activity for LMS, favorable catastrophes incurred in 2012 compared to 2011 and lower favorable net incurred losses attributable to prior years within Syndicate 4472.

Revenues for the three and nine months ended September 30, 2012 were $1.187 billion and $3.365 billion, respectively, increases of $121 million and $344 million over the same periods in 2011. 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, 2012 was $1.087 billion and $3.072 billion, respectively, increases of $108 million and $304 million over the same periods in 2011. The increases in both periods reflect the previously mentioned growth in NWP.

Net investment income for the three and nine months ended September 30, 2012 was $85 million and $253 million, respectively, increases of $2 million and $11 million over the same periods in 2011. The increases in both periods reflect a higher invested asset base due to the reinvestment of cash flow from operations driven by the growth in NWP, partially offset by lower investment yields.

Claims, benefits and expenses for the three and nine months ended September 30, 2012 were $927 million and $2.790 billion, respectively, increases of $81 million and $163 million over the same periods in 2011. The increase for the quarter was primarily driven by the organic growth of Syndicate 4472, the LIU inland marine program as well as LIU third party business partially offset by LMS related to favorable losses attributable to prior years. The year-to-date increase was due to LMS current year loss activity and organic growth in LIU inland marine, LIU third party and LIU first party lines partially offset by the absence of catastrophe losses (primarily within Syndicate 4472 business) in 2012 as compared to the catastrophe losses related to the Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene and the tornadoes and severe storms in the U.S. in 2011.

GLOBAL SPECIALTY	Three Months Ended September 30, 2012	2011	Change (Points)	Nine Months Ended September 30, 2012	2011	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	61.3%	62.1%	(0.8)	61.3%	59.6%	1.7
Underwriting expense ratio	28.5	28.9	(0.4)	28.9	29.5	(0.6)
Dividend ratio	0.2	0.2	-	0.2	0.2	-
Subtotal	90.0	91.2	(1.2)	90.4	89.3	1.1
Catastrophes [1]	1.2	(1.2)	2.4	(0.1)	12.6	(12.7)
Net incurred losses attributable to prior years	(6.7)	(4.8)	(1.9)	(0.4)	(7.6)	7.2
Total combined ratio	84.5%	85.2%	(0.7)	89.9%	94.3	(4.4)

1 Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Global Specialty combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2012 was 90.0% and 90.4%, respectively, a decrease of 1.2 points and an increase of 1.1 points versus the same periods in 2011. The decrease in the quarter was attributable to lower non-catastrophe current accident year claims in Syndicate 4472 and the lower underwriting expense ratio driven by the increased scale and efficiencies of the business. The year-to-date increase reflects higher non-catastrophe and current accident year claims and claim adjustment expenses, primarily driven by LMS and LIU first party, partially offset by lower underwriting expense ratio driven by the increased scale and efficiencies of the 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, 2012 was 84.5% and 89.9%, respectively, decreases of 0.7 points and 4.4 points from the same periods in 2011. The decrease in the three month period ended September 30, 2012 reflects the changes to the combined ratio discussed above, more favorable net incurred losses attributable to prior years, primarily in LMS partially offset by catastrophe losses related to Hurricane Isaac. The decrease in the nine month period ended September 30, 2012 also reflects net favorable catastrophe losses incurred in 2012 compared to the catastrophe losses related to the Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene and the tornadoes and severe storms in the U.S. in 2011, partially offset by lower 2012 favorable incurred losses attributable to prior years and the changes in the combined ratio previously discussed.

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 Commercial Insurance business, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation and certain distribution channels related to Prudential Property and Casualty Insurance Company, Prudential General Insurance Company and Prudential Commercial Insurance Company (together, "PruPac").

- Effective July 1, 2011, Corporate and Commercial Insurance novated their reinsurance treaty that applied to certain pre-2005 workers compensation claims and entered into two new agreements including: (1) certain pre-2011 voluntary workers compensation claims and, (2) certain pre-2011 involuntary workers compensation claims.

- Interest expense on the Company's outstanding debt.

- Certain risks of its SBUs that the Company reinsures as part of its risk management program, and risks on Personal Insurance's Personal Lines homeowners business covered by the externally ceded homeowners quota share reinsurance treaty.

- The Company reports its written premium on workers compensation contracts on the "booked as billed" method. Commercial Insurance reports workers compensation written premium 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 at risk-free discount rates. Commercial Insurance reports its discount based on statutory discount rates. Corporate and Other results reflect the difference between the statutory 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, 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 related to LP and LLC investments.

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

- Effective January 1, 2011, certain retroactive reinsurance agreements previously reported within Commercial Insurance.

Corporate and Other NWP by line of business was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Reinsurance, net	($143)	($162)	(11.7%)	($288)	($354)	(18.6%)
Workers compensation[1]	(11)	(30)	(63.3)	(11)	(137)	(92.0)
Other	(2)	3	NM	-	3	(100.0)
Total NWP	($156)	($189)	(17.5%)	($299)	($488)	(38.7%)

[1] Booked as billed adjustment.
NM = Not Meaningful

NWP for the three and nine months ended September 30, 2012 was ($156) million and ($299) million, respectively, increases of $33 million and $189 over the same periods in 2011. The changes were primarily due to a decrease in the Company's workers compensation "booked as billed" adjustment and an increase in assumed premium related to the Company's internal reinsurance program, partially offset by an increase in ceded premium related to the homeowners quota share treaty covering Personal Insurance's Personal Lines homeowners.

Results of Operations – Corporate and Other

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2012**	**2011**	**Change**	**2012**	**2011**	**Change**
Revenues	$55	$88	(37.5%)	$286	$361	(20.8%)
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years and LP and LLC income	(305)	(286)	6.6%	(811)	(670)	21.0%
Catastrophes[1]	(28)	69	NM	71	193	(63.2)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(53)	(339)	(84.4)	(57)	(341)	(83.3)
- All other[3]	(241)	2	NM	(229)	(28)	NM
Pre-tax operating loss before LP and LLC income	(627)	(554)	13.2	(1,026)	(846)	21.3
LP and LLC income [4]	42	138	(69.6)	254	476	(46.6)
Pre-tax operating loss	($585)	($416)	40.6%	($772)	($370)	108.6

1 Catastrophes include all current and prior accident year catastrophe losses excluding losses related to the Company's external reinsurance assumed lines except for Hurricane Isaac, the 2011 Australia floods, Cyclone Yasi, Japan earthquake and tsunami, New Zealand earthquakes, Hurricane Irene, Thailand floods, the 2011 and 2012 tornadoes and other severe storms in the U.S. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 2011 includes $294 million of strengthening of asbestos related reserves in connection with a ground-up reserve study.

3 Net of earned premium attributable to prior years of zero and ($1) for the three and nine months ended September 30, 2012 and ($8) for the same periods in 2011. Net of amortization of deferred gains on retroactive reinsurance of $10 million and $30 million for the three and nine months ended September 30, 2012 and $15 million and $124 million for the same periods in 2011. 2011 reflects a gain on commutation of two retroactive reinsurance contracts during the first quarter.

4 LP and LLC income is included in net investment income in the accompanying consolidated statements of operations.
NM = Not Meaningful

Pre-tax operating loss for the three and nine months ended September 30, 2012 was $585 million and $772 million, respectively, decreases of $169 million and $402 million from the same periods in 2011. The changes were primarily driven by lower valuation increases in LP and LLC investments, higher corporate expenses primarily due to employee benefits as a result of improved profitability and a lower pension discount rate, lower ceded catastrophe losses, and an increase in the amount of incurred losses attributable to prior years related to pre-2011 workers compensation business assumed from Commercial Insurance, partially offset by higher increases in asbestos and environmental reserves in 2011. The change in the year is also driven by a gain on the commutation of two workers compensation retroactive reinsurance agreements that occurred in 2011, partially offset by a decrease in interest expense as a result of debt repurchases.

Revenues for the three and nine months ended September 30, 2012 were $55 million and $286 million, respectively, decreases of $33 million and $75 million from the same periods in 2011. The major components of revenues are net premium earned, net investment income, net realized gains, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2012 was ($100) million and ($310) million, respectively, increases of $22 million and $60 million over the same periods in 2011. The increases reflect the earned premium associated with the changes in reinsurance NWP previously discussed.

Net investment income for the three and nine months ended September 30, 2012 was ($31) million and $98 million, respectively, decreases of $145 million and $305 million from the same periods in 2011. The decreases in both periods primarily reflect lower valuation increases in LP and LLC investments. In addition, the quarter also reflects a decrease in taxable interest income due to lower investment yields primarily attributable to a tactical portfolio re-alignment.

Net realized gains for the three and nine months ended September 30, 2012 were $114 million and $297 million, respectively, increases of $68 million and $121 million over the same periods in 2011. The increases in both periods relate to gains recognized from security sales as part of a tactical portfolio re-alignment. The increase in the year reflects a gain on the sale of investments in the energy sector and contingent consideration recognized in connection with the prior sale of certain Commercial Insurance policy renewal rights in 2009, partially offset by increased impairments due to market volatility.

Fee and other revenues for the three and nine months ended September 30, 2012 were $72 million and $201 million, increases of $22 million and $49 million over the same periods in 2011. The increases primarily reflect higher oil and gas revenues due to increased production.

Claims, benefits and expenses for the three and nine months ended September 30, 2012 were $526 million and $761 million, respectively, increases of $68 million and $206 million over the same periods in 2011. The increases in both periods reflect higher corporate expenses primarily due to employee benefits, a decrease in ceded losses associated with the homeowners quota share treaty, an increase in assumed losses related to internal reinsurance programs growth, an increase in the amount of incurred losses attributable to prior years primarily related to pre-2011 workers compensation business assumed from Commercial Insurance, and higher depreciation charges related to Liberty Energy, partially offset by higher increases in asbestos and environmental reserves in 2011. The increase in the year was also impacted by the commutation of two workers compensation retroactive reinsurance agreements that occurred in 2011, partially offset by a decrease in interest expense as a result of debt repurchases.

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 natural resource 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 predominantly uses a subsidiary investment adviser registered with the Securities and Exchange Commission 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, 2012 and December 31, 2011:

$ in Millions	**As of September 30, 2012**		**As of December 31, 2011**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$62,899	80.7 %	$60,576	82.2%
Equity securities, available for sale, at fair value	2,321	3.0	1,954	2.7
LPs and LLCs	3,819	4.9	3,389	4.6
Commercial mortgage loans	1,304	1.7	1,196	1.6
Short-term investments	308	0.4	201	0.3
Other investments	672	0.9	400	0.5
Cash and cash equivalents	6,573	8.4	5,972	8.1
Total invested assets	$77,896	100.0%	$73,688	100.0%

Total invested assets as of September 30, 2012 were $77.896 billion, an increase of $4.208 billion or 5.7% over December 31, 2011. The increase reflects an increase in unrealized gains related to decreases in interest rates, positive equity market performance, and the reinvestment of cash flow from operations.

Fixed maturities as of September 30, 2012 were $62.899 billion, an increase of $2.323 billion or 3.8% over December 31, 2011. The increase reflects investment of cash associated with the QIL acquisition, an increase in unrealized gains related to decreases in interest rates, and the reinvestment of cash flow from operations. As of September 30, 2012, included in fixed maturities are commitments to purchase various residential mortgage-backed securities at a cost and fair value of $78 million and $79 million, respectively, and various corporate and municipal securities at a cost and fair value of $48 million.

Equity securities available for sale as of September 30, 2012 were $2.321 billion ($1.922 billion common stock and $399 million preferred stock) versus $1.954 billion as of December 31, 2011 ($1.608 billion common stock and $346 million preferred stock), an increase of $367 million or 18.8% over December 31, 2011. Of the $1.922 billion of common stock at September 30, 2012, $301 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 was consistent with the Company's continued investment in this asset class as well as broader equity market performance.

Investments in LPs and LLCs as of September 30, 2012 were $3.819 billion, an increase of $430 million or 12.7% over December 31, 2011. These investments consist of traditional private equity partnerships of $2.096 billion, other partnerships (primarily energy) of $1.064 billion, and real estate partnerships of $659 million. The increase reflects improved valuations and new investments. The Company's investments in LPs and LLCs 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.

As of September 30, 2012, the Company had unfunded commitments in traditional private equity partnerships, real estate, energy, and other of $846 million, $319 million, $801 million, and $360 million, respectively.

Commercial mortgage loans as of September 30, 2012 were $1.304 billion (net of $20 million of loan loss reserves or 1.5% of the outstanding loan portfolio), an increase of $108 million or 9.0% over December 31, 2011. The increase primarily reflects a $178 million increase in loans, partially offset by $68 million in principal repayments and an increase of $2 million to the loan loss reserve. The entire commercial loan portfolio is U.S. based. As of September 30, 2012, the average total loan size was $1 million and the average loan participation size was less than $1 million. The number of loans in the portfolio increased from 3,272 at December 31, 2011 to 3,567 at September 30, 2012. Approximately 92% of the loans are full or partial recourse to borrowers.

Cash and cash equivalents as of September 30, 2012 were $6.573 billion, an increase of $601 million or 10.1% over December 31, 2011. The increase was primarily related to debt financing activity, a reduction of liquidity in the market and an increase in securities lending cash collateral.

Regarding fair value measurements, as of September 30, 2012, excluding separate accounts and other assets, the Company reflected $3.972 billion (6.0%) 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, 2012, the Company reported $60.243 billion (91.5%) as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported $1.620 billion (2.5%) 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, 2012, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.5% of invested assets.

The following tables summarize the Company's available for sale portfolio by security type as of September 30, 2012 and December 31, 2011:

$ in Millions **September 30, 2012**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government and agency securities	$2,786	$299	($1)	$3,084
Residential MBS [1]	8,607	577	(4)	9,180
Commercial MBS	1,809	88	(1)	1,896
Other MBS and ABS [2]	2,107	144	(1)	2,250
U.S. state and municipal	12,872	1,381	(19)	14,234
Corporate and other	24,402	2,195	(75)	26,522
Foreign government securities	5,558	243	(68)	5,733
Total fixed maturities	58,141	4,927	(169)	62,899
Common stock	1,648	349	(75)	1,922
Preferred stock	422	27	(50)	399
Total equity securities	2,070	376	(125)	2,321
Total securities available for sale	$60,211	$5,303	($294)	$65,220

1 Mortgage-backed securities ("MBS")
2 Asset-backed securities ("ABS")

$ in Millions **December 31, 2011**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government and agency securities	$3,044	$312	($-)	$3,356
Residential MBS	9,018	525	(46)	9,497
Commercial MBS	2,086	74	(3)	2,157
Other MBS and ABS	1,645	132	(2)	1,775
U.S. state and municipal	12,530	1,159	(24)	13,665
Corporate and other	23,978	1,596	(319)	25,255
Foreign government securities	4,807	158	(94)	4,871
Total fixed maturities	57,108	3,956	(488)	60,576
Common stock	1,510	235	(137)	1,608
Preferred stock	432	17	(103)	346
Total equity securities	1,942	252	(240)	1,954
Total securities available for sale	$59,050	$4,208	($728)	$62,530

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of September 30, 2012:

$ in Millions	**As of September 30, 2012**							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality[1]	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$1,929	$-	$-	$-	$-	$-	$1,929	14.4%
GNMA residential mortgage	3,312	5	-	-	-	-	3,317	24.9
FNMA residential mortgage	2,606	-	-	-	-	-	2,606	19.6
FHLMC residential mortgage	2,742	-	-	-	-	-	2,742	20.6
Prime residential mortgage	21	20	16	13	6	213	289	2.2
Alt-A residential mortgage	-	20	-	8	16	128	172	1.3
Sub-prime residential mortgage	22	-	3	1	6	22	54	0.4
Commercial MBS	1,752	110	8	20	6	-	1,896	14.2
Non-mortgage ABS	194	19	23	64	5	16	321	2.4
Total	$12,578	$174	$50	$106	$39	$379	$13,326	100.0 %
% of Total	94.4%	1.3%	0.4%	0.8%	0.3%	2.8%	100.0%	

[1]For purposes of this disclosure, credit quality is primarily based upon average credit ratings.

Approximately 79.5% 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 approximately 98% rated AA or above with 13.4% 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, 2012 and December 31, 2011:

$ in Millions	**As of September 30, 2012**		**As of December 31, 2011**	
Fixed Maturities by Credit Quality[1]	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
AAA	$22,156	35.3%	$21,732	36.0%
AA+, AA, AA-	10,521	16.7	10,445	17.2
A+, A, A-	13,376	21.3	11,646	19.2
BBB+, BBB, BBB-	11,407	18.1	10,289	17.0
BB+, BB, BB-	1,684	2.7	2,202	3.6
B+, B, B-	2,908	4.6	3,330	5.5
CCC or lower	847	1.3	932	1.5
Total fixed maturities	$62,899	100.0%	$60,576	100.0%

[1]For purposes of this disclosure, credit quality is primarily based upon average credit ratings.

The Company's allocation to investment grade (fixed maturities with an average credit rating of BBB- or higher) securities increased to 91% at September 30, 2012 from 89% at December 31, 2011. The increase in investment grade securities was related to a tactical portfolio re-alignment. Overall, the average credit quality rating stands at A+ as of September 30, 2012. 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 available-for-sale fixed maturity securities by contractual maturity at September 30, 2012 and December 31, 2011. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid with or without call or prepayment penalties. Due to potential for prepayment on MBS and ABS, they are not categorized by contractual maturity.

$ in Millions	**As of September 30, 2012**		**As of December 31, 2011**	
Fixed Maturities by Maturity Date	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
1 year or less	$3,394	5.4%	$2,847	4.7%
Over 1 year through 5 years	18,364	29.2	17,738	29.3
Over 5 years through 10 years	15,329	24.4	14,489	23.9
Over 10 years	12,486	19.8	12,073	19.9
MBS and ABS	13,326	21.2	13,429	22.2
Total fixed maturities	$62,899	100.0%	$60,576	100.0%

During 2012, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company has made only minor adjustments to the average duration of its investment portfolio.

Net Investment Income

The following table summarizes the Company's net investment income for the three and nine months ended September 30, 2012 and 2011:

$ in Millions	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Net Investment Income	**2012**	**2011**	**2012**	**2011**
Taxable interest income	$608	$629	$1,871	$1,855
Tax-exempt interest income	110	115	338	350
Dividends	15	14	43	38
LP and LLC income	42	138	254	476
Commercial mortgage loans	21	20	60	58
Other investment loss	(3)	(1)	(9)	(3)
Gross investment income	793	915	2,557	2,774
Investment expenses	(38)	(34)	(108)	(104)
Net investment income	$755	$881	$2,449	$2,670

Net investment income for the three and nine months ended September 30, 2012 was $755 million and $2.449 billion, respectively, decreases of $126 million and $221 million from the same periods in 2011. The decreases in both periods primarily reflect lower valuation increases in LP and LLC investments. In addition, the quarter also reflects a decrease in taxable interest income due to lower investment yields primarily attributable to a tactical portfolio re-alignment.

Net Realized Gains (Losses)

The following tables summarize the Company's net realized gains (losses) for the three and nine months ended September 30, 2012 and 2011:

$ in Millions **Net Realized Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Three Months Ended September 30, 2012:				
Fixed maturities	$129	($3)	$-	$126
Common and preferred stock	23	(13)	-	10
Other	7	-	(15)	(8)
Total	$159	($16)	($15)	$128
Three Months Ended September 30, 2011:				
Fixed maturities	$6	($1)	$-	$5
Common and preferred stock	23	(19)	-	4
Other	32	-	-	32
Total	$61	($20)	$-	$41

$ in Millions **Net Realized Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Nine Months Ended September 30, 2012:				
Fixed maturities	$238	($45)	$-	$193
Common and preferred stock	66	(37)	-	29
Other	142	-	(15)	127
Total	$446	($82)	($15)	$349
Nine Months Ended September 30, 2011:				
Fixed maturities	$81	($31)	$-	$50
Common and preferred stock	77	(20)	-	57
Other	61	-	-	61
Total	$219	($51)	$-	$168

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Components of Net Realized Gains (Losses)	**2012**	**2011**	**2012**	**2011**
Fixed maturities:				
Gross realized gains	$148	$24	$283	$140
Gross realized losses	(22)	(19)	(90)	(90)
Equities:				
Gross realized gains	27	33	78	91
Gross realized losses	(17)	(29)	(49)	(34)
Other:				
Gross realized gains	11	49	164	96
Gross realized losses	(19)	(17)	(37)	(35)
Total net realized gains	$128	$41	$349	$ 168

Net realized gains for the three and nine months ended September 30, 2012 were $128 million and $349 million, respectively, increases of $87 million and $181 million over the same periods in 2011. The increase in the quarter and year-to-date primarily relates to gains recognized from security sales as part of a tactical portfolio re-alignment. Additionally, year-to-date is impacted by a gain on the sale of investments in the energy sector, a gain recognized from the sale of a business segment in Argentina and contingent consideration recognized in connection with the prior sale of certain Commercial Insurance policy renewal rights in 2009, partially offset by increased impairments due to market volatility.

The following table summarizes the Company's unrealized losses and fair value by security type and by duration as of September 30, 2012 that are not deemed to be other-than-temporarily impaired:

$ in Millions	Less Than 12 Months		12 Months or Longer	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($1)	$83	$-	$-
Residential MBS	-	54	(4)	85
Commercial MBS	(1)	60	-	28
Other MBS and ABS	-	28	(1)	9
U.S. state and municipal	(6)	289	(13)	46
Corporate and other	(17)	939	(58)	723
Foreign government securities	(13)	401	(55)	519
Total fixed maturities	(38)	1,854	(131)	1,410
Common stock	(27)	272	(48)	253
Preferred stock	-	-	(50)	272
Total equities	(27)	272	(98)	525
Total	($65)	$2,126	($229)	$1,935

Unrealized losses decreased from $728 million as of December 31, 2011 to $294 million as of September 30, 2012 primarily due to the tightening of credit spreads, improvement in the equity markets, and decline in the treasury yields. Unrealized losses less than 12 months decreased from $311 million at December 31, 2011 to $65 million as of September 30, 2012. Unrealized losses 12 months or longer decreased from $417 million as of December 31, 2011 to $229 million as of September 30, 2012. As of September 30, 2012, there were 971 securities that were in an unrealized loss position for 12 months or longer. 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 flows and fair value. For the three and nine months ended September 30, 2012, the Company recorded $3 million and $45 million of fixed maturity impairment losses. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of September 30, 2012 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, 2012 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. For the three and nine months ended September 30, 2012, the Company recorded $13 million and $37 million in impairment losses on equity securities. The Company has concluded that the gross unrealized losses of equity securities as of September 30, 2012 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, 2012 (including cash and cash equivalents) totaled $77.896 billion.

Debt outstanding as of September 30, 2012 and December 31, 2011 was follows:

Current maturities of long term debt:

$ in Millions	**As of September 30, 2012**	**As of December 31, 2011**
Current maturities of long-term debt[1]	$26	$205

[1] 2012 includes $25 million of 7.86% Medium Term Notes. 2011 includes $204 million of debt originally issued by Safeco and due September 1, 2012. On December 29, 2008, $187 million of the outstanding $204 million 7.25% notes due 2012 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.

Long-term debt:

$ in Millions	As of September 30, 2012	As of December 31, 2011
7.86% Medium term notes, due 2013	$ -	$25
8.00% Notes, due 2013	260	260
5.75% Notes, due 2014	239	500
7.30% Notes, due 2014	104	200
5.588% Mortgage loan, due 2015	48	48
6.70% Notes, due 2016	249	249
7.00% Junior Subordinated notes, due 2067[1]	300	300
5.00% Notes, due 2021	600	600
4.95% Notes, due 2022	750	-
8.50% Surplus notes, due 2025	140	140
7.875% Surplus notes, due 2026	227	227
7.625% Notes, due 2028	3	3
3.91% - 4.25% Federal Home Loan Bank Borrowings, due 2032	300	-
7.00% Notes, due 2034	231	231
6.50% Notes, due 2035	471	471
7.50% Notes, due 2036	19	19
7.80% Junior Subordinated notes, due 2087[2]	700	700
10.75% Junior Subordinated notes, due 2088[3]	676	981
6.50% Notes, due 2042	750	-
7.697% Surplus notes, due 2097	260	435
Subtotal	6,327	5,389
Unamortized discount	(22)	(48)
Total long-term	$6,305	$5,341

[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 4, 2012 and August 17, 2012, LMGI issued $500 million and $250 million of Senior Notes due 2022 (the "2022 Notes"), respectively. Also, on May 4, 2012 and August 17, 2012, LMGI issued $500 million and $250 million of Senior Notes due 2042 (the "2042 Notes"), respectively. Interest is payable semi-annually at a fixed rate of 4.95% for the 2022 Notes and 6.50% for the 2042 Notes. The 2022 Notes mature on May 1, 2022 and the 2042 Notes mature on May 1, 2042.

On April 18, 2012, the Company announced the commencement of two tender offers. The first offer was a cash tender offer to purchase up to $350 million, subject to increase, of the aggregate principal amount of (i) LMGI's 10.75% Series C Junior Subordinated Notes due 2088 by LMGI and (ii) Liberty Mutual Insurance Company's ("LMIC") 7.697% Surplus Notes due 2097 by LMIC, each at a purchase price determined in accordance with the procedures of a modified "Dutch Auction" (the "Dutch Auction Offer"). The second offer was a cash tender offer by LMGI to purchase up to $350 million, subject to increase, of the aggregate principal amount of its 5.75% Senior Notes due 2014 and its 7.30% Senior Notes due 2014, each at a price determined by reference to a fixed spread above the bid-side yield on the applicable reference security and accepted in accordance with the acceptance priority level set forth in the tender documents (the "Waterfall Offer"). The Waterfall Offer was conditioned on LMGI issuing at least $350 million aggregate principal amount of new senior notes. The Waterfall Offer was increased to include all notes tendered in the Waterfall Offer. The Dutch Auction Offer was increased by up to $175 million in aggregate principal amount to permit the additional purchase of the applicable notes tendered at the full tender offer consideration. The tender offers expired on May 15, 2012 and the Company paid in aggregate approximately $949 million in connection with such tender offers, including approximately $17 million in accrued and unpaid interest, to holders of the Notes involved in the tender offers. As a result of these transactions, the Company recorded pre-tax losses of $147 million that are included in loss on extinguishment of debt in the accompanying consolidated statements of operations. After completion of the tender offers, the following principal amounts remain outstanding for such notes, $676 million of the 10.75% Series C Junior Subordinated Notes due 2088, $260 million of the 7.697% Surplus Notes due 2097, $239 million of the 5.75% Senior Notes due 2014 and $104 million of the 7.30% Senior Notes due 2014.

Additionally, during the three and nine months ended September 30, 2012, the Company repurchased zero and $41 million, respectively, of the 10.75% Junior Subordinated notes due 2088. Pre-tax losses of zero and $16 million, respectively, were recorded on these transactions and are included in loss on extinguishment of debt in the accompanying consolidated statements of operations.

LMIC, Peerless Insurance Company ("PIC") and Liberty Life Assurance Company of Boston ("LLAC") are members of the Federal Home Loan Bank of Boston. Liberty Mutual Fire Insurance Company ("LMFIC") became a member of the Federal Home Loan Bank of Chicago on January 11, 2012. Employers Insurance Company of Wausau ("EICOW") became a member of the Federal Home Loan Bank of Chicago on August 30, 2012. Membership provides the Company with access to secured asset-based borrowings with loan maturities of up to 30 years. The combined estimated borrowing capacity of the five entities is $6.2 billion. On March 21, 2012, LMFIC borrowed $150 million at a rate of 3.91% with a maturity date of March 22, 2032. On March 23, 2012 and April 2, 2012, LMIC borrowed $127 million at a rate of 4.24% with a maturity date of March 23, 2032 and $23 million at a rate of 4.25% with a maturity date of April 2, 2032, respectively. As of September 30, 2012, all of the outstanding Federal Home Loan Bank borrowings are fully collateralized.

On January 20, 2012, LMGI entered into two interest rate swap transactions having a notional amount of $300 million with respect to LMGI's $300 million 7.00% Junior Subordinated Notes due 2067. Pursuant to the terms of the swap agreements, commencing on March 15, 2017 and effective through March 15, 2037, LMGI has agreed with the counterparties to pay a fixed rate of interest on the notional amount and the counterparties have agreed to pay a floating rate of interest on the notional amount.

On October 24, 2011, LMAC and Ohio Casualty Corporation terminated their $200 million unsecured three-year credit facility with a syndicate of lenders.

On October 17, 2011, LMGI entered into a five-year $750 million unsecured revolving credit facility which terminates on October 17, 2016. To date, no funds have been borrowed under the facility. In connection with the new facility, LMGI terminated its $400 million unsecured revolving credit facility.

The Company places commercial paper through a program issued by LMGI and guaranteed by LMIC. Effective October 17, 2011, the $400 million commercial paper program was increased to $750 million and is backed by the five-year $750 million unsecured revolving credit facility. As of September 30, 2012, there was no commercial paper outstanding.

On May 18, 2011, LMGI issued Senior Notes due 2021 (the "2021 Notes") with a face amount of $600 million. Interest is payable semi-annually at a fixed rate of 5.00%. The 2021 Notes mature on June 1, 2021.

On March 21, 2011 the Company announced a tender offer for its 7.50% Senior Notes due 2036 (the "2036 Notes"). On April 15, 2011, the Company paid approximately $449 million in connection with such tender offer, including approximately $5 million in accrued and unpaid interest, to holders of the 2036 Notes tendered in such tender offer. Subsequent to the closing of the tender offer, the Company made an open market purchase of $5 million aggregate principal amount of the 2036 Notes. As a result of these transactions, the Company recorded a $40 million pre-tax loss in 2011. After completion of the tender offer and subsequent open market purchase, $19 million aggregate principal amount of the 2036 Notes remains outstanding.

As of September 30, 2012, the Company has $1 billion of three-year committed repurchase agreements maturing in 2013. As of September 30, 2012, no borrowings were outstanding under the agreements.

Interest Expense

Consolidated interest expense for the three and nine months ended September 30, 2012 was $104 million and $314 million, decreases of $7 million and $19 million from the same periods in 2011. The decreases reflect the completion of the tender offers, the repurchases of the 10.75% Junior Subordinated notes due 2088 and increased capitalized interest associated with the construction of the Company's new building, partially offset by the new debt issuances. As previously discussed, the Company continues to evaluate market conditions and may periodically effect transactions in its debt, subject to applicable limitations. 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, 2012, the Company, through its downstream subsidiary LMGI, had $5.353 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 meet 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 LMFIC and 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, 2011) and 2012 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	**2011**	**2010**	**2012**	**2012**
LMIC	469%	503%	$1,359	$49
LMFIC	458%	551%	-	$11
EICOW	623%	671%	$49	-

[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, 2012. Available dividend capacity as of September 30, 2012 is calculated as 2012 dividend capacity less dividends paid for the preceding 12 months. Dividends paid October 1, 2011 through September 30, 2012 for LMIC, LMFIC and EICOW were $65 million, $15 million and zero, respectively.

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.
- Investment management agreements with affiliated entities pursuant to which an LMGI subsidiary registered investment advisor is entitled to recover annual expenses for investment management services performed by its 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, 2012, LCS recorded $122 million and $320 million in pre-tax income.
- 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 $16.694 billion and $15.701 billion at September 30, 2012 and December 31, 2011, respectively. The increase in surplus primarily reflects net income of $242 million (the sum of earnings from the Company’s 58 domestic property-casualty insurance companies and dividends from subsidiaries), unaffiliated unrealized gains of $349 million, affiliated unrealized gains of $403 million, and other changes in surplus of $171 million, partially offset by repurchases of surplus notes ($172) million. Other changes in surplus are driven by increases in capital contributions and admitted goodwill, partially offset by an increase in non-admitted assets, dividends to stockholders, and amortization expense.

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 (1) unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years; (2) reinsurance recoverables and associated uncollectible allowance; (3) fair value determination and other-than-temporary impairments of the investment portfolio; (4) deferred acquisition costs; (5) valuation of goodwill and intangible assets; and (6) deferred income tax valuation allowance.

While the amounts included in the consolidated financial statements reflect management's best estimates and assumptions, these amounts ultimately could vary.

Certain reclassifications have been made to the 2011 amounts to conform with the 2012 presentation.

Adoption of New Accounting Standards

Effective January 1, 2012, the Company adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Update 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* ("ASU 2010-26"). This guidance, as codified in FASB Accounting Standards Codification ("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. Either prospective or retrospective application is permitted. The Company elected to apply the guidance retrospectively, and the cumulative effect of the change in the method of accounting resulted in a decrease in the opening balance of total equity as of January 1, 2012 of $265 million, net of tax.

For the three months ended September 30, 2011, the accounting change resulted in (decreases) increases in benefits, claims and claim adjustment expenses, insurance operating costs and expenses, amortization of deferred policy acquisition costs, unrealized gains on securities, and foreign currency translation and other adjustments of $(2) million, $174 million, $(171) million, $5 million, and $2 million, respectively. For the nine months ended September 30, 2011, the accounting change resulted in (decreases) increases in benefits, claims and claim adjustment expenses, insurance operating costs and expenses, amortization of deferred policy acquisition costs, income tax expense, and unrealized gains on securities of $(4) million, $522 million, $(506) million, $(4) million, and $8 million, respectively. As of December 31, 2011, the accounting change resulted in the following changes to previously reported balances: (decreases) increases in deferred acquisition costs, deferred income taxes, life unpaid claims and claim adjustment expenses and future policy benefits, other liabilities, unassigned equity, and accumulated other comprehensive income of $(417) million, $137 million, $(12) million, $(3) million, $(276) million, and $11 million, respectively.

Effective January 1, 2012, the Company adopted Accounting Standards Update 2011-05, *Comprehensive Income* ("ASU 2011-05"). This guidance requires companies to present the total of comprehensive income, components of net income, and components of other comprehensive income ("OCI") in one continuous statement or in two separate but consecutive statements. The Company has elected to present this financial information in two separate consecutive statements.

Future Adoption of New Accounting Standards

None of the accounting standards issued for the nine months ended September 30, 2012 will have a material impact on the Company.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $50.803 billion and $50.228 billion as of September 30, 2012 and December 31, 2011, respectively.

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 reserves for unpaid claims and claim adjustment expenses, net of reinsurance decreased $68 million from $1.332 billion as of December 31, 2011 to $1.264 billion as of September 30, 2012.

In the third quarter of 2011, the Company completed asbestos ground-up and aggregate environmental reserve studies. These studies were completed by a multi-disciplinary team of internal claims, legal, reinsurance and actuarial personnel, and included all major business segments of the Company's direct, assumed, and ceded asbestos and environmental unpaid claim liabilities. As part of the internal review, policyholders with the largest direct asbestos unpaid claim liabilities were individually evaluated using the Company's proprietary stochastic ground-up model, which is consistent with published actuarial methods of 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, injury type, jurisdiction and legal defenses. Reinsurance recoveries for these policyholders were then separately evaluated by the Company's reinsurance and actuarial personnel. Asbestos and environmental unpaid claim liabilities for all other policyholders were evaluated using aggregate methods that utilized information and experience specific to these policyholders. The studies resulted in an increase to reserves of $338 million.

All asbestos and environmental 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 asbestos and environmental 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 a 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 $13.194 billion and $13.272 billion at September 30, 2012 and December 31, 2011, respectively, net of allowance for doubtful accounts of $325 million and $326 million, respectively. Included in these balances are $1.006 billion and $941 million of paid recoverables and $12.513 billion and $12.657 billion of unpaid recoverables, respectively.

As part of its reinsurance security oversight, the Company has established a Reinsurance Credit Committee (the "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.

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 charges to the consolidated statement of operations.

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 7.8% annually. These contracts resulted in deferred gains (including experience related profit accruals of $113 million) that are amortized into income using the effective interest method over the estimated settlement periods. As of September 30, 2012, and December 31, 2011, deferred gains related to these reinsurance arrangements were $294 million and $315 million, respectively, and are included in other liabilities within the accompanying consolidated balance sheets. Interest credited to the funds held balances for the three and nine months ended September 30, 2012 was $21 million and $62 million, respectively, as compared to $35 million and $84 million for the three and nine months ended September 30, 2011, respectively. Deferred gain amortization was $10 million and $30 million for the three and nine months ended September 30, 2012, respectively, as compared to $15 million and $124 million for the three and nine months ended September 30, 2011, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $1.183 billion and $1.217 billion as of September 30, 2012, and December 31, 2011, respectively. Effective March 31, 2011, the Company commuted two workers compensation excess of loss retroactive reinsurance agreements. The commutations, which represent the complete and final settlement and discharge of all present and future obligations between the parties arising out of the agreements, resulted in a gain to the Company of $54 million, net of tax.

Additionally, the Company has an aggregate stop loss program covering substantially all of the Commercial Insurance 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, any premium and loss activity subsequent to December 31, 2001 is 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 2009, the Company entered into a multi-year property catastrophe agreement with Mystic Re II Ltd. ("Mystic II"), a Cayman Islands domiciled reinsurer, to provide $225 million of reinsurance coverage for the Company and its affiliates in the event of a U.S. hurricane or earthquake event. The reinsurance agreement was collateralized. Such collateral was provided by Mystic II using proceeds from the issuance of certain catastrophe bonds. The reinsurance agreement provided 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 2009 reinsurance agreement terminated on March 13, 2012. Since no recoveries were recorded under this program, the associated collateral was released.

On March 6, 2012, the Company entered into two multi-year property catastrophe reinsurance agreements with Mystic Re III Ltd. ("Mystic III"), a Cayman Islands domiciled reinsurer, to provide a total of $275 million of reinsurance coverage for the Company and its affiliates for a U.S. hurricane or earthquake event. The reinsurance agreements are collateralized. Such collateral is provided by Mystic III using proceeds from the issuance of certain catastrophe bonds. The reinsurance agreements provide coverage based on actual reported losses by the Company and its affiliates. The Company has not recorded any recoveries under this program. Mystic III 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 maturity securities that the Company does not intend to sell or for which it is more likely than not that the Company would not be required to sell before an anticipated recovery in value, the Company separates impairments into credit loss and non-credit loss components. The determination of the credit loss component of the impairment charge is based on the Company's best estimate of the present value of the cash flows expected to be collected from the debt security compared to its amortized cost and is reported as part of net realized gains. The non-credit component, the residual difference between the credit impairment component and the fair value, is recognized in other comprehensive income. 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 does not have the 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 September 30, 2012, 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 September 30, 2012 the Company has determined that it is the primary beneficiary of one VIE in the energy investment sector and one VIE in the low-income housing tax credit sector, and as such, these VIEs have been consolidated in the Company's financial statements. As of December 31, 2011, the Company determined that it was the primary beneficiary of one VIE in the energy investment sector, and as such, this VIE was consolidated in the Company's financial statements. The carrying value of assets was $91 million and $4 million as of September 30, 2012 and December 31, 2011, respectively and the Company's maximum exposure to loss was $184 million and $24 million as of September 30, 2012 and December 31, 2011, respectively, for consolidated VIEs.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323, *Investments-Equity Method and Joint Ventures*. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. For these VIEs, the Company absorbs a portion, but not a majority, of this variability. The carrying value of assets was $319 million and $250 million as of September 30, 2012 and December 31, 2011, respectively, and the Company's maximum exposure to loss was $405 million and $309 million as of September 30, 2012 and December 31, 2011, respectively, for unconsolidated VIEs in which the Company has a significant variable interest. The assets are included in Other Investments on the accompanying 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.

Deferred Acquisition Costs

Total deferred acquisition costs were $2.666 billion and $2.391 billion as of September 30, 2012 and December 31, 2011, respectively. Deferred acquisition costs are 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, are charged to expense as incurred. 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 and underwriting expenses.

Goodwill

Goodwill assets were $4.859 billion and $4.766 billion as of September 30, 2012 and December 31, 2011, respectively. Goodwill is tested for impairment at least annually using either a qualitative or a quantitative process. Election of the approach can be made at the reporting unit level. The reporting unit has the option to skip the qualitative test and move directly to completion of the quantitative process. The Company's SBUs are deemed reporting units. As a result of the realignment of the Company's SBUs on July 24, 2012, the Company performed a relative fair value assessment to reallocate the existing goodwill to the SBUs. In conjunction with the reallocation the Company performed a quantitative impairment assessment of goodwill for each of the SBUs.

The qualitative approach can be used to evaluate if there are any indicators of impairment. Through this process, the reporting unit must determine if there is indication that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill. If it is determined that there is an indication of potential impairment, the reporting unit must complete the quantitative process. The quantitative approach is a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount is not recoverable from the discounted cash flows using a "market" rate and is measured as the difference between the carrying amount and the implied fair value. Other changes in the carrying amount of goodwill are primarily caused by foreign currency translation adjustments and acquisitions.

Deferred Income Taxes

The net deferred tax asset was $327 million and $952 million as of September 30, 2012 and December 31, 2011, net of a valuation allowance of $172 million and $136 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. The increase in the valuation allowance is primarily due to net operating losses generated in certain foreign subsidiaries where there is uncertainty in the timing and amount of realization of those losses, currency translation adjustments, and revisions to prior year amounts. Management believes it is more likely than not that the Company's net deferred income tax asset will be realized based upon the Company's ability and the likelihood of generating future taxable income.

The income tax provision is calculated under the liability method of accounting. Deferred income tax assets are recorded based upon 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, 2011	$332
Additions based on tax positions related to current year	1
Additions for tax positions of prior years	45
Reductions for tax positions of prior years	(18)
Settlements	(10)
Balance at September 30, 2012	$350

Included in the tabular roll forward of unrecognized tax benefits is interest and penalties in the amount of $93 million and $78 million as of September 30, 2012 and December 31, 2011, respectively.

Included in the balance at September 30, 2012, is $172 million related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties in Federal, state, and foreign income tax expense. During the three months ended September 30, 2012 and 2011, the Company recognized approximately ($4) million and $3 million in interest and penalties, respectively. During the nine months ended September 30, 2012 and 2011, the Company recognized $7 million and $4 million in interest and penalties, respectively. The Company had approximately $99 million and $82 million of interest and penalties accrued at September 30, 2012 and December 31, 2011, 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 2009 tax years. Any adjustments that may result from the IRS examinations 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 LMHC, the parent corporation of the Liberty Mutual Insurance group of entities, is a diversified global insurer and third largest property and casualty insurer in the U.S. based on 2011 direct written premium. The Company also ranks 84^{th} on the Fortune 100 list of largest corporations in the U.S. based on 2011 revenue. As of December 31, 2011, LMHC had \$116.851 billion in consolidated assets, \$99.252 billion in consolidated liabilities, and \$34.671 billion in annual consolidated revenue.

LMHC, 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 LMHC.

Functionally, the Company conducts substantially all of its business through strategic business units, with each operating independently of the others with 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.

LMHC 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.