



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

Quarter Ended September 30, 2014

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, 2014 and 2013. 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, 2013 Audited Consolidated Financial Statements, September 30, 2014 Unaudited Consolidated Financial Statements and Third Quarter 2014 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).

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Cautionary Statement Regarding Forward Looking Statements

This report contains forward looking statements that are intended to enhance the reader's ability to assess the Company's future financial and business performance. Forward looking statements include, but are not limited to, statements that represent the Company's beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "may," "expects," "should," "believes," "anticipates," "estimates," "intends" or similar expressions. Because these forward looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond the Company's control or are subject to change, actual results could be materially different.

Some of the factors that could cause actual results to differ include, but are not limited to the following: the occurrence of catastrophic events (including terrorist acts, hurricanes, hail, tornados, 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 cyclical nature 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 2014 Unaudited Consolidated Financial Statements.

Three Months Ended September 30, 2014 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2014 were \$10.085 billion, an increase of \$247 million or 2.5% over the same period in 2013.
- Net written premium ("NWP") for the three months ended September 30, 2014 was \$9.450 billion, an increase of \$253 million or 2.8% over the same period in 2013.
- Pre-tax operating income ("PTOI") for the three months ended September 30, 2014 was \$857 million, an increase of \$246 million or 40.3% over the same period in 2013.
- Catastrophe losses for the three months ended September 30, 2014 were \$288 million, a decrease of \$4 million or 1.4% from the same period in 2013.
- LP and LLC income for the three months ended September 30, 2014 was \$221 million, an increase of \$133 million or 151.1% over the same period in 2013.
- Pre-tax gain associated with the Venezuela devaluation and foreign exchange under hyper inflationary accounting (including other-than-temporary-impairments) was \$48 million (PTOI) in 2014 compared to a pre-tax gain of \$52 million (PTOI) in the same period in 2013.
- Net income attributable to LMHC for the three months ended September 30, 2014 was \$609 million, an increase of \$128 million or 26.6% over the same period in 2013.
- During the quarter, the Company entered into a retroactive stop loss reinsurance agreement (the "NICO Reinsurance Transaction") with National Indemnity Company ("NICO"). The NICO Reinsurance Transaction is accounted for as retroactive reinsurance in the Company's GAAP consolidated financial statements and resulted in a pre-tax loss of approximately \$130 million as of the effective date, which is included in the third quarter results. Subsequent to the effective date, the Company recorded \$85 million of net asbestos and environmental ("A&E") and workers compensation adverse development. As a result of the NICO Reinsurance Transaction, the Company was able to recognize the \$85 million as a benefit to income. See Consolidated Section for additional details of the transaction.
- The consolidated combined ratio before catastrophes¹, net incurred losses attributable to prior years² and current accident year re-estimation for the three months ended September 30, 2014 was 92.3%, an improvement of 2.3 points over the same period in 2013. 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, 2014 improved 2.4 points to 96.6%.

¹Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta floods and German hailstorm. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

²Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years (including prior year losses related to natural catastrophes and prior year catastrophe reinstatement premium) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains.

- Cash flow used in operations for the three months ended September 30, 2014 was \$1.428 billion, compared to cash provided of \$1.579 billion in the same period in 2013. The cash outflow includes approximately \$3.0 billion total consideration paid to fund the NICO Reinsurance Transaction.

Nine Months Ended September 30, 2014 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2014 were \$29.683 billion, an increase of \$1.240 billion or 4.4% over the same period in 2013.
- NWP for the nine months ended September 30, 2014 was \$27.418 billion, an increase of \$1.064 billion or 4.0% over the same period in 2013.
- PTOI for the nine months ended September 30, 2014 was \$2.070 billion, an increase of \$229 million or 12.4% over the same period in 2013.
- Catastrophe losses for the nine months ended September 30, 2014 were \$1.451 billion, an increase of \$290 million or 25.0% over the same period in 2013.
- LP and LLC income for the nine months ended September 30, 2014 was \$605 million, an increase of \$249 million or 69.9% over the same period in 2013.
- Pre-tax loss associated with the Venezuela devaluation and foreign exchange under hyper inflationary accounting (including other-than-temporary-impairments) was \$135 million (net of \$119 million of PTOI) in 2014 compared to a pre-tax loss of \$39 million (net of \$184 million of PTOI) in the same period in 2013.
- A net loss of \$77 million associated with the disposition of the Argentina operations is included within Discontinued Operations for the nine months ended September 30, 2014.
- Net income attributable to LMHC for the nine months ended September 30, 2014 was \$1.274 billion, an increase of \$27 million or 2.2% over the same period in 2013.
- The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the nine months ended September 30, 2014 was 92.8%, an improvement of 1.8 points over the same period in 2013. 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, 2014 improved 0.7 points to 98.8%.
- Cash flow provided by operations for the nine months ended September 30, 2014 was \$68 million, a decrease of \$3.033 billion or 97.8% from the same period in 2013. The decrease reflects approximately \$3.0 billion total consideration paid to fund the NICO Reinsurance Transaction.

Financial Condition as of September 30, 2014

- Total assets were \$123.753 billion as of September 30, 2014, an increase of \$2.471 billion or 2.0% over December 31, 2013.
- Total equity was \$20.621 billion as of September 30, 2014, an increase of \$1.609 billion or 8.5% over December 31, 2013.

Subsequent Events

On October 28, 2014, Liberty Mutual Group Inc. ("LMGI") issued an additional \$300 million par value of Senior Notes due 2044 (the "2044 Notes"). Interest is payable semi-annually at a fixed rate of 4.85%. The 2044 Notes mature on August 1, 2044.

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 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 17, 2014, the Company entered into the NICO Reinsurance Transaction with NICO, a subsidiary of Berkshire Hathaway Inc., on a combined aggregate adverse development cover for substantially all of the Company's U.S. workers compensation and A&E liabilities, attaching at approximately \$12.5 billion of combined aggregate reserves, with an aggregate limit of \$6.5 billion and sublimits of \$3.1 billion for A&E liabilities and \$4.507 billion for certain workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but effective as of January 1, 2014, the Company ceded approximately \$3.3 billion of existing liabilities under a retroactive reinsurance agreement. NICO will provide approximately \$3.2 billion of additional aggregate adverse development cover. The Company paid NICO total consideration of approximately \$3.0 billion. In general terms, the covered business includes post December 31, 2013 development on: (1) A&E liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005; and (2) workers compensation liabilities arising out of policies on the books of the Company's Commercial Insurance SBU as of December 31, 2013, as respects injuries or accidents occurring prior to January 1, 2014. With respect to the ceded A&E business, NICO has been given authority to handle claims, subject to the Company's oversight and control. With respect to the ceded workers compensation business, the Company will continue to handle claims. The NICO Reinsurance Transaction is accounted for as retroactive reinsurance in the Company's GAAP consolidated financial statements and results in a pre-tax loss of approximately \$130 million as of the effective date, which is included in the third quarter results. Subsequent to the effective date, the Company recorded \$85 million of net A&E and workers compensation adverse development. As a result of the NICO Reinsurance Transaction, the Company was able to recognize the \$85 million as a benefit to income. Once the aggregate of workers compensation and A&E development exceeds the original pre-tax loss, deferred gains will be recorded. Deferred gains are subsequently recognized into earnings as if the revised estimate was available at the inception date of the transaction.

On July 16, 2014, the Company purchased from Uni.Asia Capital Sdn Bhd its 68.09% stake in Uni.Asia General Insurance Berhad ("Uni.Asia"), a Malaysian property-casualty insurer, for approximately \$118 million. On September 8, 2014, the Company purchased 18,679,881 ordinary shares representing an additional 18.68% stake in Uni.Asia through a mandatory tender offer for approximately \$32 million. As a result of these actions, the Company now owns 86.77% of Uni.Asia.

On July 8, 2014, the Company acquired Mexican surety company Primero Fianzas from Grupo Valores

Operativos Monterrey, a private investor group. The parties have not disclosed the financial terms of the transaction. Primero Fianzas had \$33 million of gross written premium in 2013.

On June 12, 2014, the Company announced its plans to acquire Hughes Insurance (“Hughes Insurance Agreement”), an independent insurance broker in Northern Ireland, in a transaction expected to close on or about July 1, 2015 for approximately \$73 million. The Company’s subsidiary in Ireland has agreed to become the primary underwriter of Hughes Insurance in Northern Ireland. Hughes Insurance offers motor, van, household, small-to-medium-enterprise commercial insurance and travel insurance with £60 million in gross written premium for the financial year ended March 31, 2014, making it the independent insurance broker with the largest amount of gross written premium in Northern Ireland for that year. The company distributes 1 in 5 motor insurance policies sold in Northern Ireland and employs over 300 people.

On June 10, 2014, the Company consolidated its existing Group Benefits, Accident and Health (“A&H”), and Individual Life operations into a new market segment in Commercial Insurance called Liberty Mutual Benefits. All prior periods have been restated to reflect the new market segment.

On April 1, 2014, the Company sold Summit Holding Southeast, Inc., a mono-line workers compensation company based in Florida, and its related companies (together, “Summit”), to American Financial Group. The results of Summit are presented as Discontinued Operations on the accompanying Consolidated Statements of Income and are no longer included with Commercial Insurance. All prior periods have been restated to reflect the sale.

On February 21, 2014, Liberty International Argentina Holdings S.A. and Liberty Risk Services Argentina S.A. (together, the “Argentina operations”) were sold by Liberty International Latin America Holdings LLC and Liberty UK and Europe Holdings Limited to LAFO S LLC and LAFT S LLC resulting in a net loss of \$77 million. The results of the Argentina operations are presented as Discontinued Operations on the accompanying Consolidated Statements of Income and are no longer included with Liberty International. All prior periods have been restated to reflect the sale.

Since 2010 the Company’s Venezuela operations have met the requirements of hyperinflationary accounting whereby the reporting currency, the U.S. dollar, is the functional currency and the remeasurement of monetary assets and liabilities is recognized through the Consolidated Statements of Income.

In January 2014, the Venezuelan government issued Exchange Agreement No. 25, which required the use of a secondary exchange auction system referred to as the Complimentary System of Foreign Currency Acquirement (“SICAD I”) that will be applied prospectively to certain transactions that previously were subject to the official rate. The National Center for Foreign Trade will be responsible for determining the sectors that will be allowed to buy U.S. dollars through the SICAD I auction. Upon announcement of Exchange Agreement No. 25 and completing consultation with external and internal advisors, the Company concluded that effective January 31, 2014, its operations no longer qualify for settlements at the official rate and elected to apply prospectively the SICAD I rates to the remeasurement of its Venezuela operations as this is believed the rate at which transactions will be settled prospectively. As SICAD I is an auction process, rates of bolivar (“VEF”) to U.S. dollar will continue to fluctuate as it did from January 31, 2014 (11.36:1) to September 30, 2014 (12.00:1).

For the nine months ended September 30, 2014, the aforementioned change resulted in the Company recognizing a net \$119 million gain in PTOI comprised of a net loss from remeasuring its monetary assets and liabilities (\$178 million), the net gain from the earn-through of unearned premium and amortization of deferred acquisition costs at historical rates of \$310 million and the amortization of basis on certain investments (\$13 million). The Company also recognized a \$254 million loss on the impairment of investments. In total, the Company recognized a pre-tax loss of \$135 million in the Consolidated Statements of Income as well as a reduction of \$128 million in other comprehensive income. As of September 30, 2014 the Company had GAAP equity of approximately \$753 million, which could be impacted by a future devaluation charge.

Additionally, on February 11, 2014, the Venezuelan government announced the launch of SICAD II. The Venezuelan government has published operating rules for the new exchange mechanism in Exchange Agreement No. 27, and SICAD II began operating on March 24, 2014. SICAD II is purportedly a free-floating currency exchange mechanism for the private sector. Transactions can be made in either currency or bonds and the price is based on bid-ask mechanisms. However, the government holds the right to intervene should prices move dramatically. As of September 30, 2014, the SICAD II variable exchange rate was 49.99:1. There continues to be great uncertainty regarding the SICAD II mechanism. SICAD II does not eliminate or change the official rate or SICAD I above-described mechanism. As such, at this time SICAD II is not seen as representative of the rate used by the Company to settle transactions and is not deemed appropriate for financial reporting translation. The Company shall continue to closely monitor the currency exchange mechanisms in Venezuela and will assess changes as they develop.

In February 2013, the Finance Minister in Venezuela announced the devaluation of the VEF by 32% to VEF 6.3:1 from VEF 4.3:1 and the elimination of the Sistema de Transacciones con Titulos en Moneda Extranjera (SITME) rate. As a result of the devaluation, the Company recognized a net \$187 million gain in PTOI comprised of a net loss, primarily from remeasuring its monetary assets and liabilities (\$14 million), offset by a net gain from the earn-through of unearned premium and amortization of deferred acquisition costs at historical rates \$210 million and the amortization of basis on certain investments (\$9 million). The Company also recognized a \$223 million loss on the impairment of investments. In total, the Company recognized a pre-tax loss of \$36 million in the Consolidated Statements of Income as well as a reduction of \$59 million in other comprehensive income attributable to unrealized losses on certain investments.

The Company's four SBUs are as follows:

- Personal Insurance includes all domestic personal lines business. Liberty Mutual Insurance and Safeco Insurance brands and products are distributed through separately managed distribution channels.
- Commercial Insurance offers a wide array of property-casualty, group benefits, and life insurance coverages through independent agents, brokers, benefit consultants, captive agents, and bank partners throughout the United States. Commercial Insurance is organized into the following four market segments: Business Insurance, National Insurance, Liberty Mutual Benefits, and Other Commercial Insurance.
- Liberty International sells property, casualty, health and life insurance products and services to individuals and businesses in four market segments: Latin America and Iberia, Emerging Europe, Asia, and Large Emerging Markets, including Russia, China and India.
- Global Specialty is composed of a wide array of products and services offered through three market segments: Liberty International Underwriters ("LIU"), Liberty Specialty Markets ("LSM"), and Liberty Mutual Surety ("LM Surety"). LSM is composed of Liberty Syndicate ("Syndicate 4472") and Liberty Mutual Insurance Europe ("LMIE"), formerly included in LIU and Liberty Mutual Reinsurance ("LMR").

Overview – Consolidated

Consolidated NWP by significant line of business was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Private passenger automobile	\$3,520	\$3,363	4.7%	\$9,855	\$9,397	4.9%
Homeowners	1,548	1,322	17.1	4,249	3,597	18.1
Specialty insurance ¹	668	641	4.2	2,181	1,975	10.4
Commercial multiple-peril / fire	690	702	(1.7)	1,953	1,978	(1.3)
Workers compensation - Voluntary	570	668	(14.7)	1,670	1,949	(14.3)
Workers compensation - Involuntary	10	30	(66.7)	64	91	(29.7)
Global specialty reinsurance	228	280	(18.6)	974	1,069	(8.9)
Commercial automobile	495	482	2.7	1,422	1,387	2.5
General liability	396	376	5.3	1,142	1,043	9.5
Group disability and group life	359	338	6.2	1,047	968	8.2
Individual life and health	248	261	(5.0)	742	745	(0.4)
Surety	206	201	2.5	581	570	1.9
Global specialty inland marine	100	154	(35.1)	339	443	(23.5)
Other ²	412	379	8.7	1,199	1,142	5.0
Total NWP³	\$9,450	\$9,197	2.8%	\$27,418	\$26,354	4.0%

1 Specialty insurance is included in Global Specialty. Refer to Global Specialty's section for more detail.

2 Primarily includes NWP from assumed voluntary reinsurance ("AVR"), allied lines and domestic inland marine.

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

NWP for the three and nine months ended September 30, 2014 was \$9.450 billion and \$27.418 billion, respectively, increases of \$253 million and \$1.064 billion over the same periods in 2013. Significant changes by major line of business include:

- Private passenger automobile NWP increased \$157 million and \$458 million in the quarter and year, respectively. The increases in both periods primarily reflect in-force growth, rate and model year increases in Personal Insurance and growth in Liberty International due in part to acquisitions during the year.
- Homeowners NWP increased \$226 million and \$652 million in the quarter and year, respectively. The increases in both periods primarily reflect growth of policies in-force, rate and coverage increases in Personal Insurance and a decrease in ceded premium.
- Specialty insurance increased \$27 million and \$206 million in the quarter and year, respectively. The increases in both periods primarily reflect growth driven by Syndicate 4472, LMIE and LIU U.S. primarily due to new business, higher renewals and reinsurance program changes.
- Workers compensation - Voluntary NWP decreased \$98 million and \$279 million in the quarter and year, respectively. The decreases in both periods were due to exposure reductions partially offset by rate increases.
- Group disability and group life NWP increased \$21 million and \$79 million in the quarter and year, respectively. The increases in both periods primarily reflect strong retention and in-force exposure growth.
- Global specialty inland marine NWP decreased \$54 million and \$104 million in the quarter and year, respectively. The decreases in both periods primarily reflect program changes.

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

Consolidated NWP by SBU was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Personal Insurance	\$4,324	\$4,067	6.3%	\$12,100	\$11,269	7.4%
Commercial Insurance	2,385	2,494	(4.4)	6,860	6,946	(1.2)
Liberty International	1,560	1,506	3.6	4,296	4,228	1.6
Global Specialty	1,201	1,226	(2.0)	3,974	3,885	2.3
Corporate and Other	(20)	(96)	(79.2)	188	26	NM
Total NWP	\$9,450	\$9,197	2.8%	\$27,418	\$26,354	4.0%
Foreign exchange effect on NWP change			(4.2)			(3.6)
NWP change excluding foreign exchange ¹			7.0%			7.6%

¹ Determined by assuming constant foreign exchange rates between periods.
NM=Not Meaningful

Major drivers of NWP growth were as follows:

\$ in Millions	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014	2013	\$ Change	Points Attribution	2014	2013	\$ Change	Points Attribution
Total NWP ¹	\$9,450	\$9,197	\$253	2.8	\$27,418	\$26,354	\$1,064	4.0
Components of Growth:								
Domestic personal automobile	2,575	2,449	126	1.4	7,287	6,879	408	1.5
-Domestic homeowners	1,521	1,387	134	1.5	4,166	3,756	410	1.6
-Homeowners quota share	(39)	(125)	86	0.9	(106)	(337)	231	0.9
Total domestic homeowners	1,482	1,262	220	2.4	4,060	3,419	641	2.5
International local businesses (ex foreign exchange) ²	1,953	1,506	447	4.9	5,277	4,228	1,049	4.0
Specialty insurance (ex foreign exchange) ²	664	646	18	0.2	2,174	1,992	182	0.7
Global specialty reinsurance (ex foreign exchange) ²	225	280	(55)	(0.6)	963	1,069	(106)	(0.4)
Global specialty inland marine (ex foreign exchange) ²	99	154	(55)	(0.6)	335	443	(108)	(0.4)
Domestic workers compensation	531	649	(118)	(1.3)	1,592	1,901	(309)	(1.2)
Domestic individual life	143	142	(1)	-	403	384	19	0.1
Domestic group disability and group life	254	238	16	0.2	746	672	74	0.3
Surety	206	201	5	0.1	581	570	11	-
Foreign exchange ²	(384)	-	(384)	(4.2)	(946)	-	(946)	(3.6)
Other commercial lines	1,702	1,670	32	0.3	4,946	4,797	149	0.5
Total NWP	\$9,450	\$9,197	\$253	2.8	\$27,418	\$26,354	\$1,064	4.0

¹ NWP associated with internal reinsurance has been re-allocated to the appropriate lines of business.

² Determined by assuming constant foreign exchange rates between periods.

Consolidated NWP by geographic distribution channels was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
U.S.	\$7,251	\$7,057	2.7%	\$20,909	\$20,037	4.4%
International ¹	2,199	2,140	2.8	6,509	6,317	3.0
Total NWP	\$9,450	\$9,197	2.8%	\$27,418	\$26,354	4.0%

¹ Excludes domestically written business in Global Specialty's LIU market 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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$10,085	\$9,838	2.5%	\$29,683	\$28,443	4.4%
PTOI before catastrophes, net incurred losses attributable to prior years, Venezuela devaluation and foreign exchange, current accident year re-estimation and LP and LLC income	\$954	\$821	16.2%	\$2,858	\$2,444	16.9%
Catastrophes ¹	(288)	(292)	(1.4)	(1,451)	(1,161)	25.0
Net incurred losses attributable to prior years:						
- Asbestos & environmental	(111)	(280)	(60.4)	(113)	(284)	(60.2)
- All other ²	33	239	(86.2)	52	302	(82.8)
Venezuela devaluation and foreign exchange	48	52	(7.7)	119	184	(35.3)
Current accident year re-estimation ³	-	(17)	(100.0)	-	-	-
PTOI before LP and LLC income	636	523	21.6	1,465	1,485	(1.3)
LP and LLC income ⁴	221	88	151.1	605	356	69.9
PTOI	857	611	40.3	2,070	1,841	12.4
Net realized (losses) gains	(33)	80	NM	(192)	(54)	NM
SBU realignment expense	-	11	(100.0)	-	8	(100.0)
Loss on extinguishment of debt	(29)	(96)	(69.8)	(29)	(156)	(81.4)
Pre-tax income	795	606	31.2	1,849	1,639	12.8
Income tax expense	190	131	45.0	513	417	23.0
Consolidated net income before discontinued operations	605	475	27.4	1,336	1,222	9.3
Discontinued operations, net of tax	-	4	(100.0)	(81)	14	NM
Consolidated net income	605	479	26.3	1,255	1,236	1.5
Less: Net loss attributable to non-controlling interest	(4)	(2)	100.0	(19)	(11)	72.7
Net income attributable to LMHC	\$609	\$481	26.6%	\$1,274	\$1,247	2.2%
Cash flow (used in) provided by operations	(\$1,428)	\$1,579	NM	\$68	\$3,101	(97.8%)

1 Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta floods and German hailstorm. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium and reinstatement premium attributable to prior years of (\$2) million and \$10 million for the three and nine months ended September 30, 2014 and \$93 million and \$205 million for the same periods in 2013. Net of amortization of deferred gains on retroactive reinsurance of \$1 million and \$3 million for the three and nine months ended September 30, 2014 and \$159 million and \$179 million for the same periods in 2013. Net of the impact of the NICO Reinsurance Transaction including the original loss of approximately \$130 million offset by the subsequent benefit of \$85 million.

3 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2014 and 2013.

4 LP and LLC income is included in net investment income in the accompanying Consolidated Statements of Income.

NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2014 was \$857 million and \$2.070 billion, respectively, increases of \$246 million and \$229 million over the same periods in 2013. The increases in both periods primarily reflect strong underwriting results in Commercial Insurance excluding catastrophes and net incurred losses attributable to prior years, Personal Insurance premium growth, higher LP and LLC income and lower unfavorable A&E loss development, partially offset by less favorable prior year development. The year was further impacted by an increase in catastrophe losses.

Revenues for the three and nine months ended September 30, 2014 were \$10.085 billion and \$29.683 billion, respectively, increases of \$247 million and \$1.240 billion over the same periods in 2013. The

major components of revenues are net premium earned, net investment income, net realized (losses) gains, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2014 was \$8.949 billion and \$26.349 billion, respectively, increases of \$195 million and \$991 million over the same periods in 2013. The increases in both periods primarily reflect strong written premium growth in the last three months of 2013 and the first nine months of 2014 including rate increases.

Net investment income for the three and nine months ended September 30, 2014 was \$818 million and \$2.505 billion, respectively, increases of \$132 million and \$259 million over the same periods in 2013. The increases in both periods were mainly due to higher valuation changes in LP and LLC investments which benefited from an increase in IPO activity as well as strong financial performance in the underlying investments. Both periods also reflect lower valuation losses in other equity method investments compared to prior year. Those increases are partially offset by a reduction in taxable and tax-exempt interest income due to lower investment yields.

Net realized (losses) gains for the three and nine months ended September 30, 2014 were (\$33) million and (\$192) million, respectively, versus \$80 million and (\$54) million in the same periods in 2013. The increase in net losses in the year primarily relates to higher impairment losses recognized as a result of the change in the Venezuela currency exchange rate used for remeasurement purposes in January 2014 and the Venezuela government's devaluation of its currency in February 2013. The Company executed a purchase agreement to sell a number of its private equity investments which resulted in an impairment loss of approximately \$60 million in the current period. Both periods also reflect equity gains in 2013 that did not recur in 2014.

Fee and other revenues for the three and nine months ended September 30, 2014 were \$351 million and \$1.021 billion, respectively, increases of \$33 million and \$128 million over the same periods in 2013. The increases in both periods primarily reflect higher oil and gas revenues (in Corporate and Other) and servicing revenues (in Commercial Insurance) due to higher third-party administrator fee income and higher commission revenue from service carrier operations.

Claims, benefits and expenses for the three and nine months ended September 30, 2014 were \$9.261 billion and \$27.805 billion, respectively, increases of \$114 million and \$1.149 billion over the same periods in 2013. Both periods reflect losses and expenses consistent with business growth, less favorable incurred losses attributable to prior years and foreign exchange, partially offset by lower unfavorable A&E loss development. The year was further impacted by increased catastrophe losses.

Loss on extinguishment of debt for the three and nine months ended September 30, 2014 was \$29 million, decreases of \$67 million and \$127 million from the same periods in 2013. Fifty-one million dollars of debt at an interest rate of 10.75% was repurchased in the year and \$750 million of senior debt was issued with an interest rate of 4.85%.

Income tax expense on continuing operations for the three and nine months ended September 30, 2014 was \$190 million and \$513 million, respectively, increases of \$59 million and \$96 million over the same periods in 2013. The Company's effective tax rates on continuing operations for the three and nine months ended September 30, 2014 were 24% and 28% compared to 22% and 25% for the same periods in 2013. The increase in the effective tax rate on continuing operations from 2013 to 2014 is due to greater pre-tax income in 2014 and lower foreign tax benefits, partially offset by a tax benefit of \$60 million recorded in September 2014 as a result of settling the IRS exam for the 2002-2005 tax years. The Company's effective tax rate on continuing operations differs from the U.S. Federal statutory rate of 35% principally due to tax-exempt investment income, general business credits, settlement of the IRS exam, and lower foreign tax benefits.

Discontinued operations, net of tax (Summit and the Argentina operations) for the three and nine months ended September 30, 2014 was zero and a loss of \$81 million respectively, versus gains of \$4 million and

\$14 million in the same periods in 2013. The year was impacted by Summit and a net loss of \$77 million associated with the disposition of the Argentina operations.

Net income attributable to LMHC for the three and nine months ended September 30, 2014 was \$609 million and \$1.274 billion, increases of \$128 million and \$27 million over the same periods in 2013.

Cash flow (used in) provided by operations for the three and nine months ended September 30, 2014 was (\$1.428) billion and \$68 million, respectively, versus \$1.579 billion and \$3.101 billion in the same periods in 2013. The decreases in both periods reflect funding of the NICO Reinsurance Transaction.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014 ¹	2013 ¹	Change (Points)	2014 ¹	2013 ¹	Change (Points)
CONSOLIDATED						
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	61.2%	63.6%	(2.4)	62.1%	63.9%	(1.8)
Underwriting expense ratio	31.1	30.9	0.2	30.7	30.6	0.1
Dividend ratio	-	0.1	(0.1)	-	0.1	(0.1)
Subtotal	92.3	94.6	(2.3)	92.8	94.6	(1.8)
Catastrophes ²	3.4	3.6	(0.2)	5.9	4.9	1.0
Net incurred losses attributable to prior years:						
- Asbestos & environmental	1.3	3.5	(2.2)	0.4	1.2	(0.8)
- All other ³	(0.4)	(2.9)	2.5	(0.3)	(1.2)	0.9
Current accident year re-estimation ⁴	-	0.2	(0.2)	-	-	-
Total combined ratio ⁵	96.6%	99.0%	(2.4)	98.8%	99.5%	(0.7)

1 The combined ratio has been adjusted to exclude the impact of the Venezuela devaluation and foreign exchange.

2 Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta floods and German hailstorm. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

3 Net of earned premium and reinstatement premium attributable to prior years and amortization of deferred gains on retroactive reinsurance. Net of the impact of the NICO Reinsurance Transaction.

4 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2014 and 2013.

5 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 less managed care income 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 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 A&E 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, 2014 was 92.3% and 92.8%, improvements of 2.3 points and 1.8 points over the same periods in 2013. Both periods reflect a decrease in the claims and claim adjustment expense ratio primarily due to improvement in current accident year loss ratios in Commercial Insurance.

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, 2014 was 96.6% and 98.8%, improvements of 2.4 points and 0.7 points over the same periods in 2013. Both periods reflect the changes in the combined ratio previously discussed. The year also includes increased catastrophe losses.

PERSONAL INSURANCE

Overview – Personal Insurance

Personal Insurance sells automobile, homeowners and other types of property and casualty insurance coverage to individuals in the United States. Personal Insurance is composed of 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 and the Internet. Personal Lines' largest source of new business is through its over 17,000 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 second quarter of 2014, the Individual Life business was moved from Personal Insurance to Commercial Insurance. All prior periods have been restated to reflect this change.

Personal Insurance NWP by segment was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Personal Lines	\$2,435	\$2,289	6.4%	\$6,852	\$6,394	7.2%
Safeco	1,889	1,778	6.2	5,248	4,875	7.7
Total NWP	\$4,324	\$4,067	6.3%	\$12,100	\$11,269	7.4%

Personal Insurance NWP by line of business was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Private passenger automobile	\$2,576	\$2,448	5.2%	\$7,283	\$6,872	6.0%
Homeowners and other	1,748	1,619	8.0	4,817	4,397	9.6
Total NWP	\$4,324	\$4,067	6.3%	\$12,100	\$11,269	7.4%

NWP for the three and nine months ended September 30, 2014 was \$4.324 billion and \$12.100 billion, respectively, increases of \$257 million and \$831 million over the same periods in 2013.

Private passenger automobile NWP for the three and nine months ended September 30, 2014 was \$2.576 billion and \$7.283 billion, respectively, increases of \$128 million and \$411 million over the same periods in 2013. The increases reflect 1.6% growth in auto policies in-force as compared to September 30, 2013 as well as rate and model year increases.

Homeowners and other NWP for the three and nine months ended September 30, 2014 was \$1.748 billion and \$4.817 billion, respectively, increases of \$129 million and \$420 million over the same periods in 2013. The increases reflect 2.0% growth in homeowners policies in-force as compared to September 30, 2013 as well as rate and coverage increases.

Results of Operations – Personal Insurance

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$4,104	\$3,811	7.7%	\$11,960	\$10,977	9.0%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	\$707	\$664	6.5%	\$2,005	\$1,847	8.6%
Catastrophes ¹	(64)	(95)	(32.6)	(979)	(806)	21.5
Net incurred losses attributable to prior years	(5)	(41)	(87.8)	(41)	(51)	(19.6)
Current accident year re-estimation ²	-	(9)	(100.0)	-	-	-
PTOI	\$638	\$519	22.9%	\$985	\$990	(0.5%)

¹ Catastrophes include all current accident year catastrophe losses. 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, 2014 and 2013.

PTOI for the three and nine months ended September 30, 2014 was \$638 million and \$985 million, respectively, an increase of \$119 million in the quarter and a decrease of \$5 million in the year versus the same periods in 2013. Both periods were impacted by growth in earned premium and lower net incurred losses attributable to prior years partially offset by higher current accident year non-catastrophe losses. Both periods were also impacted by a change in terms for an internal reinsurance treaty which covers severe storm catastrophe losses. The attachment point for the internal reinsurance treaty increased from \$825 million in 2013 to \$945 million in 2014. Due to an increase in catastrophe losses, the attachment point was reached sooner in 2014 yielding lower net catastrophe losses for the quarter.

Revenues for the three and nine months ended September 30, 2014 were \$4.104 billion and \$11.960 billion, respectively, increases of \$293 million and \$983 million over the same periods in 2013. 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, 2014 was \$3.929 billion and \$11.448 billion, respectively, increases of \$291 million and \$977 million over the same periods in 2013. The increases in both periods reflect the premium earned associated with the changes in NWP previously discussed and NWP growth during the last three months of 2013.

Net investment income for the three and nine months ended September 30, 2014 was \$144 million and \$422 million, respectively, increases of \$1 million and \$3 million over the same periods in 2013. The increases were driven by a higher invested asset base partially offset by a lower investment yield.

Claims, benefits and expenses for the three and nine months ended September 30, 2014 were \$3.466 billion and \$10.975 billion, respectively, increases of \$174 million and \$988 million over the same periods in 2013. Both periods experienced increases consistent with business growth, unfavorable current accident year non-catastrophe loss trends in the auto line of business, and favorable prior year catastrophe development in 2013. The increase in the year was also driven by higher current accident year catastrophes and higher advertising expenses.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change (Points)	2014	2013	Change (Points)
PERSONAL INSURANCE						
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	59.7%	59.5%	0.2	60.2%	59.9%	0.3
Underwriting expense ratio	25.2	25.5	(0.3)	25.3	25.8	(0.5)
Subtotal	84.9	85.0	(0.1)	85.5	85.7	(0.2)
Catastrophes ¹	1.7	2.7	(1.0)	8.6	7.7	0.9
Net incurred losses attributable to prior years	0.1	1.1	(1.0)	0.4	0.5	(0.1)
Current accident year re-estimation ²	-	0.2	(0.2)	-	-	-
Total combined ratio	86.7%	89.0%	(2.3)	94.5%	93.9%	0.6

1 Catastrophes include all current accident year catastrophe losses. 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, 2014 and 2013.

The Personal 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, 2014 was 84.9% and 85.5%, respectively, decreases of 0.1 point and 0.2 points from the same periods in 2013. The increase in the claims and claim adjustment expense ratio in both periods primarily reflects higher current accident year non-catastrophe losses in the auto line of business. The decreases in the underwriting expense ratio in both periods were driven by premium earned growing at a faster rate than overall expenses.

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, 2014 was 86.7% and 94.5%, respectively, a decrease of 2.3 points and an increase of 0.6 points versus the same periods in 2013. In addition to the changes in the combined ratio previously discussed, both periods were impacted by an increase in the attachment point for an internal reinsurance treaty which covers severe storm catastrophe losses as well as an increase in catastrophe losses in the year compared to 2013.

COMMERCIAL INSURANCE

Overview – Commercial Insurance

Commercial Insurance offers a wide array of property-casualty, group benefits, and life insurance coverages through independent agents, brokers, benefit consultants, captive agents, and bank partners throughout the United States. Commercial Insurance is organized into the following four market segments: Business Insurance, National Insurance, Liberty Mutual Benefits, and Other Commercial Insurance. Business Insurance serves small and middle market customers through a regional operating model that combines local underwriting, market knowledge and service with the scale advantages of a national company. National Insurance provides commercial lines products and services, including third-party administration, to large businesses. Liberty Mutual Benefits provides short and long-term disability, accident, health and group life insurance to mid-sized and large businesses, as well as life and annuity products to individuals in the United States. 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 April 1, 2014, the Company sold Summit, a mono-line workers compensation company based in Florida, to American Financial Group. The results of Summit are presented as Discontinued Operations on the accompanying Consolidated Statements of Income and are no longer included with Commercial Insurance. All prior periods have been restated to reflect the sale.

On June 10, 2014, a new market segment was established in Commercial Insurance called Liberty Mutual Benefits, consolidating the existing Group Benefits, A&H, and Individual Life operations into one unit. All prior periods have been restated to reflect the new structure.

Commercial Insurance NWP by market segment was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Business Insurance	\$1,387	\$1,447	(4.1%)	\$3,956	\$4,046	(2.2%)
National Insurance	582	631	(7.8)	1,636	1,728	(5.3)
Liberty Mutual Benefits	394	377	4.5	1,143	1,051	8.8
Other Commercial Insurance	22	39	(43.6)	125	121	3.3
Total NWP	\$2,385	\$2,494	(4.4%)	\$6,860	\$6,946	(1.2%)

Commercial Insurance NWP by line of business was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Commercial multiple-peril	\$552	\$560	(1.4%)	\$1,532	\$1,528	0.3%
Workers compensation - Voluntary	551	656	(16.0)	1,483	1,751	(15.3)
Workers compensation - Involuntary	11	30	(63.3)	90	91	(1.1)
Commercial automobile	376	375	0.3	1,093	1,077	1.5
General liability	314	305	3.0	912	841	8.4
Group disability and life	254	238	6.7	746	671	11.2
Individual life	139	138	0.7	392	375	4.5
Other lines	188	192	(2.1)	612	612	-
Total NWP	\$2,385	\$2,494	(4.4%)	\$6,860	\$6,946	(1.2%)

NWP for the three and nine months ended September 30, 2014 was \$2.385 billion and \$6.860 billion, decreases of \$109 million and \$86 million from the same periods in 2013. The decreases in both periods were driven by decreases in workers compensation - voluntary as a result of exposure reductions partially

offset by rate increases. The decreases in both periods were partially offset by group disability and life due to strong retention and in-force exposure growth and continued positive rate and new business across most other lines of business. The year also reflects higher structured settlement sales in individual life.

Results of Operations – Commercial Insurance

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$2,760	\$2,877	(4.1%)	\$8,292	\$8,486	(2.3%)
PTOI before catastrophes, net incurred losses attributable to prior years, current accident year re-estimation and LP and LLC income	\$341	\$221	54.3%	\$949	\$670	41.6%
Catastrophes ¹	(50)	(42)	19.0	(282)	(184)	53.3
Net incurred losses attributable to prior years ²	12	27	(55.6)	50	118	(57.6)
Current accident year re-estimation ³	-	(8)	(100.0)	-	-	-
PTOI before LP & LLC income	303	198	53.0	717	604	18.7
LP and LLC income	2	-	NM	11	4	175.0
PTOI	\$305	\$198	54.0%	\$728	\$608	19.7%

1 Catastrophes include all current 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 (\$4) million and \$17 million for the three and nine months ended September 30, 2014 and (\$3) million and (\$15) million for the same periods in 2013. Net of amortization of deferred gains on assumed retroactive reinsurance of zero and \$1 million for the three and nine months ended September 30, 2014 and \$1 million and \$2 million for the same periods in 2013.

3 Re-estimation of the current accident year loss reserves for the six months ended June 30, 2014 and 2013.

NM=Not Meaningful

PTOI for the three and nine months ended September 30, 2014 was \$305 million and \$728 million, increases of \$107 million and \$120 million over the same periods in 2013. The increases in both periods were driven by decreased current accident year losses across most casualty lines of business, lower non-catastrophe property losses and lower variable compensation costs partially offset by higher catastrophe losses, lower net investment income, less favorable development of prior year losses, and higher information technology expenditures.

Revenues for the three and nine months ended September 30, 2014 were \$2.760 billion and \$8.292 billion, respectively, decreases of \$117 million and \$194 million from the same periods in 2013. The major components of revenues are net premium earned, net investment income, net realized losses, and fee and other revenues.

Net premium earned for the three and nine months ended September 30, 2014 was \$2.250 billion and \$6.759 billion, respectively, decreases of \$113 million and \$198 million from the same periods in 2013. The decreases in both periods reflect a decrease in NWP during the last half of 2013 primarily due to a decline in workers compensation premium, as well as the premium earned associated with the changes in NWP previously discussed.

Net investment income for the three and nine months ended September 30, 2014 was \$384 million and \$1.149 billion, respectively, decreases of \$4 million and \$14 million from the same periods in 2013. The decreases in both periods were primarily driven by lower investment yields partially offset by increased LP and LLC income.

Net realized losses for the three and nine months ended September 30, 2014 were \$6 million and \$8 million, respectively, decreases of \$6 million and \$11 million from the same periods in 2013.

Fee and other revenues for the three and nine months ended September 30, 2014 were \$132 million and \$392 million, respectively, increases of \$6 million and \$29 million over the same periods in 2013. The increases reflect higher third-party administrator fee income and higher commission revenue from servicing carrier operations. 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, 2014 were \$2.461 billion and \$7.572 billion, respectively, decreases of \$218 million and \$303 million from the same periods in 2013. The decreases were driven by decreased current accident year losses across most casualty lines of business, lower non-catastrophe property losses, a more profitable business mix, and lower variable compensation costs, partially offset by higher catastrophe property losses, less favorable development of prior accident year losses, and higher information technology expenditures.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change (Points)	2014	2013	Change (Points)
COMMERCIAL INSURANCE						
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	61.7%	70.3%	(8.6)	63.6%	69.4%	(5.8)
Underwriting expense ratio	33.3	32.2	1.1	32.9	32.7	0.2
Dividend ratio	0.1	0.3	(0.2)	0.1	0.3	(0.2)
Subtotal	95.1	102.8	(7.7)	96.6	102.4	(5.8)
Catastrophes ¹	2.7	2.1	0.6	5.0	3.1	1.9
Net incurred losses attributable to prior years ²	(0.6)	(1.4)	0.8	(0.9)	(2.1)	1.2
Current accident year re-estimation ³	-	0.4	(0.4)	-	-	-
Total combined ratio	97.2%	103.9%	(6.7)	100.7%	103.4%	(2.7)

1 Catastrophes include all current 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, 2014 and 2013.

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, 2014 was 95.1% and 96.6%, decreases of 7.7 points and 5.8 points from the same periods in 2013. The decreases in both periods were driven by lower claims and claim adjustment expenses due to decreased current accident year losses across most casualty lines of business and lower property losses as well as lower policyholder dividend costs. The decreases in both periods were partially offset by higher underwriting expense ratios due to lower earned premium and higher information technology expenditures, partially offset by lower variable compensation costs.

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, 2014 was 97.2% and 100.7%, decreases of 6.7 points and 2.7 points from the same periods in 2013. The decreases reflect the improvements previously discussed, partially offset by higher current year catastrophe losses and less favorable development of prior accident year losses.

LIBERTY INTERNATIONAL

Overview – Liberty International

Liberty International sells property, casualty, health and life insurance products and services to individuals and businesses in four market segments.

The Liberty International SBU was realigned effective in the third quarter of 2014. The realignment will better position the organization for continued growth and improved profitability in an increasingly competitive global marketplace. The four market segments that comprise the SBU are Latin America and Iberia, including Venezuela, Brazil, Colombia, Chile, Ecuador, Spain and Portugal; Emerging Europe, including Turkey, Poland, Ireland and the United Kingdom; Asia, including Thailand, Singapore, Hong Kong, Vietnam and Malaysia (as a result of the Uni.Asia General Insurance Berhad acquisition in July 2014); and Large Emerging Markets, including Russia, China and India. All prior periods have been restated to reflect this change. Private passenger automobile insurance is the single largest line of business.

Effective February 21, 2014, the Company sold the Argentina operations resulting in a net loss of \$77 million. The results of the Argentina operations are presented as Discontinued Operations on the accompanying Consolidated Statements of Income and are no longer included with Liberty International. All prior periods have been restated to reflect the sale.

Liberty International NWP by market segment was as follows:

\$ in Millions	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014	2013	Change	Change ex. foreign exchange ¹	2014	2013	Change	Change ex. foreign exchange ¹
Latin America and Iberia	\$1,236	\$1,233	0.2%	32.2%	\$3,414	\$3,453	(1.1%)	27.0%
Emerging Europe	138	120	15.0	11.1	388	338	14.8	11.8
Asia	129	97	33.0	33.5	326	290	12.4	15.8
Large Emerging Markets	57	56	1.8	6.1	168	147	14.3	19.5
Total NWP	\$1,560	\$1,506	3.6%	29.6%	\$4,296	\$4,228	1.6%	24.8%

¹ Determined by assuming constant foreign exchange rates between periods.

Liberty International NWP by line of business was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Private passenger automobile	\$945	\$914	3.4%	\$2,568	\$2,518	2.0%
Commercial automobile	119	107	11.2	328	309	6.1
Homeowners	66	60	10.0	189	178	6.2
Life and health	210	219	(4.1)	640	657	(2.6)
Other ¹	220	206	6.8	571	566	0.9
Total NWP	\$1,560	\$1,506	3.6%	\$4,296	\$4,228	1.6%

¹ Premium related to other personal and commercial lines including personal accident, 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, 2014 was \$1.560 billion and \$4.296 billion, respectively, increases of \$54 million and \$68 million over the same periods in 2013. The increases in both periods reflect local currency growth across all segments including Latin America and Iberia due to increases in sum insured values in the auto and health lines of business resulting from inflation in

Venezuela, Emerging Europe driven by the Hughes Insurance Agreement in Ireland, Asia driven by the acquisition of Malaysia in the third quarter, and expansion in Large Emerging Markets. The increase in the year also reflects an increase in new private passenger auto business in Brazil. The increases in both periods were partially offset by the impact of foreign exchange, primarily driven by Venezuela.

Results of Operations – Liberty International

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$1,664	\$1,558	6.8%	\$4,583	\$4,430	3.5%
PTOI before catastrophes, net incurred losses attributable to prior years and Venezuela devaluation and foreign exchange	\$36	\$59	(39.0%)	\$88	\$126	(30.2%)
Catastrophes ¹	-	-	-	(9)	-	NM
Net incurred losses attributable to prior years	25	8	NM	54	30	80.0
Venezuela devaluation and foreign exchange	48	52	(7.7)	119	187	(36.4)
PTOI	\$109	\$119	(8.4%)	\$252	\$343	(26.5%)

¹ Catastrophes include all current accident year catastrophe losses for the U.K. and Ireland floods. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
NM = Not Meaningful

PTOI for the three and nine months ended September 30, 2014 was \$109 million and \$252 million, respectively, decreases of \$10 million and \$91 million from the same periods in 2013. Both periods reflect lower net PTOI due to claim costs exceeding premium as a result of inflation in Venezuela, favorable private passenger auto severity in Brazil due to enhanced fraud controls and cost containment efforts, and the negative impact of foreign exchange driven by Venezuela. The year was further impacted by catastrophe losses due to the U.K. and Ireland floods.

Revenues for the three and nine months ended September 30, 2014 were \$1.664 billion and \$4.583 billion, increases of \$106 million and \$153 million over the same periods in 2013. The primary components of revenues are net premium earned, net investment income and net realized investment gains (losses).

Net premium earned for the three and nine months ended September 30, 2014 was \$1.520 billion and \$4.427 billion, increases of \$104 million and \$199 million over the same periods in 2013. The increases in both periods reflect the premium earned associated with the growth in NWP previously discussed, and foreign exchange in Venezuela.

Net investment income for the three and nine months ended September 30, 2014 was \$93 million and \$279 million, decreases of \$11 million and \$33 million from the same periods in 2013. The decreases in both periods reflect higher cash balances and limited investment options in Venezuela reducing overall yields relative to prior periods.

Net realized investment gains (losses) for the three and nine months ended September 30, 2014 were \$3 million and (\$247) million, versus (\$4) million and (\$229) million in the same periods in 2013. The change in the quarter was primarily driven by 2013 investment sales in Venezuela that resulted in realized losses. The change in the year was primarily driven by a higher impairment of Venezuelan BsF denominated investments recognized as the result of the 2014 devaluation over the prior year devaluation.

Claims, benefits and expenses for the three and nine months ended September 30, 2014 were \$1.552 billion and \$4.578 billion, increases of \$109 million and \$262 million over the same periods in 2013. Both periods reflect foreign exchange losses primarily the result of the Venezuela devaluation and foreign exchange and the acquisition of Malaysia. Excluding this impact, both periods reflect favorable incurred losses attributable to prior years primarily driven by favorable claims experience and favorable private passenger

auto severity in Brazil, offset by higher costs consistent with business growth, an increase in private passenger auto severity due to inflation in Venezuela and an increase in commission expenses due to competition in Colombia. The increase in the year is further impacted by higher catastrophe losses due to the U.K. and Ireland floods.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014 ¹	2013 ¹	Change (Points)	2014 ¹	2013 ¹	Change (Points)
LIBERTY INTERNATIONAL						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	66.5%	66.1%	0.4	66.2%	66.1%	0.1
Underwriting expense ratio	37.5	37.0	0.5	38.2	38.0	0.2
Subtotal	104.0	103.1	0.9	104.4	104.1	0.3
Catastrophes ²	0.1	-	0.1	0.2	-	0.2
Net incurred losses attributable to prior years	(1.8)	(0.7)	(1.1)	(1.3)	(0.8)	(0.5)
Total combined ratio	102.3%	102.4%	(0.1)	103.3%	103.3%	-

1 The combined ratio has been adjusted to exclude the impact of the Venezuela devaluation and foreign exchange.

2 Catastrophes include all current accident year catastrophe losses for the U.K. and Ireland floods. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Liberty International combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2014 was 104.0% and 104.4%, respectively, increases of 0.9 points and 0.3 points over the same periods in 2013. The increase in the quarter includes a 0.4 point increase in the claims and claim adjustment expense ratio primarily due to an increase in private passenger auto severity in Venezuela. The underwriting expense ratio increased 0.5 points and 0.2 points in the quarter and year, respectively, primarily due to an increase in information technology investment.

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, 2014 was 102.3% and 103.3%, respectively, a decrease of 0.1 points in the quarter and no change in the year versus the same periods in 2013. The total combined ratios in both periods reflect the changes in the combined ratio previously discussed, as well as favorable incurred losses attributable to prior years, primarily in Venezuela, Spain, Ireland and Singapore. The total combined ratio for the nine months ended September 30, 2014 also includes catastrophe losses related to the U.K. and Ireland floods.

GLOBAL SPECIALTY

Overview – Global Specialty

Global Specialty is composed of a wide array of products and services offered through three market segments: LIU, LSM and LM Surety. LIU sells inland marine and specialty commercial insurance worldwide, through offices in Asia, Australia, the Middle East, North America and Latin America. LSM provides specialty insurance, inland marine and reinsurance worldwide through its three divisions: Syndicate 4472, LMIE and LMR. LM Surety is a leading provider of global contract and commercial surety bonds to businesses of all sizes. Other primarily consists of internal reinsurance.

The integration of LSM occurred during the first quarter of 2014. LSM is composed of Syndicate 4472, LMIE, formerly included in LIU, and LMR. All prior periods have been restated to reflect this change.

Effective in the second quarter of 2014, the A&H business was moved from Global Specialty to Commercial Insurance. All Global Specialty A&H activity from prior periods has been restated to reflect the new structure.

Global Specialty NWP by market segment was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
LSM	\$606	\$627	(3.3%)	\$2,163	\$2,117	2.2%
LIU	357	388	(8.0)	1,148	1,160	(1.0)
LM Surety	203	197	3.0	570	558	2.2
Other	35	14	150.0	93	50	86.0
Total NWP	\$1,201	\$1,226	(2.0%)	\$3,974	\$3,885	2.3%
Foreign exchange effect on NWP change			1.1			1.0
NWP change excluding foreign exchange ¹			(3.1%)			1.3%

¹ Determined by assuming constant foreign exchange rates between periods.

Global Specialty's major product lines are as follows:

- (1) Specialty Insurance: includes marine, energy, construction, aviation, property, casualty, excess casualty, directors and officers, errors and omissions, environmental impairment liability, commercial automobile, railroad, workers compensation, trade credit, excess and surplus property, crisis management, contingent lines and other;
- (2) Reinsurance: includes worldwide multi-line marine, property and casualty reinsurance;
- (3) Surety: includes contract and commercial surety bonds;
- (4) Inland Marine: handset protection coverage for lost or damaged devices; and
- (5) Other: internal reinsurance within Global Specialty.

Global Specialty NWP by line of business was as follows:

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Specialty insurance	\$649	\$589	10.2%	\$2,056	\$1,816	13.2%
Reinsurance	212	270	(21.5)	909	1,013	(10.3)
Surety	205	199	3.0	577	563	2.5
Inland marine	100	154	(35.1)	339	443	(23.5)
Other	35	14	150.0	93	50	86.0
Total NWP	\$1,201	\$1,226	(2.0%)	\$3,974	\$3,885	2.3%

NWP for the three and nine months ended September 30, 2014 was \$1.201 billion and \$3.974 billion, respectively, a decrease of \$25 million and an increase of \$89 million versus the same periods in 2013. Both periods were impacted by growth in specialty insurance primarily driven by Syndicate 4472, LMIE and LIU U.S. due to reinsurance program changes, new business and higher renewals, partially offset by a decrease in inland marine due to program changes and reinsurance due to a competitive market. Non-recurring adjustments to ultimate premium estimates in 2013 more than offset the increase in the quarter and partially offset the increase for the year.

Results of Operations – Global Specialty

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$1,286	\$1,349	(4.7%)	\$3,844	\$3,808	0.9%
PTOI before catastrophes and net incurred losses attributable to prior years	\$153	\$180	(15.0%)	\$493	\$534	(7.7%)
Catastrophes ¹	(10)	(35)	(71.4)	(31)	(95)	(67.4)
Net incurred losses attributable to prior years ²	(23)	22	NM	(39)	(28)	39.3
PTOI	\$120	\$167	(28.1%)	\$423	\$411	2.9%

1 Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta floods, and German hailstorm. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium and reinstatement premium attributable to prior years of \$1 million and \$9 million for the three and nine months ended September 30, 2014 and (\$4) million and \$21 million for the same periods in 2013.
NM=Not Meaningful

PTOI for the three and nine months ended September 30, 2014 was \$120 million and \$423 million, respectively, a decrease of \$47 million and an increase of \$12 million versus the same periods in 2013. The decrease in the quarter is primarily driven by increases to losses attributable to prior years as compared to decreases in 2013 reflecting higher than expected loss activity in Syndicate 4472, LIU U.S. and LM Surety, partially offset by lower catastrophe losses, better current year loss activity within inland marine, and favorable net investment income. Additionally, the decrease was impacted by lower earned premium in Syndicate 4472 primarily driven by favorable non-recurring premium adjustments in 2013 as well as LSM higher commission expense due to business mix and integration costs. The increase in the year reflects lower catastrophe losses, improved current year loss results within inland marine, and favorable net investment income partially offset by higher net incurred losses attributable to prior years as well as lower earned premiums and higher commissions due to the drivers noted previously.

Revenues for the three and nine months ended September 30, 2014 were \$1.286 billion and \$3.844 billion, respectively, a decrease of \$63 million and an increase of \$36 million versus the same periods in 2013. 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, 2014 was \$1.195 billion and \$3.585 billion, respectively, a decrease of \$74 million and an increase of \$37 million versus the same periods in 2013. Both periods reflect the previously mentioned NWP drivers, and non-recurring adjustments due to LM Surety timing, the change to ultimate premium mentioned above and timing of earnings related to growth in specialty insurance primarily driven by Syndicate 4472.

Net investment income for the three and nine months ended September 30, 2014 was \$85 million and \$250 million, respectively, increases of \$7 million and \$19 million over the same periods in 2013. The increases in both periods reflect a higher invested asset base partially offset by lower yields.

Claims, benefits and expenses for the three and nine months ended September 30, 2014 were \$1.164 billion and \$3.420 billion, respectively, a decrease of \$18 million and an increase of \$46 million versus the same periods in 2013. Both periods were impacted by business growth, increased retention, higher incurred losses attributable to prior years and higher commissions. Favorable catastrophe losses and inland marine program changes more than offset the increase for the quarter and partially offset the increase for the year.

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change (Points)	2014	2013	Change (Points)
GLOBAL SPECIALTY						
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	61.1%	63.0%	(1.9)	59.5%	61.7%	(2.2)
Underwriting expense ratio	32.5	28.2	4.3	32.7	28.9	3.8
Dividend ratio	0.2	0.2	-	0.2	0.2	-
Subtotal	93.8	91.4	2.4	92.4	90.8	1.6
Catastrophes ¹	0.8	2.7	(1.9)	0.9	2.7	(1.8)
Net incurred losses attributable to prior years ²	2.0	(1.7)	3.7	1.1	0.8	0.3
Total combined ratio	96.6%	92.4%	4.2	94.4%	94.3%	0.1

¹ Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta Floods, and German hailstorm. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

² Net of earned premium and reinstatement premium attributable to prior years.

The Global Specialty combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2014 was 93.8% and 92.4%, respectively, increases of 2.4 points and 1.6 points over the same periods in 2013. The claims and claim adjustment expense and underwriting expense ratios reflect changes in the mix of business and favorable current year losses partially offset by higher underwriting expenses in the inland marine line of business due to a change of terms and conditions on a program as well as other program changes. The underwriting expense ratio was further impacted by LSM higher commissions driven by business mix and market conditions, as well as underwriting expenses due to integration costs in line with the re-alignment announced earlier in the year. The ratios in the quarter were also adversely impacted by the favorable adjustments to ultimate premium estimates in 2013.

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, 2014 was 96.6% and 94.4%, respectively, increases of 4.2 points and 0.1 points over the same periods in 2013. The increase in both periods reflects the change to the combined ratio previously discussed, partially offset by favorable catastrophe losses. Net incurred losses attributable to prior years were unfavorable for both periods due to Syndicate 4472 and LIU U.S., while the year was further impacted by LM Surety.

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”) and Liberty Re annuity business.
- Cessions related to certain retroactive reinsurance agreements, including the recent NICO Reinsurance Transaction, which is described further in “Reinsurance Recoverables”.
- Effective January 1, 2014, Corporate and Commercial Insurance novated their voluntary and involuntary reinsurance treaties that applied to certain pre-2013 workers compensation claims and entered into two new agreements including: (1) certain pre-2014 voluntary workers compensation claims and, (2) certain pre-2014 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 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 fully 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.

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

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Reinsurance, net	\$7	(\$65)	NM	\$137	(\$42)	NM
Workers compensation - Voluntary ¹	(27)	(35)	(22.9)	74	67	10.4
Workers compensation - Involuntary	(1)	-	NM	(26)	-	NM
Other	1	4	(75.0)	3	1	NM
Total NWP	(\$20)	(\$96)	(79.2%)	\$188	\$26	NM

¹Booked as billed adjustment.

NM = Not Meaningful

NWP for the three and nine months ended September 30, 2014 was (\$20) million and \$188 million, respectively, increases of \$76 million and \$162 million over the same periods in 2013. The increases were primarily driven by a decrease in ceded premium related to a homeowners quota share treaty covering Personal Insurance homeowners business due to a change in terms. Both periods were also impacted by changes in the workers compensation “booked as billed” adjustment.

Results of Operations – Corporate and Other

\$ in Millions	Three Months Ended September 30,			Nine Months Ended September 30,		
	2014	2013	Change	2014	2013	Change
Revenues	\$271	\$243	11.5%	\$1,004	\$742	35.3%
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years, Venezuela devaluation, and LP and LLC income	(283)	(303)	(6.6%)	(677)	(733)	(7.6%)
Catastrophes ¹	(164)	(120)	36.7	(150)	(76)	97.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	(111)	(280)	(60.4)	(113)	(284)	(60.2)
- All other ²	24	223	(89.2)	28	233	(88.0)
Venezuela devaluation	-	-	NM	-	(3)	(100.0)
Pre-tax operating loss before LP and LLC income	(534)	(480)	11.3	(912)	(863)	5.7
LP and LLC income ³	219	88	148.9	594	352	68.8
Pre-tax operating loss	(\$315)	(\$392)	(19.6%)	(\$318)	(\$511)	(37.8%)

1 Catastrophes include all current accident year catastrophe losses for severe storms in the U.S., U.K. and Ireland floods, Windstorm Ela, Cyclone Oswald, Central European floods, Alberta floods, and German hailstorm. 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 (\$16) million for the three and nine months ended September 30, 2014 and \$100 million and \$200 million for the same periods in 2013. Net of amortization of deferred gains on retroactive reinsurance of \$1 million and \$2 million for the three and nine months ended September 30, 2014 and \$158 million and \$177 million for the same periods in 2013. Net of the impact of the NICO Reinsurance Transaction including the original loss of approximately \$130 million offset by the subsequent benefit of \$85 million.

3 LP and LLC income is included in net investment income in the accompanying Consolidated Statements of Income.
NM = Not Meaningful

Pre-tax operating loss for the three and nine months ended September 30, 2014 was \$315 million and (\$318) million, respectively, decreases of \$77 million and \$193 million from the same periods in 2013. The decreases were driven by valuation changes in LP and LLC investments, lower unfavorable A&E loss development, reduced reinsurance costs due to a change in terms and lower employee pension expenses, partially offset by the commutation of two workers compensation retroactive reinsurance agreements in 2013 that did not recur, losses related to the NICO Reinsurance Transaction (including a reduction to the initial loss on the transaction due to a cession of A&E loss development), higher depreciation and

impairments related to Liberty Energy and unfavorable annuity reserve development. The decrease in the year is further impacted by favorable prior year incurred loss development in 2013 that did not recur.

Revenues for the three and nine months ended September 30, 2014 were \$271 million and \$1.004 billion, respectively, increases of \$28 million and \$262 million over the same periods in 2013. 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, 2014 were \$55 million and \$130 million, respectively, decreases of \$13 million and \$24 million from the same periods in 2013. The decreases in both periods reflect lower earned but not reported development on certain pre-2013 workers compensation business assumed from Commercial Insurance, partially offset by a reduction in ceded premium due to a change in terms on the homeowners quota share treaty covering Personal Insurance homeowners effective December 31, 2013.

Net investment income for the three and nine months ended September 30, 2014 were \$112 million and \$405 million, respectively, increases of \$139 million and \$284 million over the same periods in 2013. The increases were driven by higher valuation changes in LP and LLC investments.

Net realized (losses) gains for the three and nine months ended September 30, 2014 were (\$32) million and \$62 million, respectively, versus \$84 million and \$149 million in the same periods in 2013. Both periods were impacted by gains on sales of common stock in 2013 that did not recur in 2014 and impairment losses on LP investments in 2014.

Fee and other revenues for the three and nine months ended September 30, 2014 were \$136 million and \$407 million, respectively, increases of \$18 million and \$89 million over the same periods in 2013. The increases in both periods primarily reflect higher oil and gas revenues due to increased production.

Claims, benefits and expenses for the three months and nine months ended September 30, 2014 were \$618 million and \$1.260 billion, respectively, increases of \$67 million and \$156 million over the same periods in 2013. The increases in both periods were driven by a lower ceding percentage on the homeowners quota share treaty due to a change in terms, the commutation of two workers compensation retroactive reinsurance agreements in 2013 that did not recur, higher depreciation and impairments related to Liberty Energy, losses related to the NICO Reinsurance Transaction and unfavorable annuity reserve development, partially offset by lower unfavorable loss development on certain pre-2014 workers compensation business assumed from Commercial Insurance, lower unfavorable A&E loss development and lower employee pension expenses. The change in the year is further impacted by favorable prior year incurred loss development in 2013 that did not recur.

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 leveraged 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 analytical 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 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, 2014 and December 31, 2013:

\$ in Millions	As of September 30, 2014		As of December 31, 2013	
	Carrying Value	% of Total	Carrying Value	% of Total
Invested Assets by Type				
Fixed maturities, available for sale, at fair value	\$63,356	80.4%	\$64,256	81.4%
Equity securities, available for sale, at fair value	3,105	3.9	2,952	3.7
LPs and LLCs	4,600	5.8	4,091	5.2
Commercial mortgage loans	1,701	2.2	1,583	2.0
Short-term investments	556	0.7	393	0.5
Other investments	857	1.1	829	1.1
Cash and cash equivalents	4,647	5.9%	4,778	6.1
Total invested assets	\$78,822	100.0%	\$78,882	100.0%

Total invested assets as of September 30, 2014 were \$78.822 billion, a decrease of \$60 million or 0.1% from December 31, 2013. The decrease reflects sales of fixed maturities for funding of the NICO Reinsurance Transaction and the impact of the change in the Venezuela currency exchange rate used for remeasurement purposes offset by an increase in fixed maturity unrealized gains related to lower treasury yields and spread tightening and strong private equity market performance.

Fixed maturities as of September 30, 2014 were \$63.356 billion, a decrease of \$900 million or 1.4% from December 31, 2013. The decrease reflects sales of fixed maturities for funding of the NICO Reinsurance Transaction and the change in the Venezuela currency exchange rate used for remeasurement purposes, partially offset by an increase in unrealized gains related to lower treasury yields and spread tightening. As of September 30, 2014, included in fixed maturities are commitments to purchase various residential mortgage-backed securities at a cost and fair value of \$153 million, and various corporate and municipal securities at a cost and fair value of \$63 million.

Equity securities available for sale as of September 30, 2014 were \$3.105 billion (\$2.748 billion common stock and \$357 million preferred stock) versus \$2.952 billion as of December 31, 2013 (\$2.625 billion common stock and \$327 million preferred stock), an increase of \$153 million or 5.2% over December 31, 2013. Of the \$2.748 billion of common stock at September 30, 2014, \$431 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 primarily due to a combination of strong equity market performance and the reinvestment of cash flows from operations.

Investments in LPs and LLCs as of September 30, 2014 were \$4.600 billion, an increase of \$509 million or 12.4% over December 31, 2013. These investments consist of traditional private equity partnerships of \$2.210 billion, natural resources partnerships of \$828 million (\$639 million related to energy investments), real estate partnerships of \$617 million and other partnerships of \$945 million. The increase reflects net improved valuations and new investments offset by distributions received. The Company's investments in LPs and LLCs are long-term in nature. 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, 2014, the Company had unfunded commitments in traditional private equity partnerships, natural resources, real estate, and other of \$1.336 billion, \$2.480 billion (\$2.451 billion in energy investments), \$343 million, and \$597 million, respectively.

Commercial mortgage loans as of September 30, 2014 were \$1.701 billion (net of \$14 million of loan loss reserves or 0.82% of the outstanding loan portfolio), an increase of \$118 million or 7.5% over December 31, 2013. The increase primarily reflects \$226 million in funding, partially offset by \$108 million in principal reductions. The entire commercial loan portfolio is U.S. based. As of September 30, 2014, 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 4,211 at December 31, 2013 to 4,458 at September 30, 2014. Approximately 91% of the loans are full or partial recourse to borrowers.

Cash and cash equivalents as of September 30, 2014 were \$4.647 billion, a decrease of \$131 million or 2.7% from December 31, 2013. The decrease was primarily related to net cash used in investing activities, and the impact of the change in the Venezuela currency exchange rate used for remeasurement purposes partially offset by cash flows from operating activities.

Regarding fair value measurements, as of September 30, 2014, excluding separate accounts and other assets, the Company reflected \$5.057 billion (7.5%) 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, 2014 the Company reported \$61.175 billion (90.5%) as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported \$1.377 billion (2.0%) 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, 2014, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.2% of invested assets.

The following tables summarize the Company's available for sale portfolio by security type as of September 30, 2014 and December 31, 2013:

\$ in Millions September 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	\$2,962	\$174	(\$18)	\$3,118
Residential MBS ¹	7,898	271	(48)	8,121
Commercial MBS	1,489	24	(16)	1,497
Other MBS and ABS ²	2,631	67	(27)	2,671
U.S. state and municipal	13,085	880	(50)	13,915
Corporate and other	26,577	1,543	(127)	27,993
Foreign government securities	5,833	255	(47)	6,041
Total fixed maturities	60,475	3,214	(333)	63,356
Common stock	2,213	597	(62)	2,748
Preferred stock	392	20	(55)	357
Total equity securities	2,605	617	(117)	3,105
Total securities available for sale	\$63,080	\$3,831	(\$450)	\$66,461

¹ Mortgage-backed securities ("MBS")

² Asset-backed securities ("ABS")

\$ in Millions December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	\$2,948	\$161	(\$28)	\$3,081
Residential MBS	8,404	272	(102)	8,574
Commercial MBS	1,729	22	(34)	1,717
Other MBS and ABS	2,291	63	(48)	2,306
U.S. state and municipal	13,964	680	(283)	14,361
Corporate and other	26,475	1,263	(354)	27,384
Foreign government securities	6,635	270	(72)	6,833
Total fixed maturities	62,446	2,731	(921)	64,256
Common stock	2,122	524	(21)	2,625
Preferred stock	386	18	(77)	327
Total equity securities	2,508	542	(98)	2,952
Total securities available for sale	\$64,954	\$3,273	(\$1,019)	\$67,208

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of September 30, 2014:

\$ in Millions	As of September 30, 2014							
	AAA	AA	A	BBB	BB	B or Lower	Total	% of Total
Mortgage & Asset-Backed Fixed Maturities by Credit Quality¹								
SBA loans	\$2,058	\$-	\$-	\$-	\$-	\$-	\$2,058	16.7%
GNMA residential mortgage	3,671	5	-	-	-	-	3,676	29.9
FNMA residential mortgage	2,381	-	-	-	-	-	2,381	19.4
FHLMC residential mortgage	1,717	-	-	-	-	-	1,717	14.0
Prime residential mortgage	14	1	3	8	5	143	174	1.4
Alt-A residential mortgage	-	11	-	1	8	116	136	1.1
Sub-prime residential mortgage	12	-	2	-	4	19	37	0.3
Commercial MBS	1,433	10	1	53	-	-	1,497	12.2
Non-mortgage ABS	405	-	56	141	3	8	613	5.0
Total	\$11,691	\$27	\$62	\$203	\$20	\$286	\$12,289	100.0%
% of Total	95.1%	0.2%	0.5%	1.7%	0.2%	2.3%	100.0%	

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

Approximately 80% of the Company's mortgage and asset-backed fixed maturity portfolio is explicitly backed by the U.S. government (SBA and GNMA) or by government-sponsored entities (FNMA and FHLMC). Approximately 95% of the holdings are rated AAA. The commercial mortgage-backed securities portfolio is well diversified and of high quality with approximately 96% rated AAA.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of September 30, 2014 and December 31, 2013:

\$ in Millions	As of September 30, 2014		As of December 31, 2013	
	Fair Value	% of Total	Fair Value	% of Total
Fixed Maturities by Credit Quality¹				
AAA	\$20,695	32.7%	\$21,122	32.9%
AA+, AA, AA-	11,220	17.7	11,337	17.6
A+, A, A-	15,078	23.8	14,611	22.7
BBB+, BBB, BBB-	11,727	18.5	12,122	18.9
Total investment grade	58,720	92.7	59,192	92.1
BB+, BB, BB-	1,495	2.4	1,566	2.4
B+, B, B-	1,686	2.6	2,809	4.4
CCC or lower	1,455	2.3	689	1.1
Total below-investment grade	4,636	7.3	5,064	7.9
Total fixed maturities	\$63,356	100.0%	\$64,256	100.0%

¹For 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 was approximately 93% at September 30, 2014, slightly higher than December 31, 2013. The Company's allocation to below-investment grade (fixed maturities with an average credit rating below BBB-) securities was approximately 7% at September 30, 2014, slightly lower than December 31, 2013. The decline in below-investment grade fair value was primarily as a result of the change in the Venezuela currency exchange rate used for remeasurement purposes in January 2014. Overall, the average credit quality rating stands at A+ as of September 30, 2014. The Company's holdings of below investment grade

securities primarily consist of an actively managed diversified portfolio of high yield securities and leveraged loans within the domestic insurance portfolios and investments in emerging market sovereign and corporate debt primarily in support of the Company's international insurance operations.

The following table summarizes available for sale fixed maturity securities by contractual maturity at September 30, 2014 and December 31, 2013. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid with or without call or prepayment penalties. Due to the potential for prepayment on MBS and ABS, they are not categorized by contractual maturity.

\$ in Millions	As of September 30, 2014		As of December 31, 2013	
	Fair Value	% of Total	Fair Value	% of Total
Fixed Maturities by Maturity Date				
One year or less	\$3,520	5.5%	\$3,521	5.5%
Over one year through five years	17,926	28.3	19,107	29.7
Over five years through ten years	17,029	26.9	17,331	27.0
Over ten years	12,592	19.9	11,700	18.2
MBS and ABS	12,289	19.4	12,597	19.6
Total fixed maturities	\$63,356	100.0%	\$64,256	100.0%

During 2014, 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, 2014 and 2013:

\$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013 ¹	2014 ²	2013 ²
Net Investment Income				
Taxable interest income	\$533	\$565	\$1,654	\$1,711
Tax-exempt interest income	99	108	312	335
Dividends	17	14	54	49
LP and LLC income	221	88	605	356
Commercial mortgage loans	24	23	69	67
Other investment loss	(38)	(59)	(66)	(111)
Gross investment income	856	739	2,628	2,407
Investment expenses	(38)	(39)	(109)	(116)
Net investment income	\$818	\$700	\$2,519	\$2,291

¹The above table contains net investment income attributable to discontinued operations of \$14 million for the three months ended September 30, 2013.

²The above table contains net investment income attributable to discontinued operations of \$14 million and \$45 million for the nine months ended September 30, 2014 and 2013, respectively.

Net investment income for the three and nine months ended September 30, 2014 was \$818 million and \$2.519 billion, respectively, increases of \$118 million and \$228 million over the same periods in 2013. The increases in both periods were mainly due to higher valuation changes in LP and LLC investments which benefited from an increase in IPO activity as well as strong financial performance in the underlying investments. Both periods also reflect lower valuation losses in other equity method investments compared to prior year. Those increases are partially offset by a reduction in taxable and tax-exempt interest income due to lower investment yields.

Net Realized Gains (Losses)

The following tables summarize the Company's net realized gains (losses) for the three and nine months ended September 30, 2014 and 2013:

\$ in Millions Net Realized Gains (Losses)	Sales & Dispositions	Impairments	Change in Derivatives Value	Total
Three Months Ended September 30, 2014:				
Fixed maturities	\$26	(\$1)	\$-	\$25
Equities	11	(6)	-	5
Other	(2)	(61)	-	(63)
Total	\$35	(\$68)	\$-	(\$33)
Three Months Ended September 30, 2013:				
Fixed maturities	\$15	(\$20)	\$-	(\$5)
Equities	124	(4)	-	120
Other	(17)	(17)	(1)	(35)
Total	\$122	(\$41)	(\$1)	\$80

\$ in Millions Net Realized Gains (Losses)	Sales & Dispositions	Impairments	Change in Derivatives Value	Total
Nine Months Ended September 30, 2014:				
Fixed maturities	\$66	(\$258)	\$-	(\$192)
Equities	70	(9)	-	61
Other	6	(67)	-	(61)
Total	\$142	(\$334)	\$-	(\$192)
Nine Months Ended September 30, 2013:				
Fixed maturities	\$59	(\$251)	\$-	(\$192)
Equities	185	(8)	-	177
Other	(13)	(18)	(8)	(39)
Total	\$231	(\$277)	(\$8)	(\$54)

\$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Components of Net Realized Gains (Losses)				
Fixed maturities:				
Gross realized gains	\$31	\$46	\$127	\$137
Gross realized losses	(6)	(51)	(319)	(329)
Equities:				
Gross realized gains	27	146	95	218
Gross realized losses	(22)	(26)	(34)	(41)
Other:				
Gross realized gains	5	15	47	39
Gross realized losses	(68)	(50)	(108)	(78)
Total net realized gains (losses)	(\$33)	\$80	(\$192)	(\$54)

Net realized (losses) gains for the three and nine months ended September 30, 2014 were (\$33) million and (\$192) million, respectively, versus \$80 million and (\$54) million in the same periods in 2013. The increase in net losses in the year primarily relates to higher impairment losses recognized as a result of the change in the Venezuela currency exchange rate used for remeasurement purposes in January 2014 and the Venezuela government's devaluation of its currency in February 2013. The Company executed a purchase agreement to sell a number of its private equity investments which resulted in an impairment loss of approximately \$60 million in the current period. Both periods also reflect equity gains in 2013 that did not recur in 2014.

The following table summarizes the Company's gross unrealized losses and fair value of fixed income and equity securities by the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2014 and that are not deemed to be other-than-temporarily impaired:

\$ in Millions	Less Than 12 Months		12 Months or Longer	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. Government and agency securities	(2)	488	(16)	700
Residential MBS	(7)	1,075	(41)	1,386
Commercial MBS	(1)	108	(15)	470
Other MBS and ABS	(1)	153	(26)	832
U.S. state and municipal	(8)	569	(42)	973
Corporate and other	(48)	3,935	(79)	2,195
Foreign government securities	(19)	956	(28)	852
Total fixed maturities	(86)	7,284	(247)	7,408
Common stock	(53)	550	(9)	54
Preferred stock	-	-	(55)	253
Total equity securities	(53)	550	(64)	307
Total securities available for sale	(139)	7,834	(311)	7,715

Unrealized losses decreased from \$1.019 billion as of December 31, 2013 to \$450 million as of September 30, 2014 primarily related to a decrease in treasury yields and spread tightening. Unrealized losses less

than 12 months decreased from \$755 million at December 31, 2013 to \$139 million as of September 30, 2014. Unrealized losses 12 months or longer increased from \$264 million as of December 31, 2013 to \$311 million as of September 30, 2014. Of the \$9 million unrealized losses 12 months or longer on common stock, \$3 million relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. As of September 30, 2014, there were 1,170 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 maturity securities before they recover their fair value.

If the Company believes a decline in the value (including foreign exchange rate changes) 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 maturity 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, 2014, the Company recorded \$1 million and \$258 million, respectively, of fixed maturity impairment losses. Fixed maturity impairment losses for the nine months ended are primarily driven by the Company's decision to treat the Venezuela devaluation as an other-than-temporary impairment. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of September 30, 2014 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, 2014 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, 2014, the Company recorded \$6 million and \$9 million, respectively, in impairment losses on equity securities. The Company has concluded that the gross unrealized losses of equity securities as of September 30, 2014 are temporary.

LIQUIDITY AND CAPITAL RESOURCES

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, 2014 (including cash and cash equivalents) totaled \$78.822 billion.

Debt outstanding as of September 30, 2014 and December 31, 2013 was as follows:

Short-term debt and current maturities of long-term debt:

\$ in Millions	As of September 30, 2014	As of December 31, 2013
Current maturities of long-term debt ¹	\$47	\$343
Total short-term debt and current maturities of long-term debt	\$47	\$343

¹ 2014 includes \$47 million of 5.588% mortgage loan due 1/1/2015. 2013 includes \$239 million of 5.75% Notes due 3/15/2014 and \$104 million of 7.30% Notes due 6/15/2014.

Long-term debt:

\$ in Millions	As of September 30, 2014	As of December 31, 2013
5.588% Mortgage loan, due 2015	\$ -	\$47
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	750
4.25% Notes, due 2023	1,000	1,000
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	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	204	255
6.50% Notes, due 2042	750	750
4.85% Notes, due 2044	750	-
7.697% Surplus notes, due 2097	260	260
Subtotal	6,954	6,302
Unamortized discount	(15)	(17)
Total long-term	\$6,939	\$6,285

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

During the three and nine months ended September 30, 2014, the Company repurchased \$51 million of the 10.75% Junior Subordinated notes due 2088 compared to repurchases of \$164 million and \$268 million, respectively, in 2013. Pre-tax losses of \$29 million were recorded on these transactions for the three months and nine months ended September 30, 2014 compared to pre-tax losses of \$96 million and \$156 million, respectively, in 2013 and are included in loss on extinguishment of debt in the accompanying consolidated statements of income.

On July 24, 2014, LMGI issued \$750 million of Senior Notes due 2044 (the “2044 Notes”). Interest is payable semi-annually at a fixed rate of 4.85%. The 2044 Notes mature on August 1, 2044.

On July 1, 2014, Liberty Mutual Insurance Company (“LMIC”) entered into a one-year renewable \$1 billion repurchase agreement which terminates July 2, 2015 unless renewed. To date, no funds have been borrowed under the facility.

On December 9, 2013, the Company’s five-year \$750 million unsecured revolving credit facility was amended and restated to extend to December 10, 2018. This facility backs the Company’s \$750 million commercial paper program that is guaranteed by LMIC. As of September 30, 2014, there was no commercial paper or borrowings outstanding on the facility.

On June 18, 2013 and November 5, 2013, LMGI issued \$600 million and \$400 million of Senior Notes due 2023 (the “2023 Notes”), respectively. Interest is payable semi-annually at a fixed rate of 4.25%. The 2023 Notes mature on June 15, 2023.

On December 20, 2012, LMIC entered into a three-year \$1 billion repurchase agreement which terminates on December 20, 2015. As of September 30, 2014, there are no borrowings outstanding on the facility. In connection with the new facility, the Company terminated its \$1 billion three-year repurchase agreements dated March 26, 2010.

LMIC, Peerless Insurance Company (“PIC”), Liberty Life Assurance Company of Boston (“LLAC”), Liberty Mutual Fire Insurance Company (“LMFIC”) and Employers Insurance Company of Wausau (“EICOW”) are members of the Federal Home Loan Bank. 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, 2014, 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.

Interest Expense

Consolidated interest expense for the three and nine months ended September 30, 2014 was \$106 million and \$310 million, decreases of \$4 million and \$5 million from the same periods in 2013. Interest expense reflects the new debt issuances in 2013 and 2014, offset by debt repurchases and maturities. 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, 2014, the Company, through its downstream subsidiary LMGI, had \$6.098 billion of debt outstanding, excluding discount. This amount includes a short-term loan of \$75 million from LMIC with a maturity date of November 29, 2014.

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, 2013) and 2014 available dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

\$ in Millions	RBC Ratio¹		Dividend Capacity²	Dividends Paid³
RBC Ratios and Dividend Capacity	2013	2012	2014	2014
LMIC	474%	457%	\$1,465	\$49
LMFIC	453%	343%	79	\$23
EICOW	427%	567%	43	-

¹ Authorized control level risk-based capital as defined by the NAIC.

² Represents the estimated 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, 2014. Available dividend capacity as of September 30, 2014 is calculated as 2014 dividend capacity less dividends paid for the preceding 12 months. Dividends paid October 1, 2013 through September 30, 2014 for LMIC, LMFIC and EICOW were \$65 million, \$23 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 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, 2014, LCS recorded \$105 million and \$276 million, respectively, 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 to regards policyholders for the combined operations of LMIC and its U.S affiliates, including international branches, was \$18.024 billion and \$17.508 billion at September 30, 2014 and December 31, 2013, respectively. The increase in surplus primarily reflects net income of \$680 million (the sum of earnings from the Company's 56 domestic property-casualty insurance companies and dividends from subsidiaries), unaffiliated unrealized gains of \$60 million, and an increase to other changes in surplus of \$2 million, partially offset by affiliated unrealized losses of \$226 million. Other changes in surplus is primarily driven by capital contributions and non-admitted goodwill, partially offset by a decrease in net deferred tax assets, goodwill amortization expense, and dividends to stockholders.

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 A&E 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) recoverability of deferred acquisition costs, (5) valuation of goodwill and intangible assets, (6) deferred income tax valuation allowance, and (7) pension and postretirement benefit obligations.

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

Adoption of Accounting Standards

The Company has not adopted any accounting standards through the third quarter of 2014.

Accounting Standards Not Yet Adopted

There are no accounting standards not yet adopted by the Company that are expected to have a material impact on its financial position or results of operations.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were \$50.950 billion and \$52.750 billion as of September 30, 2014 and December 31, 2013, 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 A&E reserves for unpaid claims and claim adjustment expenses, net of reinsurance before NICO and including uncollectible reinsurance, were \$1.282 billion and \$1.329 billion as of September 30, 2014 and December 31, 2013, respectively.

In the third quarter of 2014, 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 A&E 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. A&E 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 \$111 million including: \$83 million of asbestos reserves, primarily associated with increased defense costs; and \$28 million of pollution reserves.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company acquired PruPac in 2003 and any increase in A&E reserves is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial, Inc.

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties; the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding A&E 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 \$14.226 billion and \$11.786 billion at September 30, 2014 and December 31, 2013, respectively, net of allowance for doubtful accounts of \$150 million and \$163 million, respectively. The increase in reinsurance recoverables is primarily due to the NICO Reinsurance Transaction (see below for additional details). Included in these balances are \$653 million and \$607 million of paid recoverables and \$13.723 billion and \$11.342 billion of unpaid recoverables, respectively.

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 Statements of Income.

On July 17, 2014, the Company entered into a reinsurance agreement with NICO, a subsidiary of Berkshire Hathaway Inc., on a combined aggregate adverse development cover for substantially all of the Company's U.S. workers compensation and A&E liabilities, attaching at \$12.5 billion of combined aggregate reserves, with an aggregate limit of \$6.5 billion and sublimits of \$3.1 billion for A&E liabilities and \$4.5 billion for certain workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but

effective as of January 1, 2014, the Company ceded approximately \$3.3 billion of existing liabilities under this retroactive reinsurance agreement. NICO will provide approximately \$3.2 billion of additional aggregate adverse development cover.

In general terms, the covered business includes post December 31, 2013 development on: (1) A&E liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005; and (2) workers compensation liabilities arising out of policies on the books of the Company's Commercial Insurance SBU as of December 31, 2013, as respects injuries or accidents occurring prior to January 1, 2014.

The Company paid NICO total consideration of \$3.0 billion. The NICO Reinsurance Transaction will be accounted for as retroactive reinsurance in the Company's GAAP consolidated financial statements.

The following table displays the impact of the NICO Reinsurance Transaction on the consolidated statements of income (amounts in millions):

Nine months ended September 30, 2014	2014
A&E (favorable) / unfavorable development before consideration of NICO Reinsurance Transaction	\$ 110
Workers compensation (favorable) / unfavorable development before consideration of NICO Reinsurance Transaction	(25)
Total additional amounts ceded under NICO Reinsurance Transaction	<u>85</u>
Retroactive reinsurance benefits recognized into income	<u>(85)</u>
Pre-tax impact of unrecognized deferred retroactive reinsurance benefit	<u>\$ -</u>

During 2014, the Company recorded \$85 million of net A&E and workers compensation adverse development. As a result of the NICO Reinsurance Transaction, the Company was able to recognize the full \$85 million as a benefit to income. Once the aggregate of workers compensation and A&E development exceeds the original pre-tax loss of \$128 million, deferred gains will be recorded. Deferred gains are subsequently recognized into earnings as if the revised estimate was available at the inception date of the NICO Reinsurance Transaction.

The Company has an aggregate stop loss program covering substantially all of Commercial Insurance's voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. A significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at an average rate of 8.5% annually. Under the contract, 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.

During 2013, the Company commuted four workers compensation excess of loss retroactive reinsurance agreements. The commutations, which represented the complete and final settlement and discharge of all the present and future obligations between the parties arising out of the agreements, resulted in a gain to the Company of \$227 million, net of tax.

The above aggregate stop loss program and the four commuted reinsurance agreements resulted in deferred gains that are amortized into income using the effective interest method over the estimated settlement period.

As of September 30, 2014, and December 31, 2013, deferred gains were \$8 million and \$8 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, 2014 was \$1

million and \$2 million, respectively, as compared to \$21 million and \$64 million for the three to nine months ended September 30, 2013, respectively. Deferred gain amortization was \$1 million and \$2 million for the three and nine months ended September 30, 2014, respectively, as compared to \$158 million and \$178 million for the three and nine months ended September 30, 2013, respectively. Reinsurance recoverables related to these transactions were \$68 million and \$72 million as of September 30, 2014, and December 31, 2013, respectively.

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 (including foreign exchange rate changes) 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 maturity 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 maturity, 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 fixed maturity 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 fixed maturity 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) impact of foreign exchange rates on foreign currency denominated securities and (f) 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 fixed maturity 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, 2014, the Company has not recognized any additional material other-than-temporary impairments.

Variable Interest Entities

The Company invests in limited partnerships and other entities subject to variable interest entity (“VIE”) analysis under the VIE subsections of Accounting Standards Codification (“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, 2014 the Company has determined that it is the primary beneficiary of one VIE in the low-income housing tax credit sector, and as such, this VIE has been consolidated in the Company’s financial statements. The carrying value of assets and liabilities and the Company’s maximum exposure to loss of the consolidated VIE as of September 30, 2014 and December 31, 2013 were immaterial to the Company.

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*. These 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 net carrying value of non-consolidated VIEs in which the Company has a significant variable interest was \$312 million and \$212 million as of September 30, 2014 and December 31, 2013, respectively, and the Company’s maximum exposure to loss was \$622 million and \$242 million as of September 30, 2014 and December 31, 2013, respectively. 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 VIEs. There is no recourse provision to the general credit of the Company for any VIEs beyond the full amount of the Company’s loss exposure.

Deferred Acquisition Costs

Total deferred acquisition costs were \$3.188 billion and \$3.115 billion as of September 30, 2014 and December 31, 2013, 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 \$4.867 billion and \$4.820 billion as of September 30, 2014 and December 31, 2013, 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.

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.

As of August 31, 2014, the Company is utilizing a qualitative test in accordance with its accounting policy for all reporting units except for Liberty International, for which a quantitative test is being utilized due to the Venezuelan devaluation recognized during the year. As a result of the Company's Liberty Mutual Benefits realignment, the Company is performing a relative fair value assessment in order to reallocate the existing goodwill to the SBUs based on June 30, 2014 results. In conjunction with the reallocation, the Company is performing a quantitative impairment assessment of goodwill for each of the impacted SBUs. In 2013, the Company utilized a qualitative test in accordance with its accounting policy.

Deferred Income Taxes

The net deferred tax asset was \$370 million and \$1.251 billion as of September 30, 2014 and December 31, 2013, net of a valuation allowance of \$159 million and \$173 million, respectively. The net decrease in the Company's net deferred income tax asset is primarily due to changes in net unrealized capital gains and losses on investments and current year utilization of net operating losses. The decrease in the valuation allowance is primarily due to the disposal of certain foreign subsidiaries and fluctuations in certain foreign currency exchange rates, offset by an increase due to net operating losses generated in certain foreign subsidiaries where there is uncertainty in the timing and amount of realization of these losses. 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. Deferred income tax assets and liabilities 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 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, 2013	\$298
Additions for tax positions in current year	3
Additions for tax positions of prior years	48
Reductions for tax positions of prior years	(114)
Settlements	(22)
Translation	(1)
Balance at September 30, 2014	<u>\$212</u>

Included in the tabular roll forward of unrecognized tax benefits is interest and penalties in the amount of \$55 million and \$93 million as of September 30, 2014 and December 31, 2013, respectively.

Included in the balance at September 30, 2014, is \$98 million related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. For the three months ended September 30, 2014 and 2013, the Company recognized (\$43) million and zero of interest and penalties, respectively. For the nine months ended September 30, 2014 and 2013, the Company recognized (\$35) million and \$5 million of interest and penalties, respectively. The Company had \$61 million and \$95 million of interest and penalties accrued as of September 30, 2014 and December 31, 2013, respectively.

The IRS has completed its review of the Company's United States Federal income tax returns through the 2005 tax year and is currently reviewing income tax returns for the 2006 through 2011 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.

Pension and Postretirement Benefit Obligations

The Company sponsors non-contributory defined benefit pension plans (“the Plans”) covering substantially all U.S. and Canadian employees. The benefits and eligibility are based on age, years of service, and the employee’s final average compensation, as more fully described in the Plans. Some foreign subsidiaries also sponsor defined benefit pension plans. In 2014, the Company added a new cash balance benefit formula for all eligible U.S. employees and froze credited service under the plan’s final average pay formula.

The Company sponsors non-qualified supplemental pension plans for selected highly compensated employees to restore the pension benefits they would be entitled to under the Company’s U.S. tax qualified, defined benefit pension plan had it not been for limits imposed by the Internal Revenue Code. The supplemental plans are unfunded.

The Company also provides certain postretirement healthcare and life insurance benefits covering substantially all U.S. and Canadian employees. In 2014, the Company’s U.S. postretirement medical and dental cost sharing arrangement changed to a defined contribution model with an annual dollar contribution amount based on age and years of eligible credited service. Life insurance benefits are based on a participant’s final compensation subject to the plan maximum. The postretirement plan is unfunded.

The discount rate assumption used to determine the benefit obligations is based on a yield curve approach where the cash flows related to the benefit plans’ liability stream is discounted at an interest rate specifically applicable to the timing of the cash flows. The process calculates the present value of these cash flows and determines the equivalent single discount rate that produces the same present value of the future cash flows. On an annual basis, the Company reviews the discount rate assumption used to determine the benefit obligations and the composition of various yield curves to ensure that the assumed discount rate reflects the Company’s best estimate of the rate of return inherent in a portfolio of high-quality debt instruments that would provide the cash flows necessary to settle the Company’s projected benefit payments. In choosing the expected long-term rate of return on plan assets, the Company’s Retirement Board considers the historical returns of equity and fixed income markets in conjunction with current economic and financial market conditions.

Internal Controls Deficiency

In August 2014 the Company identified a deficiency in its internal controls caused by a failure in the systems application governing access granted to employees. The period impacted was from October 2013 to August 2014, resulting in certain employees retaining an unnecessary level of access to the Company’s financially significant systems following changes in their responsibilities within the Company. Access controls over terminated employees were not impacted. The Company has remediated the deficiency as of this date. The Company has reviewed the affected employees’ access to its financial systems and has concluded that there was no impact on its financial position or results of operations.

In addition, the Company has determined that after consideration of compensating controls this issue constituted a significant deficiency in the Company’s internal controls over financial reporting. The related compensating controls require appropriate testing to determine their effectiveness and it is possible that the deficiency could have constituted a material weakness if the compensating controls did not function as intended.

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 2013 direct written premium. The Company also ranks 76th on the Fortune 100 list of largest corporations in the U.S. based on 2013 revenue. As of December 31, 2013, LMHC had \$121.282 billion in consolidated assets, \$102.270 billion in consolidated liabilities, and \$38.509 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 50,000 people in approximately 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.