Liberty Mutual Holding Company Inc.

Fourth Quarter 2008

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

(unaudited)

	Years Ended December 31,		
	2008	**2007**	**2006**
Revenues			
Premiums earned	$ 25,524	$ 21,887	$ 19,794
Net investment income	2,880	2,885	2,548
Net realized investment (losses) gains	(330)	436	343
Fee and other revenues	781	744	823
Total revenues	28,855	25,952	23,508
Claims, Benefits and Expenses			
Benefits, claims and claim adjustment expenses	18,852	16,092	14,609
Insurance operating costs and expenses	4,105	3,863	3,432
Amortization of deferred policy acquisition costs	3,989	3,281	2,808
Interest expense	411	320	212
Interest credited to policyholders	203	198	189
Total claims, benefits and expenses	27,560	23,754	21,250
Income before income tax expense	1,295	2,198	2,258
Income tax expense	155	680	632
Net income	$ 1,140	$ 1,518	$ 1,626

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

(unaudited)

	December 31, 2008	December 31, 2007
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of $49,902 and $46,848)	$ 47,731	$ 46,934
Equity securities, available for sale, at fair value (cost of $1,279 and $2,418)	1,184	3,285
Trading securities, at fair value (cost of $1 and $16)	1	16
Short-term investments	1,193	764
Mortgage loans	1,090	657
Other investments	2,728	2,348
Total investments	53,927	54,004
Cash and cash equivalents	5,848	3,199
Premium and other receivables (net of allowance of $136 and $99)	7,834	6,764
Reinsurance recoverables (net of allowance of $344 and $331)	15,309	15,518
Deferred income taxes (net of valuation allowance of $131 and $112)	3,166	1,469
Deferred acquisition costs and acquired in-force policy intangibles	2,541	2,045
Goodwill	4,645	1,962
Prepaid reinsurance premiums	1,565	1,180
Separate account assets	3,062	3,431
Other assets	6,419	5,443
Total assets	$ 104,316	$ 95,015
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	$ 48,727	$ 42,992
Life	6,258	6,063
Other policyholder funds and benefits payable	3,031	2,818
Unearned premiums	12,944	10,625
Funds held under reinsurance treaties	1,855	1,941
Short-term debt	-	91
Long-term debt	6,089	4,360
Separate account liabilities	3,062	3,431
Other liabilities	12,190	10,328
Total liabilities	94,156	82,649
Policyholders' equity:		
Unassigned equity	12,720	11,621
Accumulated other comprehensive (loss) income	(2,560)	745
Total policyholders' equity	10,160	12,366
Total liabilities and policyholders' equity	$ 104,316	$ 95,015

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

(unaudited)

	Unassigned Equity	Accumulated Other Comprehensive Income (Loss)	Policyholders' Equity
Balance, January 1, 2006	$ 8,466	$ 392	$ 8,858
Comprehensive income			
Net income	1,626	-	1,626
Other comprehensive income, net of taxes:			
Unrealized gains on securities	-	211	211
Less: reclassification adjustment for gains			-
and losses included in net income	-	(223)	(223)
Minimum pension liability adjustment	-	312	312
Foreign currency translation and other adjustments	-	111	111
Other comprehensive income, net of taxes	-	411	411
Total comprehensive income			2,037
Balance, December 31, 2006	$ 10,092	$ 803	$ 10,895
Adjustment for adoption of FIN 48 (Note 1)	11		11
Comprehensive income			
Net income	1,518	-	1,518
Other comprehensive income, net of taxes:			
Unrealized gains on securities	-	213	213
Less: reclassification adjustment for gains			
and losses included in net income	-	(283)	(283)
Minimum pension liability adjustment	-	23	23
Foreign currency translation and other adjustments	-	277	277
Other comprehensive income, net of taxes	-	230	230
Total comprehensive income			1,748
Adjustment for adoption of FAS 158 (Note 1)		(288)	(288)
Balance, December 31, 2007	$ 11,621	$ 745	$ 12,366
Adjustment for adoption of EITF 06-4 (Note 1)	(41)		(41)
Comprehensive loss			
Net income	1,140	-	1,140
Other comprehensive loss, net of taxes:			
Unrealized losses on securities	-	(2,246)	(2,246)
Less: reclassification adjustment for gains			
and losses included in net income	-	215	215
Change in pension and post retirement plans funded status	-	(869)	(869)
Foreign currency translation and other adjustments	-	(405)	(405)
Other comprehensive loss, net of taxes	-	(3,305)	(3,305)
Total comprehensive loss			(2,165)
Balance, December 31, 2008	$ 12,720	$ (2,560)	$ 10,160

See accompanying notes to the unaudited consolidated financial statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

(unaudited)

	Years Ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income	$ 1,140	$ 1,518	$ 1,626
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	313	260	238
Realized investment losses (gains)	330	(436)	(343)
Undistributed private equity investment losses (gains)	5	(324)	(275)
Premium, other receivables, and reinsurance recoverables	582	755	660
Deferred policy acquisition costs	(16)	(126)	(154)
Liabilities for insurance reserves	1,793	2,272	1,865
Taxes payable, net of deferred	(126)	256	169
Other, net	(1,276)	(133)	109
Total adjustments	1,605	2,524	2,269
Net cash provided by operating activities	2,745	4,042	3,895
Cash flows from investing activities:			
Purchases of investments	(13,668)	(19,719)	(20,952)
Sales and maturities of investments	18,257	18,405	16,508
Property and equipment purchased, net	(143)	(259)	(762)
Payment for purchase of companies, net of cash acquired	(5,414)	(2,700)	(48)
Other investing activities	(185)	(430)	270
Net cash used in investing activities	(1,153)	(4,703)	(4,984)
Cash flows from financing activities:			
Net activity in policyholder accounts	62	34	69
Debt financing, net	1,121	889	646
Net security lending activity and other financing actitivites	(65)	(602)	684
Net cash provided by financing activities	1,118	321	1,399
Effect of exchange rate changes on cash	(61)	27	47
Net increase (decrease) in cash and cash equivalents	2,649	(313)	357
Cash and cash equivalents, beginning of year	3,199	3,512	3,155
Cash and cash equivalents, end of year	$ 5,848	$ 3,199	$ 3,512
Supplemental disclosure of cash flow information:			
Income taxes paid	$ 310	$ 563	$ 496

See accompanying notes to the unaudited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions, except per share amounts)

(unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2007 consolidated financial statements to conform to the 2008 presentation. All material intercompany transactions and balances have been eliminated.

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

Adoption of New Accounting Standards
Effective November 15, 2008, the Company adopted Statement of Financial Accounting Standards No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of entities that are presented in conformity with accounting principles generally accepted in the United States. The adoption of SFAS 162 did not have a material impact on the Company.

On October 10, 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position FAS 157-3*, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active"* ("FSP FAS 157-3") that provided implementation guidance for fair value considerations of thinly traded securities. The adoption of FSP FAS 157-3 had no impact on the Company's financial statements.

Effective January 1, 2008 the Company adopted Statement of Financial Accounting Standards No. 157, "*Fair Value Measurement*," ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 provides guidance on how to measure fair value when required under existing accounting standards. The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value based on the requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities,"* ("SFAS 133") are impacted by the application of SFAS 157. The adoption of SFAS 157 did not have a material effect on the Company's results of operations, financial position or liquidity.

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS 115*" ("SFAS 159"). The Company has not made any fair value elections under SFAS 159.

Effective January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") issue No. 06-4, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"* ("EITF 06-4"). This issue provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. The adoption of EITF 06-4 resulted in a decrease to policyholders' unassigned equity of $41.

Effective January 1, 2008, the Company adopted EITF issue No. 06-10, "*Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements"* ("EITF 06-10"). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Accounting Principles Board Opinion 12. The adoption of EITF 06-10 had no impact on the Company's financial statements.

Effective December 31, 2007, the Company adopted Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132(R)"* ("SFAS 158"). This statement requires the Company to (a) recognize the funded status of its pension, supplemental pension and postretirement benefit plans on the consolidated balance sheet as an asset or liability, measured as the difference between plan assets at fair value and the benefit obligation as of the employer's fiscal year end, with a corresponding adjustment to accumulated other comprehensive income ("AOCI"), net of tax; and to (b) recognize as a component of AOCI, net of tax, actuarial gains or losses or prior service cost or credit that arise during the period but are not recognized as a component of net periodic benefit cost. Consistent with the provisions of SFAS 158, these amounts will be subsequently recognized in the income statement pursuant to the Company's historical accounting policy for amortizing such amounts with a corresponding offset to AOCI. The provisions of Statement of Financial

Accounting Standards No. 87, *"Employers' Accounting for Pensions"* and Statement of Financial Accounting Standards No. 106, *"Employers' Accounting for Postretirement Benefits Other than Pensions"* continue to apply in measuring plan assets and benefit obligations, as of the date of fiscal year-end statement of financial position, and in determining net periodic benefit cost. The adoption of SFAS 158 as of December 31, 2007 decreased other assets by $245, increased other liabilities by $198, increased deferred tax assets by $155, and decreased AOCI, a component of policyholders' equity by $288, net of tax. Adoption of SFAS 158 did not affect the Company's results of operations or liquidity as SFAS 158 did not affect the determination of net periodic benefit costs.

Effective January 1, 2007, the Company adopted Statement of Financial Accounting Standards No. 155, "*Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140*" ("SFAS 155"). SFAS 155 nullifies the guidance in the FASB's Derivatives Implementation Group Issue D1 "*Application of Statement 133 to Beneficial Interests in Securitized Assets*", which had deferred the bifurcation requirements of SFAS 133 for certain beneficial interests in securitized financial assets. SFAS 155 requires beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or hybrid instruments that contain an embedded derivative requiring bifurcation. SFAS 155 is effective for all financial instruments acquired, issued or subject to a re-measurement (new basis) event occurring after the beginning of an entity's fiscal year after September 15, 2006. In January 2007, the FASB issued Derivative Implementation Group Issue No. B40, "*Embedded Derivatives Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets"* ("DIG B40"). DIG B40 provided limited exemption from bifurcation of embedded derivatives as required by paragraph 13(b) of SFAS 133. Management has concluded the exemption applies for the Company's investment in its mortgage backed securities, and as a result, SFAS 155 did not impact the Company's consolidated financial statements.

Effective January 1, 2007, the Company adopted the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") Statement of Position No. 05-1, *"Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts"* ("SOP 05-1"). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in Statement of Financial Accounting Standards No. 97, *"Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments"* ("SFAS 97"). As defined by SOP 05-1, an internal replacement is a modification in product benefits, features, rights, or coverage that occurs by exchange of a contract for a new contract, or by amendment, endorsement, rider, or by election of a feature or coverage within an existing contract. The adoption of SOP 05-1 did not impact the Company's consolidated financial statements.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*" ("FIN 48"). FIN 48 requires companies to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The amount recognized is the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability is recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty (if applicable) on the excess. As a result of the adoption, the Company recognized a decrease of approximately $11 in the liability for unrecognized tax benefits, which was accounted for as an increase to unassigned equity.

As of the date of adoption of FIN 48, the total amount of unrecognized tax benefits was approximately $107, including approximately $85 related to tax positions that would impact the annual effective rate. The Company recognizes interest and penalties related to unrecognized tax benefits in Federal and foreign income tax expense and had approximately $39 accrued as of January 1, 2007.

Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), "*Share-Based Payments"* ("SFAS 123(R)"). The Company has elected to continue to measure its awards at intrinsic value. Compensation cost related to these plans is determined in accordance with plan formulas and recorded over the years the employee service is provided. The adoption of SFAS 123(R) did not impact the Company's consolidated financial statements.

Effective January 1, 2006, the Company adopted FASB Staff Position No. FAS 115-1 and FAS 124-1, "*Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments,"* which provides guidance on determining whether investment impairment is other-than-temporary regardless of the intent to sell and when a security is impaired due to fluctuations in interest rates. The adoption of the statement did not have a material impact on the Company's consolidated financial statements.

Future Adoption of New Accounting Standards

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), *"Business Combinations"* ("SFAS 141(R)"). This statement will result in significant changes to accounting for business combinations. Prospective adoption is required and early adoption is not permitted. The Company is required to adopt SFAS 141(R) effective January 1, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "*Noncontrolling Interests in Consolidated Financial Statements"* ("SFAS 160"). SFAS 160 will result in the consolidation of all non-controlling interests within the income statement and balance sheet of the Company for all consolidated subsidiaries. The Company is required to adopt SFAS 160 effective January 1, 2009. Prospective adoption is required, except for the required reclassifications which are to be applied retrospectively. Early adoption is not permitted. The adoption of SFAS 160 will not have a material impact on the Company.

(dollars in millions, except per share amounts)

In March 2008, FASB issued Statement of Financial Accounting Standards No. 161, "*Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*" ("SFAS 161"). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, results of operations, and cash flows. The Company is required to adopt SFAS 161 effective January 1, 2009. The adoption of SFAS 161 will not have a material impact on the Company.

In April 2008, the FASB released FASB Staff Position FAS 142-3, "*Determination of the Useful Life of Intangible Assets*" ("FSP FAS 142-3"). FSP FAS 142-3 applies to all recognized intangible assets and is effective January 1, 2009. Early adoption is prohibited and application is prospective. The goal of FSP FAS 142-3 is to improve consistency between the useful life of an intangible asset and the period of expected cash flows used in measuring the fair value of intangible assets, and it requires new disclosures that enable users of financial statements to assess the extent to which the expected future cash flows associated with those assets are affected by the entity's intent and or ability to renew or extend the arrangement. The adoption of FSP FAS 142-3 will not have a material impact on the Company.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, "*Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60,*" ("SFAS 163"). SFAS 163 is intended to increase comparability in financial reporting of financial guarantee insurance contracts by insurance companies. SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how Statement of Financial Accounting Standards No. 60, *"Accounting and Reporting by Insurance Enterprises,"* applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. SFAS 163 is effective January 1, 2009. As the Company does not write financial guarantee insurance contracts, SFAS 163 will have no impact.

In November 2008, the EITF ratified the consensus reached on EITF issue No. 08-6, "*Equity Method Investment Accounting Considerations*" ("EITF 08-6"). EITF 08-6 was primarily issued to address updating Accounting Principles Board Opinion 18, "*The Equity Method of Accounting for Investments in Common Stock*," for consideration of the release of SFAS 141(R) and SFAS 160. EITF 08-6 is effective January 1, 2009 and is to be applied prospectively. Early application is prohibited. The adoption of EITF 08-6 will not have a material impact on the Company.

Accumulated Other Comprehensive (Loss) Income

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

The components of accumulated other comprehensive (loss) income, net of related deferred acquisition costs and taxes, for the years ended December 31, 2008, 2007, and 2006 are as follows:

	2008	2007	2006
Unrealized (losses) gains on securities	$(1,457)	$574	$644
Foreign currency translation and other adjustments	51	456	179
Pension liability adjustment	(1,154)	(285)	(20)
Accumulated other comprehensive (loss) income	$(2,560)	$745	$803

(2) ACQUISITIONS AND GOODWILL

Safeco Corporation

On September 22, 2008, Liberty Mutual Group completed the acquisition of Safeco Corporation ("Safeco"). Pursuant to the terms of the purchase agreement, the Company paid cash of $68.25 per share in exchange for all outstanding shares of the Safeco common stock for a total purchase price of $6,244. The results of operations for the acquired business are included in the financial statements subsequent to September 22, 2008. Net income for Safeco subsequent to acquisition was $74. The operations of Safeco were merged into the Agency Markets strategic business unit. The Company believes that this acquisition will significantly strengthen Agency Markets' independent agency business and expand its independent agency distribution.

Integration Activities

As part of the Safeco acquisition, management is conducting integration efforts resulting in employment reductions, contract terminations, systems integrations and other transitional activities. Total Safeco integration costs incurred for the year ended December 31, 2008 were $144, of which $70 was recognized as assumed liabilities as part of purchase accounting for the acquisition. Integration costs are included in insurance operating costs and expenses in the consolidated statements of income. $61 of the costs were paid in 2008, and the majority of the balance will be paid in 2009.

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

Ohio Casualty Corporation
On August 24, 2007, Liberty Mutual Group completed the acquisition of Ohio Casualty Corporation ("Ohio Casualty"). Pursuant to the terms of the purchase agreement, the Company paid cash of $44.00 per share in exchange for all outstanding shares of the Ohio Casualty common stock for a total purchase price of $2,780. The results of operations for the acquired business are included in the financial statements subsequent to August 24, 2007. Net income for Ohio Casualty subsequent to acquisition was $57. The operations of Ohio Casualty were merged into the Agency Markets strategic business unit. The Company believes that this acquisition will significantly strengthen Agency Markets' independent agency business and expand its independent agency distribution.

Integration Activities
As part of the Ohio Casualty acquisition, management is conducting integration efforts resulting in employment reductions and contract terminations. Total Ohio Casualty integration costs incurred for the year ended December 31, 2007 were $38, of which $26 was recognized as assumed liabilities as part of purchase accounting for the acquisition. Integration costs are included in insurance operating costs and expenses in the consolidated statements of income. $18 and $11 of the costs were paid in 2008 and 2007, respectively, and the majority of the balance will be paid in 2009.

Şeker Sigorta A.Ş
On September 5, 2006, and during the course of the fourth quarter of 2006, the Company, through its Spanish subsidiary, Liberty Seguros Compania de Seguros y Reaseguros S.A. ("Liberty Seguros"), acquired 90.425% of Şeker Sigorta A.Ş., a mid-sized insurer located in Istanbul, Turkey. Goodwill recognized from the transaction was $102. The results of operations for the acquired business, which are not material, are included in the financial statements subsequent to September 5, 2006.

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

In accordance with the Asset Purchase Agreements (collectively, the "Sales Agreements"), total consideration due to the Company for the sale of the renewal rights will be paid over a two or three year period subject to the Earn Out Adjustment provisions provided by the Sales Agreements. Amounts received by the Company will be recognized in earnings when received.

In connection with the above transaction, the Company recognized $35 related to restructuring efforts, principally related to employee and contract terminations. These costs are primarily included in insurance operating costs and expenses in the 2008 statement of income. Payments under restructuring activities are expected to be substantially complete in 2009.

(3) REINSURANCE

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195) that are amortized into income using the effective interest method over the estimated settlement periods. At December 31, 2008, and 2007, deferred gains related to these reinsurance arrangements were $725 and $786, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the years ended December 31, 2008, 2007, and 2006 was $115, $114, and $125, respectively. Deferred gain amortization was $77, $57, and $95 for the years ended December 31, 2008, 2007, and 2006, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2,165 and $2,222 as of December 31, 2008, and 2007, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002, renewal, 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. Activity related to each of these retroactive and prospective contracts was immaterial in 2008 and 2007. Approximately $45 and $32 of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2006, with additional premium of $29 and $23, respectively. The income statement impact of ceding the additional losses and premium on the fourth quarter 2000 through fourth quarter 2001 covered accident year periods was deferred and is amortized into income using the effective interest method over the estimated settlement period.

(dollars in millions, except per share amounts)

In 2006, the Company entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 of additional reinsurance coverage for the Company and its affiliates in the event of a Northeast hurricane. The reinsurance agreements are collateralized through a trust and guarantee received by Mystic Re from the issuance of catastrophe bonds and provide coverage for hurricane-related losses from Washington, D.C. to Maine based on industry insured losses as reported by Property Claim Services. In 2007, the Company supplemented this reinsurance in a similar transaction with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 of additional reinsurance coverage for the Company and its affiliates in the event of a Northeast and/or Florida hurricane event. The Company has not recorded any recoveries under these programs. Neither Mystic Re nor Mystic Re II has any other reinsurance in force. As of December 31, 2008, $325 of the original $525 of Mystic Re matured. As no events attached, the respective collateral was released during the fourth quarter of 2008. With respect to all Mystic Re transactions, $350 of collateral remains in place at December 31, 2008. Mystic Re and Mystic Re II are Qualifying Special Purpose Entities and therefore are exempt from consolidation.

(4) DEBT OUTSTANDING

Debt outstanding at December 31, 2008, and 2007, includes the following:

Short-term debt::	2008	2007
Commercial paper	$ -	$ -
Revolving credit facilities	-	70
Current maturities of long-term debt	-	21
Total short-term debt	$ -	$ 91

Long-term debt:	2008	2007
4.875% Notes, due 2010[1]	$300	$ -
7.25% Notes, due 2012[1]	204	-
8.00% Notes, due 2013	260	260
7.86% Medium Term Notes, due 2013	25	25
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014[2]	200	200
6.70% Notes, due 2016	250	250
7.00% Subordinated Notes, due 2067[3]	300	300
8.50% Surplus Notes, due 2025	150	150
7.875% Surplus Notes, due 2026	250	250
7.63% Notes, due 2028	3	3
7.00% Notes, due 2034	250	250
6.50% Notes, due 2035	500	500
7.50% Notes, due 2036	500	500
7.80% Subordinated Notes, due 2087[4]	700	700
10.75% Subordinated Notes, due 2088[5]	1,250	-
7.697% Surplus Notes, due 2097	500	500
	6,142	4,388
Unamortized discount[6]	(53)	(28)
Total long-term debt excluding current maturities	$6,089	$4,360

[1] Reflects debt originally issued by Safeco. On December 29, 2008, $281 of the outstanding $300 4.875% notes due 2010 and $187 of the outstanding $204 7.25% notes due 2012 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.
[2] Reflects debt originally issued by Ohio Casualty. On December 29, 2008, $180 of the outstanding $200 7.30% senior notes were exchanged for a like principal amount of newly issued LMGI notes.
[3] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.
[4] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.
[5] The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.
[6] Includes net purchase accounting adjustment of $8 related to Ohio Casualty $200 senior notes, due 2014, Safeco $300 senior notes, due 2010, and Safeco $204 senior notes, due 2012.

Short-term Debt
The Company periodically issues commercial paper to meet short-term operating needs. The total facility was $1,000 at December 31, 2008 and December 31, 2007, and is supported by a $750 line of credit facility. There was zero commercial paper issued and outstanding at December 31, 2008, and 2007.

On September 2, 2008, Liberty Mutual Insurance Company ("LMIC") entered into a $750 364-day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

In 2008, all current maturities of long term debt as of December 31, 2007 were redeemed at maturity.

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

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a $20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of December 31, 2008, no borrowings were outstanding under the facility.

The Company's Venezuelan subsidiary, Inversora Segucar, C.A., maintains a $115 revolving credit facility to provide liquidity for working capital purposes. As of December 31, 2008, no borrowings were outstanding under the facility.

Long-term Debt

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

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

On May 29, 2008, LMGI issued Series C junior subordinated notes (the "Series C Notes") with a face amount of $1,250. The Series C Notes are scheduled for redemption on June 15, 2058 with a final maturity of June 15, 2088. LMGI may redeem the Series C Notes in whole or in part, on June 15, 2038 and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or prior to June 15, 2038, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 10.75% up to, but excluding, the final fixed rate interest payment date. In the event the Series C Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 7.12%, payable quarterly in arrears. LMGI has the right to defer interest payments on the Series C Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Series C Notes, LMGI entered into a replacement capital covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, decease or purchase the Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Notes, and may not be enforced by the holders of the Series C Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036).

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1,000, consisting of $700 Series A junior subordinated notes (the "Series A Notes") and $300 Series B junior subordinated notes (the "Series B Notes"). The Notes are scheduled for redemption on March 15, 2037; the Series A notes have a par value call date and final fixed rate interest payment date of March 15, 2037 and a final maturity date of March 7, 2087; and the Series B notes have a par value call date and final fixed rate interest payment date of March 15, 2017 and a final maturity date of March 7, 2067. LMGI may redeem (a) the Series B Notes in whole or in part, on March 15, 2017, and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or (b) prior to March 15, 2037, for the Series A Notes or March 15, 2017, for the Series B Notes, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 7.800% for the Series A Notes and 7.000% for the Series B Notes up to, but excluding, the final fixed rate interest payment date. In the event the Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 3.576% for the Series A Notes and three-month LIBOR plus 2.905% for the Series B Notes, payable quarterly in arrears. LMGI has the right to defer interest payments on the Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Notes, LMGI entered into a Replacement Capital Covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, defease or purchase the Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Notes, and may not be enforced by the holders of the Series A Notes or the Series B Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036).

(dollars in millions, except per share amounts)

(5) FAIR VALUE OF FINANCIAL INSTRUMENTS

As mentioned in Note 1, effective January 1, 2008, the Company adopted Statement SFAS 157. SFAS 157 defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 provides guidance on how to measure fair value when required under existing accounting standards. The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value based on the requirements of Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities,* are impacted by the application of SFAS 157. The Company has variable annuity contracts containing embedded derivatives that are affected by SFAS 157, but the impact is immaterial.

The hierarchy requires the use of market observable information when available for assessing fair value. The following table summarizes the Company's assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2008, along with a brief description of the valuation technique for each type of asset and liability:

Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed maturities, available for sale	$1,052	$45,782	$897	$47,731
Equity securities, available for sale	582	492	110	1,184
Trading securities	-	1	-	1
Short-term investments	54	1,066	73	1,193
Other investments	-	88	62	150
Separate account assets	847	1,292	2	2,141
Other assets	18	60	27	105
Total assets	$2,553	$48,781	$1,171	$52,505
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$223	$223
Total liabilities	$ -	$ -	$223	$223

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

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

Other investments include primarily international loans, foreign cash deposits and co-investments. International loans and cash deposits are primarily valued using quoted prices for similar instruments in active markets; these assets are categorized as Level 2 of the fair value hierarchy. Co-investments are valued using internal management estimates; they are categorized as Level 3 of the hierarchy. Limited partnership investments, which represent the remainder of the other investment balance on the consolidated balance sheet, are not subject to SFAS 157 and therefore are excluded from the above table.

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

(dollars in millions, except per share amounts)

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

Life insurance obligations include certain variable annuity contracts which contain guaranteed minimum income benefits that under SFAS 133 contain embedded derivatives and are bifurcated from the host contract and carried at fair value. The measurements on these embedded derivatives is computed on a recurring basis using assumptions predominately classified as level 3 (significant unobservable) inputs. While some inputs are observable in the market such as risk free rates, volatility, and historical equity returns, the underlying future policyholder behavior inputs are highly unobservable. These assumptions include mortality, lapse, and the underlying take-up rate with regard to annuitization.

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

	Balance January 1, 2008	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer in and/ or out of Level 3	Balance December 31, 2008
Fixed maturities	$825	$(9)	$(48)	$70	$59	$897
Equity securities	43	(3)	(13)	82	1	110
Short-term investments	70	-	(19)	22	-	73
Other investments	41	12	7	2	-	62
Separate account assets	-	(1)	1	-	2	2
Other assets	13	12	-	2	-	27
Total assets	$992	$11	$(72)	$178	$62	$1,171
Life insurance obligations	$105	$151	$-	$(33)	$-	$223
Total liabilities	$105	$151	$-	$(33)	$-	$223

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as level 3 that are still held at December 31, 2008.

For the years ended December 31, 2008, 2007 and 2006, there were impairments of $29, $40, and $14, respectively, recognized for items measured at fair value on a nonrecurring basis (principally direct investments in oil and gas production ventures, which are based on independent external studies). Impairment charges for the above are reflected in insurance operating costs and expenses in the consolidated statements of income.

The fair values and carrying values of the Company's financial instruments at December 31, 2008 (not subject to SFAS 157) and 2007 are as follows:

	2008		2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Fixed maturity securities	N/A	N/A	$46,934	$46,934
Equity securities	N/A	N/A	3,285	3,285
Short-term investments	N/A	N/A	764	764
Trading securities	N/A	N/A	16	16
Other investments	$2,728	$2,728	2,348	2,348
Mortgage loans	1,090	1,054	657	645
Cash and cash equivalents	5,848	5,848	3,199	3,199
Individual and group annuities	1,008	1,043	951	995
Debt	6,089	3,956	4,451	4,390

Other investments: Fair values represent the Company's equity in the partnerships' net assets as determined by the respective general partners and equity investments in privately held businesses where cost approximates fair value where market value data is unavailable for the underlying investment.

Mortgage loans: The fair values of commercial mortgage loans were estimated using option adjusted valuation discount rates.

Cash, cash equivalents, and short-term investments: The carrying amounts reported in the consolidated balance sheets for these instruments approximate fair values.

(dollars in millions, except per share amounts)

Individual and group annuities: Fair values for deferred annuity contracts are equal to current net surrender value. Fair values of liabilities under investment-type insurance contracts, including individual and group annuities, are estimated using discounted cash flow calculations at pricing rates at December 31, 2008 and 2007.

Debt outstanding: Fair values of commercial paper and short-term borrowings approximate carrying value. Fair values of long-term debt were based on either quoted market prices or estimated using discounted cash flow analyses based on the Company's incremental borrowing rate at December 31, 2008 and 2007.

(6) BENEFIT PLANS

The net benefit costs for the years ended December 31, 2008, 2007, and 2006, include the following components:

December 31, 2008	**Pension**	**Supplemental Pension**	**Postretirement**
Components of net periodic benefit costs			
Service costs	$142	$10	$22
Interest costs	251	15	40
Expected return on plan assets	(267)	-	(1)
Settlement charge	1	-	-
Amortization of unrecognized:			
Net loss (gain)	10	5	(2)
Prior service cost	6	3	(3)
Net transition (assets) obligation	(5)	-	9
Net periodic benefit costs	**$138**	**$33**	**$65**

December 31, 2007	**Pension**	**Supplemental Pension**	**Postretirement**
Components of net periodic benefit costs			
Service costs	$148	$8	$19
Interest costs	213	13	31
Expected return on plan assets	(231)	-	(1)
Amortization of unrecognized:			
Net loss	36	4	-
Prior service cost	4	3	(3)
Net transition (assets) obligation	(5)	-	9
Net periodic benefit costs	**$165**	**$28**	**$55**

(dollars in millions, except per share amounts)

December 31, 2006	**Pension**	**Supplemental Pension**	**Postretirement**
Components of net periodic benefit costs			
Service costs	$ 154	$ 10	$19
Interest costs	184	13	28
Expected return on plan assets	(199)	-	(2)
Settlement charge	(2)	-	-
Amortization of unrecognized:			
Net loss	59	8	-
Prior service cost	1	2	(3)
Net transition (assets) obligation	(6)	-	9
Net periodic benefit costs	**$ 191**	**$ 33**	**$51**

The measurement date used to determine pension and other postretirement measurements is December 31, 2008.

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

(7) COMMITMENTS AND CONTINGENT LIABILITIES

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

The Company has been in various insurance coverage disputes with Armstrong World Industries ("Armstrong") for over twenty years relating to asbestos liabilities and insurance covering the period of 1973 to 1981. In July 2004, the Company prevailed in a favorable arbitration ruling before an appellate panel regarding Armstrong's available insurance coverage. Armstrong has filed, in the United States District Court for the Eastern District of Pennsylvania, a motion to vacate the 2004 appellate arbitration award that was favorable to the Company. The Company has filed a cross-motion seeking to confirm the award. Both motions have been briefed and remain pending at this time. Armstrong also filed a Chapter 11 Bankruptcy petition in the United States Bankruptcy Court for the District of Delaware in December 2000. A plan of reorganization was confirmed in August 2006, and Armstrong formally emerged from bankruptcy as of October 2, 2006. A declaratory judgment action, filed against the Company by Armstrong in 2002, is also pending in the United States District Court for the Eastern District of Pennsylvania. In that action, Armstrong is seeking coverage for asbestos claims under insurance policies issued to it during the period of 1973 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability, and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania coverage action is currently in the initial pleading stages after being reactivated at a Rule 16 Scheduling Conference on October 22, 2007. In June 2008, a separate action was filed against Liberty Mutual in Cook County, Illinois, in which three plaintiffs seek to have Liberty Mutual pay the balance of their pre-bankruptcy Armstrong settlements. The Armstrong Asbestos Bodily Injury Trust (the "Trust") recently intervened in this Illinois state court action, asserting a number of the same claims as are at issue in the Pennsylvania Coverage Action. The Company recently removed that case to the Federal District Court for the Northern District of Illinois, although the plaintiffs and the Trust are seeking to have the matter remanded to Cook County. The Company intends to vigorously defend its position in all pending coverage litigation, including any argument that coverage issues were finally determined in the bankruptcy proceedings. Management believes that the ultimate liability, if any, to Armstrong will not be resolved for at least one year and may possibly not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and an adverse outcome could have a material adverse effect on the Company's business, financial condition, and results of operations.

At December 31, 2008, the Company had unfunded capital commitments to private equity, real estate, and energy investments of $1,959.