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

Year Ended December 31, 2008

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

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three and twelve months ended December 31, 2008 and 2007. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2007 Annual Report, 2008 Unaudited Consolidated Financial Statements and Fourth Quarter 2008 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 on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

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Cautionary Statement Regarding Forward-Looking Statements

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

In particular, the sufficiency of the Company's reserves for (i) asbestos, (ii) environmental ((i) and (ii) together "A&E"), and (iii) toxic tort (i.e., claims that arise primarily from exposure to chemical or other potentially hazardous products or substances, including welding rod, lead paint and silica related claims), as well as its results of operations, financial condition and liquidity, to the extent impacted by the sufficiency of the Company's A&E and toxic tort reserves, are subject to a number of potential adverse developments including adverse developments involving A&E and toxic tort claims and the related level and outcome of litigation, the willingness of parties, including the Company, to settle disputes, the interpretation of aggregate policy coverage limits, the Company's ability to recover reinsurance for A&E, toxic tort and other claims, the legal, economic, regulatory, and legislative environments, and their impact on the future development of A&E and toxic tort claims, and the impact of bankruptcies of various asbestos producers and related peripheral businesses.

Some of the other factors that could cause actual results to differ include, but are not limited to, the following: the Company's inability to obtain price increases or maintain market share due to competition or otherwise; the performance of the Company's investment portfolio, which could suffer reduced returns or losses adversely affecting the Company's profitability, capitalization and liquidity; market conditions that may limit the Company's ability to replace maturing liabilities in a timely manner or that may make it difficult to value the Company's investments; developments in U.S. and global financial and capital markets, including changes in interest rates, rates of inflation, credit spreads, equity prices and foreign exchange rates; losses due to defaults of individual issuers and defaults of the collateral backing certain investments; weakening U.S. and global economic conditions, which could adversely affect the Company's ability to grow its business profitably; the potential effect of legislation and other governmental initiatives taken in response to the current financial crisis; insufficiency of, or changes in, loss reserves; the occurrence of catastrophic events, both natural and man-made, including terrorist acts, with a severity or frequency exceeding the Company's expectations; adverse changes in loss cost trends, including inflationary pressures in medical costs and automobile and home repair costs; developments relating to coverage and liability for mold claims; the effects of corporate bankruptcies on surety bond claims; adverse developments in the cost, availability and/or ability to collect reinsurance, which may be adversely affected by the current financial crisis; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the acquisition of Ohio Casualty Corporation ("Ohio Casualty") and its subsidiaries, and the recent acquisition of Safeco Corporation ("Safeco") and its subsidiaries, in accordance with its business strategy; the ability of the Company's subsidiaries to pay dividends to the Company; adverse results or other consequences from legal proceedings; the impact of regulatory investigations or reforms, including governmental actions regarding the compensation of brokers and agents and the purchase and sale of nontraditional products and related disclosures; unusual loss activity resulting from adverse weather conditions, including hurricanes, hail, tornados, snowfall and winter conditions; repatriation of foreign earnings; judicial expansion of policy coverage and the impact of new theories of liability; the impact of legislative actions, including Federal and state legislation related to asbestos liability reform; larger than expected assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings, which could adversely affect its business volumes, adversely affect its ability to access the debt markets and increase its borrowing costs; the loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of Personal Lines policies; and amendments and changes to the risk-based capital requirements. The Company's forward-looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs.

For a detailed discussion of these and other cautionary statements, visit the Company's Investor Relations web site at www.libertymutual.com/investors. The Company undertakes no obligation to update these forward-looking statements.

EXECUTIVE SUMMARY

The following highlights do not address all of the matters covered in the other sections of Management's Discussion & Analysis of Financial Condition and Results of Operations or contain all of the information that may be important to the investing public. This summary should be read in conjunction with the other sections of Management's Discussion & Analysis of Financial Condition and Results of Operations and the Company's unaudited financial statements.

Three Months Ended December 31, 2008 - Consolidated Results of Operations

- Revenues for the three months ended December 31, 2008 were $8.151 billion, an increase of $1.226 billion or 17.7% over the same period in 2007.

- Net written premium for the three months ended December 31, 2008 was $6.386 billion, an increase of $807 million or 14.5% over the same period in 2007.

- Pre-tax operating income for the three months ended December 31, 2008 was $567 million, an increase of $200 million or 54.5% over the same period in 2007. Results in the period include $174 million of net losses related to hurricanes Ike and Gustav ("September 2008 Hurricanes").

- Net income for the three months ended December 31, 2008 was $474 million, an increase of $49 million or 11.5% over the same period in 2007.

- Cash flow from operations for the three months ended December 31, 2008 was $173 million, a decrease of $942 million or 84.5% from the same period in 2007.

- The combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2] for the three months ended December 31, 2008 was 97.9%, a decrease of 1.4 points from the same period in 2007. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the three months ended December 31, 2008 decreased 6.1 points to 94.6%.

Twelve Months Ended December 31, 2008 - Consolidated Results of Operations

- Revenues for the twelve months ended December 31, 2008 were $28.855 billion, an increase of $2.903 billion or 11.2% over the same period in 2007.

- Net written premium for the twelve months ended December 31, 2008 was $25.467 billion, an increase of $2.929 billion or 13.0% over the same period in 2007.

- Pre-tax operating income for the twelve months ended December 31, 2008 was $1.625 billion, a decrease of $137 million or 7.8% from the same period in 2007. Results in the period include $871 million of net losses related to the September 2008 Hurricanes.

- Net income for the twelve months ended December 31, 2008 was $1.140 billion, a decrease of $378 million or 24.9% from the same period in 2007.

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[1] Catastrophes include all current and prior year catastrophe losses including assessments from the Texas Windstorm Insurance Association ("TWIA") but exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years (excluding prior year losses related to natural catastrophes and the events of September 11, 2001) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains.

- Cash flow from operations for the twelve months ended December 31, 2008 was $2.745 billion, a decrease of $1.297 billion or 32.1% from the same period in 2007.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the twelve months ended December 31, 2008 was 97.4%, a decrease of 0.8 points from the same period in 2007. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the twelve months ended December 31, 2008 decreased 0.2 points to 99.9%.

Financial Condition as of December 31, 2008

- Total assets were $104.316 billion as of December 31, 2008, an increase of $9.301 billion over December 31, 2007.

- Policyholders' equity was $10.160 billion as of December 31, 2008, a decrease of $2.206 billion from December 31, 2007.

Other 2008 4th Quarter Highlights

Debt Exchange Transactions

On December 29, 2008 the following transactions occurred:

- Liberty Mutual Group Inc. ("LMGI") exchanged $281 million of the outstanding $300 million Safeco 4.875% Senior Notes due 2010 for a like principal amount of newly issued LMGI 4.875% Senior Notes due 2010.

- LMGI exchanged $187 million of the outstanding $204 million Safeco 7.25% Senior Notes due 2012 for a like principal amount of newly issued LMGI 7.25% Senior Notes due 2012.

- LMGI exchanged $180 million of the outstanding $200 million Ohio Casualty 7.30% Senior Notes due 2014 for a like principal amount of newly issued LMGI 7.30% Senior Notes due 2014.

Safeco and Ohio Casualty received and accepted the requisite consents to enable each to execute a supplemental indenture governing the Safeco and Ohio Casualty Senior Notes that remain outstanding. The supplemental indenture eliminated substantially all restrictive covenants and eliminated or modified certain events of default.

Subsequent Events

- 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.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI") and net written premium as non-GAAP financial measures. PTOI is defined by the Company as pre-tax income excluding net realized gains (losses), extraordinary items, discontinued operations and cumulative effects of changes in accounting principles. PTOI is considered by the Company to be an appropriate indicator of underwriting and operating results and is consistent with the way the Company internally evaluates performance, except that limited partnership results recognized on the equity method are not included in internal PTOI. Net realized investment gains (losses) are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results. Federal and foreign income taxes are significantly impacted by permanent differences. References to "direct written premium" represent the amount of premium recorded for policies issued during a fiscal period excluding assumed reinsurance and ignoring the effects of ceded reinsurance. References to "net written premium" represent the amount of premium recorded for policies issued during a fiscal period including audits, retrospectively rated premium related to loss sensitive policies, and assumed premium, less ceded premium. Assumed and ceded reinsurance premiums include premium adjustments for reinstatement of coverage when a loss has used some portion of the reinsurance provided, generally under catastrophe treaties ("reinstatement premium"). In addition, the majority of workers compensation premium is adjusted to the "booked as billed" method through the Corporate & Other segment. "Premium earned," which is the portion of premium that applies to the expired part of the policy period, is a GAAP measure. The Company believes that net written premium is a performance measure useful to investors as it generally reflects current trends in the Company's sale of its insurance products.

The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

Overview – Consolidated

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**[1]	**2007**[2]	**Change**	**2008**[1]	**2007**[2]	**Change**
Private passenger automobile	$2,330	$1,592	46.4%	$7,913	$6,293	25.7%
Workers compensation	930	1,074	(13.4)	4,699	4,817	(2.4)
Commercial multiple peril / Fire	573	449	27.6	2,032	1,702	19.4
Homeowners	227	527	(56.9)	1,873	1,996	(6.2)
International local businesses	416	369	12.7	1,652	1,332	24.0
Commercial automobile	395	344	14.8	1,415	1,228	15.2
General liability	216	231	(6.5)	1,108	936	18.4
LIU[3] reinsurance	252	184	37.0	1,018	1,061	(4.1)
LIU third party	207	145	42.8	760	557	36.4
LIU inland marine program	160	137	16.8	620	561	10.5
Group disability and life	136	115	18.3	553	464	19.2
Bond	185	84	120.2	478	312	53.2
LIU first party	70	75	(6.7)	270	301	(10.3)
Individual life	80	75	6.7	265	280	(5.4)
Assumed voluntary reinsurance	47	30	56.7	166	113	46.9
Other[4]	162	148	9.5	645	585	10.3
Total net written premium[5]	$6,386	$5,579	14.5%	$25,467	$22,538	13.0%

1 Tables include the results of Safeco subsequent to September 22, 2008.
2 Tables include the results of Ohio Casualty subsequent to August 24, 2007.
3 Liberty International Underwriters (LIU).
4 Primarily includes net written premium from domestic inland marine and allied lines.
5 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business.

Consolidated net written premium by SBU was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Personal Markets[1]	$1,442	$1,379	4.6%	$5,969	$5,812	2.7%
Commercial Markets	1,084	1,274	(14.9)	5,595	5,616	(0.4)
Agency Markets	2,595	1,317	97.0	7,457	5,112	45.9
International	1,731	1,465	18.2	6,757	5,714	18.3
Corporate and Other[2,3]	(466)	144	NM	(311)	284	NM
Total net written premium (NWP)	$6,386	$5,579	14.5%	$25,467	$22,538	13.0%
Foreign exchange effect on growth			(2.5)			0.7
NWP growth excluding foreign exchange			17.0%			12.3%

1 Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.
2 Includes internal reinsurance.
3 Results are primarily driven by a homeowners quota share reinsurance program.
NM = Not Meaningful

Major drivers of net written premium growth were as follows:

	Three Months Ended December 31,				Twelve Months Ended December 31,			
$ in Millions	**2008**	**2007**	**$ Change**	**Pts. Attribution**	**2008**	**2007**	**$ Change**	**Pts. Attribution**
LMG NWP	$6,386	$5,579	$807	14.5	$25,467	$22,538	$2,929	13.0
Components of Growth:								
Safeco	$1,258	$-	$1,258	22.6	$1,392	$-	$1,392	6.2
Ohio Casualty	297	297	-	-	1,335	410	925	4.1
International local businesses (excluding foreign exchange)	1,160	931	229	4.1	4,051	3,301	750	3.3
Domestic personal auto[1]	1,046	971	75	1.4	4,476	4,244	232	1.0
Foreign exchange	(138)	-	(138)	(2.5)	161	-	161	0.7
Group disability and life	136	115	21	0.4	553	464	89	0.4
Bond[1]	77	70	7	0.1	312	292	20	0.1
Workers compensation booked as billed adjustment	48	86	(38)	(0.7)	18	7	11	0.1
Individual life	80	75	5	0.1	265	280	(15)	(0.1)
Other commercial lines[1]	2,425	2,538	(113)	(2.0)	11,383	11,587	(204)	(0.9)
Homeowners[1,2]	(3)	496	(499)	(9.0)	1,521	1,953	(432)	(1.9)
Total LMG NWP	$6,386	$5,579	$807	14.5	$25,467	$22,538	$2,929	13.0

1 Excludes Ohio Casualty/Safeco premium.
2 Results are primarily driven by a homeowners quota share reinsurance program.

Net written premium for the three and twelve months ended December 31, 2008 was $6.386 billion and $25.467 billion, respectively, increases of $807 million and $2.929 billion over the same periods in 2007. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $738 million and $1.620 billion in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects approximately $618 million of premium related to acquisitions made which include Safeco on September 22, 2008, and Brazilian insurer Indiana Seguros S.A. ("Indiana Seguros") on January 9, 2008 and organic growth in all of International's local businesses in Latin America. The increase was partially offset by weaker foreign currencies versus the U.S. dollar (approximately $60 million) and lower average premium per policy in Personal Markets due primarily to rate decreases in Massachusetts. The increase year-to-date reflects approximately $994 million of premium related to acquisitions made which include Ohio Casualty on August 24, 2007, Safeco, and Indiana Seguros and organic growth in all of International's local businesses in Latin America. The increase year-to-date also reflects the strengthening of foreign currencies versus the U.S. dollar (approximately $97 million) and strong customer retention in Personal Markets and Agency Markets, partially offset by lower average premium per policy in Personal Markets.

- Workers compensation net written premium decreased $144 million and $118 million in the quarter and year-to-date, respectively. The decreases in both periods primarily reflect rate decreases and lower retention in both Agency Markets and Commercial Markets and a decrease in Summit's premium due to both mandated rate decreases in Florida and lower audit and retrospectively rated premium. Partially offsetting the decrease in the quarter was approximately $26 million of premium related to the Safeco acquisition. The decrease year-to-date was partially offset by approximately $108 million of premium related to the Ohio Casualty and Safeco acquisitions and new business premium of $45 million related to a construction account with a multi-year exposure written in Commercial Markets' National Market segment. Both periods also include an adjustment to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium.
- Commercial multiple peril / fire increased $124 million and $330 million in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects approximately $136 million of premium related to the Safeco acquisition. Partially offsetting the increase in the quarter were lower retention in Commercial Markets and rate decreases in Commercial and Agency Markets due to a more competitive environment. The year-to-date increase reflects approximately $372 million of premium related to the Ohio Casualty and Safeco acquisitions and a reduction in the utilization of ceded reinsurance in Commercial Markets as compared to 2007. Partially offsetting the year-to-date increase were lower retention in Agency Markets and rate decreases in Commercial and Agency Markets as compared to 2007.
- Homeowners net written premium decreased $300 million and $123 million in the quarter and year-to-date, respectively. The decreases in both periods reflect the impact of $518 million to the Corporate and Other segment for an externally ceded homeowners quota share reinsurance treaty entered into on December 31, 2008 as part of the Company's catastrophe management strategy. Partially offsetting the decreases in the quarter and year-to-date were approximately $200 million and $314 million, respectively, related to the acquisitions of Safeco and Indiana Seguros in the quarter and additionally Ohio Casualty year-to-date. The decrease in both periods is also partially offset by strong customer retention in Personal Markets and new business growth in both Personal Markets and Agency Markets.
- International local businesses net written premium (excluding private passenger automobile), increased $47 million and $320 million in the quarter and year-to-date, respectively. The increase in both periods primarily reflects organic growth in International's local businesses, primarily in Latin America. Partially offsetting the increase in the quarter was the impact of weaker foreign currencies versus the U.S. dollar (approximately $39 million). The year-to-date increase includes the impact of stronger foreign currencies versus the U.S. dollar (approximately $62 million).
- Commercial automobile net written premium increased $51 million and $187 million in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects approximately $106 million of premium related to the Safeco acquisition. The increase year-to-date primarily reflects approximately $282 million of premium related to the Ohio Casualty and Safeco acquisitions. Partially offsetting the increases in both periods was lower retention in Commercial Markets due to a more competitive environment.
- General liability net written premium decreased $15 million and increased $172 million in the quarter and year-to-date, respectively. The decrease in the quarter primarily reflects lower retention in Commercial Markets due to a more competitive environment. Partially offsetting the decrease in the quarter was approximately $40 million of premium related to the Safeco acquisition. The year-to-date increase primarily reflects approximately $168 million of premium related to the Ohio Casualty and Safeco acquisitions.

- LIU reinsurance net written premium increased $68 million and decreased $43 million in the quarter and year-to-date, respectively. Impacting the increase in the quarter was higher non-natural catastrophe exposed net written premium. The year-to-date decrease primarily reflects a reduction of premium attributable to a reduction in aggregate exposure.
- LIU third party net written premium increased $62 million and $203 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect a decrease in ceded written premium due to a change in the structure of a reinsurance program, partially offset by a decline in rates and retention as a result of a more competitive environment.
- LIU inland marine program net written premium increased $23 million and $59 million in the quarter and year-to-date, respectively. The increases in both periods reflect growth of a cell phone insurance program.
- Group disability and life net written premium increased $21 million and $89 million in the quarter and year-to-date, respectively, due primarily to the impact of broader market penetration.
- Bond net written premium increased $101 million and $166 million in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects approximately $94 million related to the Safeco acquisition. The year-to-date increase primarily reflects approximately $147 million of premium related to both the Ohio Casualty and Safeco acquisitions.
- LIU first party net written premium decreased $5 million and $31 million in the quarter and year-to-date, respectively. The decreases in both periods are primarily due to increased ceded written premium and rate and retention decreases.
- Individual life net written premium increased $5 million and decreased $15 million in the quarter and year-to-date, respectively. The increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.
- Assumed voluntary reinsurance increased $17 million and $53 million in the quarter and year-to-date, respectively, primarily due to broader market penetration.

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

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

Results of Operations – Consolidated

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$8,151	$6,925	17.7%	$28,855	$25,952	11.2%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$334	$453	(26.3)	$2,232	$2,171	2.8
Catastrophes[1]:						
-September 2008 Hurricanes	(174)	-	NM	(871)	-	NM
-All other	(115)	(139)	(17.3)	(705)	(378)	86.5
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(2)	(62)	(96.8)	(7)	(158)	(95.6)
- All other[3]	512	92	NM	976	127	NM
- Current accident year re-estimation[4]	12	23	(47.8)	-	-	-
Pre-tax operating income	567	367	54.5	1,625	1,762	(7.8)
Realized investment (losses) gains, net	(74)	292	NM	(330)	436	NM
Federal and foreign income tax expense	(19)	(234)	(91.9)	(155)	(680)	(77.2)
Net income	$474	$425	11.5%	$1,140	$1,518	(24.9%)
Cash flow from operations	$173	$1,115	(84.5%)	$2,745	$4,042	(32.1%)

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance of zero and $7 million for the three and twelve months ended December 31, 2008, and ($14) million and ($11) million for the comparable periods of 2007.

3 Net of earned premium attributable to prior years of ($88) million and ($77) million for the three and twelve months ended December 31, 2008, and ($144) million and ($105) million for the comparable periods of 2007. Net of amortization of deferred gains on retroactive reinsurance of $29 million and $82 million for the three and twelve months ended December 31, 2008, and $15 million and $84 million for the comparable periods of 2007.

4 Re-estimation of current year accident loss reserves for the nine months ended September 30, 2008 and 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were $8.151 billion and $28.855 billion respectively, increases of $1.226 billion and $2.903 billion over the same periods in 2007. The major components of revenues are net premium earned, net investment income, net realized investment gains (losses), and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2008 was $7.364 billion and $25.524 billion, respectively, increases of $1.640 billion and $3.637 billion over the same periods in 2007. The increase in the quarter primarily reflects approximately $1.402 billion of premium related to the acquisitions of Safeco and Indiana Seguros and higher earned premium associated with the changes in net written premium in 2007 and the first half of 2008. Partially offsetting the increase in the quarter was approximately $127 million of negative foreign exchange impact due to a stronger dollar. The year-to-date increase is impacted by approximately $2.584 billion of premium related to the acquisitions of Ohio Casualty, Safeco and Indiana Seguros, higher earned premium associated with the changes in net written premium in 2007 and 2008 and approximately $149 million of positive foreign exchange impact due to a weaker dollar.

Net investment income for the three and twelve months ended December 31, 2008 was $664 million and $2.880 billion, respectively, representing decreases of $79 million and $5 million from the same periods in 2007. The decreases in both periods are primarily driven by a decrease in income from investments in limited partnerships and limited liability companies due to reduced valuations and IPO/takeover activities as compared to the same periods in 2007, lower investment yields, and a shift to tax-exempt securities. Partially offsetting these decreases were increases in interest income, primarily due to a higher invested asset base resulting from the continued investment of cash flow from operations and cash proceeds received from the May 2008 debt issuance. In addition, interest income increased slightly as a result of net assets assumed from the acquisition of Safeco.

Net realized investment losses for the three and twelve months ended December 31, 2008 were $74 million and $330 million, respectively, compared to gains of $292 million and $436 million in the same periods in 2007. Both periods reflect higher impairment losses due to a change in management's ability and intent to hold certain equity investments to recovery in light of the Company's decision to reduce exposure to the equity markets, as well as fixed maturity and equity securities deemed to be other-than-temporarily impaired due to recent market conditions (see the Investments section of this MD&A for details regarding other-than-temporary impairments). Additionally, the year-to-date change includes impairment losses on fixed maturity investments related to securities sold to raise funds for the acquisition of Safeco and lower realized gains from the Company's energy operations. Partially offsetting these losses were net derivative gains of $215 million and $331 million for the three and twelve months ended December 31, 2008, respectively, primarily related to derivative contracts the Company entered to partially hedge its equity exposure.

Fee and other revenues for the three and twelve months ended December 31, 2008 were $197 million and $781 million, respectively, increases of $31 million and $37 million over the same periods in 2007. The increases in both periods reflect an increase in oil and gas revenues and an increase in contractholder fees on non-traditional life insurance products principally in the International operations, partially offset by lower fee revenues from the Company's servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 were $7.658 billion and $27.560 billion, respectively, increases of $1.392 billion and $3.806 billion over the same periods in 2007. The increase in the quarter primarily reflects the acquisitions of Safeco and Indiana Seguros, organic business growth, in particular International's Latin America operations, higher catastrophe losses including the September 2008 Hurricanes, general cost increases including higher interest expense and an increase in non-catastrophe property losses in both Agency Markets and Commercial Markets. The year-to-date increase reflects the previously mentioned drivers as well as the Ohio Casualty acquisition. Partially offsetting the increases in both periods were more favorable incurred losses attributable to prior years, primarily related to LIU reinsurance lines, decreases in unfavorable prior year development in asbestos and environmental losses, favorable development attributable to prior years in 2008 as compared to unfavorable development attributable to prior years in 2007 in the workers compensation line of business and lower variable incentive compensation expense.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
CONSOLIDATED	**2008[1]**	**2007[1]**	**Change (Points)**	**2008[1]**	**2007[1]**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	68.8%	69.5%	(0.7)	69.4%	69.6%	(0.2)
Underwriting expense ratio	28.9	29.3	(0.4)	27.7	28.2	(0.5)
Dividend ratio	0.2	0.5	(0.3)	0.3	0.4	(0.1)
Subtotal	97.9	99.3	(1.4)	97.4	98.2	(0.8)
Catastrophes[2]:						
-September 2008 Hurricanes	2.4	-	2.4	3.6	-	3.6
-All other	1.6	2.5	(0.9)	2.8	1.8	1.0
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	0.9	(0.9)	0.1	0.7	(0.6)
- All other	(7.1)	(1.6)	(5.5)	(4.0)	(0.6)	(3.4)
- Current accident year re-estimation[3]	(0.2)	(0.4)	0.2	-	-	-
Total combined ratio[4]	94.6%	100.7%	(6.1)	99.9%	100.1%	(0.2)

1 One-time Safeco integration costs have been excluded from the combined ratio. The prior year has been restated to exclude one-time Ohio Casualty integration costs.

2 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

3 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2008 and 2007.

4 The combined ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less fee income (primarily related to the Company's involuntary market servicing carrier operations and managed care income) and less installment charges; and the ratio of policyholder dividends to earned premium. Provisions for uncollectible premium and reinsurance are not included in the combined ratio unless related to an asbestos and environmental commutation.

The consolidated combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and twelve months ended December 31, 2008 was 97.9% and 97.4% respectively, decreases of 1.4 points and 0.8 points from the same periods in 2007. The decreases in both periods reflect a decline in loss activity within LIU's reinsurance business resulting from less severe large loss events (excluding the September 2008 Hurricanes) in 2008 as compared to 2007 and a lower claims and claim adjustment expense ratio in Personal Markets mainly related to the auto liability line of business. These decreases were partially offset by higher non-catastrophe property related losses in both Agency Markets and Commercial Markets, higher auto physical damage losses due to an increase in frequency in Agency Markets and a more competitive rate environment across all SBUs and lines of business. The year-to-date decrease in the claims and claim adjustment expense ratio also was partially offset by increased loss activity within LIU's first party business. The decrease in the underwriting expense ratio in both periods was primarily due to increased personal lines business in Agency Markets, which has a lower expense ratio, reduced profit sharing associated with U.S. personal lines business acquired from Prudential Financial, Inc. ("PruPac"), and lower variable incentive compensation expense, partially offset by general expense increases, and expenses related to the Middle Market reorganization.

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 twelve months ended December 31, 2008 was 94.6% and 99.9% respectively, decreases of 6.1 points and 0.2 points from the same periods in 2007. The decrease in the quarter primarily reflects the impact of favorable net incurred loss development attributable to prior years principally in LIU reinsurance and development in asbestos and environmental reserves which did not recur in the current year. The year-to-date decrease in the combined ratio was due to favorable net incurred loss development attributable to prior years in the general liability and LIU reinsurance lines of business. The decreases in both periods also reflect a favorable development attributable to prior years in 2008 as compared to unfavorable development attributable to prior years in 2007 in the workers compensation line of business. Partially offsetting the decreases in both periods were higher catastrophe losses due mainly to the 2008 Hurricanes and an increase in frequency of non–hurricane weather events in 2008.

PTOI for the three and twelve months ended December 31, 2008 was $567 million and $1.625 billion, respectively, an increase of $200 million and a decrease of $137 million versus the same periods in 2007.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2008 was $19 million and $155 million, respectively, decreases of $215 million and $525 million from the same periods in 2007. The Company's effective tax rate for the three and twelve months ended December 31, 2008 was 4% and 12%, respectively, compared to 36% and 31% for the same periods in 2007. The current quarter reflects a cumulative adjustment to arrive at the final annual rate of 12% as compared to 17% recorded through the first nine months of 2008, primarily as a result of a lower than expected tax rate associated with the International operations, tax refund litigation, and revisions to estimates. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income, goodwill, foreign taxes and the previously mentioned tax refund litigation.

Net income for the three and twelve months ended December 31, 2008 was $474 million and $1.140 billion, respectively, an increase of $49 million and a decrease of $378 million versus the same periods in 2007.

Cash flow from operations for the three and twelve months ended December 31, 2008 was $173 million and $2.745 billion, respectively, decreases of $942 million and $1.297 billion from the same periods in 2007. The decreases in both periods primarily reflect an increase in catastrophe and non-catastrophe property losses due to the September 2008 Hurricanes and generally adverse weather conditions in the U.S. and a single premium payment of $291 million for a homeowners catastrophe reinsurance agreement the Company entered into in the fourth quarter. Partially offsetting the decreases in both periods were favorable premium and investment income collections.

Policyholders' equity was $10.160 billion as of December 31, 2008, a decrease of $2.206 billion from December 31, 2007. Included in policyholders' equity was $2.031 billion of after-tax unrealized investment losses and an $869 million adjustment to the pension and post retirement liability due to a decline in the discount rate and declines in the values of pension assets.

PERSONAL MARKETS

Overview – Personal Markets

Personal Markets sells primarily automobile, homeowners and other types of property and casualty insurance coverage, as well as a wide range of life and annuity products, to individuals in the United States. Products are distributed through approximately 1,800 licensed captive sales representatives, approximately 500 licensed direct response sales counselors, third-party producers and the Internet. Personal Markets' largest source of new business is through its more than 11,850 sponsored affinity groups (such as employers, credit unions, professional associations and alumni associations). Personal Markets' coverages are primarily personal automobile and homeowners.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Private passenger automobile	$882	$844	4.5%	$3,837	$3,749	2.3%
Homeowners and other	480	460	4.3	1,867	1,783	4.7
Individual life[1]	80	75	6.7	265	280	(5.4)
Total net written premium	$1,442	$1,379	4.6%	$5,969	$5,812	2.7%

[1] Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

Net written premium for the three and twelve months ended December 31, 2008 was $1.442 billion and $5.969 billion, respectively, increases of $63 million and $157 million over the same periods in 2007. The increases in both periods reflect new business growth, strong customer retention in both automobile and homeowners and rate increases on homeowners policies. For individual life, the increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.

Private passenger automobile net written premium for the three and twelve months ended December 31, 2008 was $882 million and $3.837 billion, respectively, increases of $38 million and $88 million over the same periods in 2007. The increases in both periods reflect a 4.5% increase in voluntary policies in-force as compared to December 31, 2007 due to strong customer retention and new business growth, partially offset by lower average premium per policy due primarily to the effect of rate decreases in Massachusetts. The introduction of managed competition in 2008 provided the Company with the opportunity to significantly increase its presence in the Massachusetts automobile insurance market.

Homeowners and other net written premium for the three and twelve months ended December 31, 2008 was $480 million and $1.867 billion, respectively, increases of $20 million and $84 million over the same periods in 2007. The increases in both periods reflect rate increases and a 4.8% increase in policies in-force (1.7 points related to renters policies) as compared to December 31, 2007 due to strong customer retention and new business growth, primarily in non-coastal areas. In addition, approximately one point of the policies in-force growth is attributable to the relationship established with GEICO in late 2007, which allows GEICO to offer Liberty Mutual property products to its auto prospects and customers through the Internet and call centers.

Individual life net written premium for the three and twelve months ended December 31, 2008 was $80 million and $265 million, respectively, an increase of $5 million and a decrease of $15 million versus the same periods in 2007. The increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.

Results of Operations – Personal Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007[1]**	**Change**	**2008**	**2007[1]**	**Change**
Revenues	$1,719	$1,673	2.7%	$6,684	$6,524	2.5%
PTOI before catastrophes net incurred losses attributable to prior years and current accident year re-estimation	$236	$223	5.8	$905	896	1.0
Catastrophes[2]:						
-September 2008 Hurricanes	(2)	-	NM	(270)	-	NM
-All other	(66)	(125)	(47.2)	(373)	(295)	26.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	30	54	(44.4)	88	172	(48.8)
Current accident year re-estimation[3]	12	58	(79.3)	-	-	-
Pre-tax operating income	$210	$210	-	$350	$773	(54.7%)

1 Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

2 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned premiums and earned reinstatement premiums.

3 Re-estimation of current accident year loss reserves for the nine months ended September 30, 2008 and 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were $1.719 billion and $6.684 billion, respectively, increases of $46 million and $160 million over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2008 was $1.520 billion and $5.874 billion, respectively, increases of $52 million and $161 million over the same periods in 2007. The increases in both periods reflect the earned premium associated with the changes in net written premium for both the voluntary automobile and homeowners lines of business in 2007 and 2008. For individual life, the increase in the quarter reflects higher structured settlement sales, while on a year-to-date basis structured settlement sales have declined.

Net investment income for the three and twelve months ended December 31, 2008 was $181 million and $711 million, respectively, increases of $4 million and $20 million over the same periods in 2007. The increases in both periods primarily reflect higher invested asset base due to the continued investment of cash flow from operations partially offset by lower investment yields.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 was $1.520 billion and $6.364 billion, respectively, increases of $57 million and $615 million over the same periods in 2007. The increases in both periods primarily reflect business growth, general cost increases, and a reduction in the amount of favorable prior year loss development on auto liability business, partially offset by lower profit share expense related to PruPac. Lower catastrophe losses in the quarter were partially offset by less favorable development from the re-estimation of current accident year automobile liability losses for the nine months ended September 30, 2008 compared to the same period in 2007. The increase year-to-date also reflects higher acquisition expenses primarily due to increased advertising costs and higher catastrophe losses mainly driven by the September 2008 Hurricanes and an increase in frequency of non-hurricane weather events in 2008.

PERSONAL MARKETS	Three Months Ended December 31, 2008	2007	Change (Points)	Twelve Months Ended December 31, 2008	2007	Change (Points)
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	64.7%	64.8%	(0.1)	63.4%	64.7%	(1.3)
Underwriting expense ratio	24.9	25.3	(0.4)	26.1	25.0	1.1
Dividend ratio	-	-	-	-	-	-
Subtotal	89.6	90.1	(0.5)	89.5	89.7	(0.2)
Catastrophes[1]:						
-September 2008 Hurricanes	0.1	-	0.1	4.8	-	4.8
-All other	4.6	9.0	(4.4)	6.7	5.4	1.3
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(2.1)	(3.8)	1.7	(1.6)	(3.1)	1.5
Current accident year re-estimation[2]	(0.9)	(4.2)	3.3	-	-	-
Total combined ratio	91.3	91.1	0.2	99.4	92.0	7.4

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned premiums and earned reinstatement premiums.

2 Re-estimation of current accident year loss reserves for the nine months ended September 30, 2008 and 2007.

The Personal Markets combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and twelve months ended December 31, 2008 was 89.6% and 89.5%, respectively, decreases of 0.5 points and 0.2 points from the same periods in 2007. The decrease in the claims and claim adjustment expense ratio in both periods is mainly related to a decrease in loss adjustment expenses and favorable loss trends in the automobile physical damage line of business. The decrease in the underwriting expense ratio for the quarter was primarily driven by lower profit sharing associated with PruPac. The increase on a year-to-date basis for the underwriting expense ratio reflects higher advertising expenditures (approximately 1.2 points year-to-date).

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 twelve months ended December 31, 2008 was 91.3% and 99.4%, respectively, increases of 0.2 points and 7.4 points over the same periods in 2007. The increases in both periods reflect the changes in the combined ratio previously discussed and a decrease in the amount of favorable net incurred loss development attributable to prior years on auto liability business as compared to the same periods in 2007. The increase in the quarter also reflects less favorable development of current accident year private passenger automobile liability losses for the nine months ended September 30, 2008, offset by lower catastrophe losses in the fourth quarter of 2008 versus 2007. Year-to-date results also reflect the impact of higher catastrophe losses primarily related to the September 2008 Hurricanes and an increase in frequency of non-hurricane weather events in 2008.

PTOI for the three and twelve months ended December 31, 2008 was $210 million and $350 million, respectively, representing no change and a decrease of $423 million versus the same periods in the prior year.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets offers a wide array of commercial insurance and reinsurance coverages to U.S. employers and insurance companies, respectively. Products are distributed primarily by agents and brokers, a direct national accounts sales force, employee benefits brokers, and consultants. The Commercial Markets business unit is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base, product grouping or distribution channel to provide tailored products and services that specifically address customers' needs. The Commercial Markets coverages include workers compensation, commercial automobile, general liability (including product liability), group disability and life, commercial multiple peril and fire, assumed voluntary reinsurance, and a variety of other coverages. The Company is also a servicing carrier for state based workers compensation and commercial automobile involuntary market pools.

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.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Middle Market[1]	$519	$674	(23.0%)	$2,670	$2,909	(8.2%)
National Market	197	263	(25.1)	1,201	1,151	4.3
Group Market	136	115	18.3	553	464	19.2
Liberty Mutual Property	51	71	(28.2)	348	342	1.8
Other Markets[2]	181	151	19.9	823	750	9.7
Total net written premium	$1,084	$1,274	(14.9%)	$5,595	$5,616	(0.4%)

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

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

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Workers compensation	$615	$723	(14.9%)	$3,184	$3,305	(3.7%)
General liability	66	123	(46.3)	588	594	(1.0)
Group disability and life	136	115	18.3	553	464	19.2
Commercial automobile	112	157	(28.7)	487	554	(12.1)
Commercial multiple peril / Fire	62	67	(7.5)	390	353	10.5
Assumed voluntary reinsurance	45	29	55.2	161	109	47.7
Other	48	60	(20.0)	232	237	(2.1)
Total net written premium	$1,084	$1,274	(14.9%)	$5,595	$5,616	(0.4%)

Net written premium for the three and twelve months ended December 31, 2008 was $1.084 billion and $5.595 billion, respectively, decreases of $190 million and $21 million from the same periods in 2007. The decreases in both periods reflect significantly lower retention levels across most lines of business and market segments due to a more competitive rate environment. Both periods also reflect a decrease in Middle Market audit and retrospective workers compensation premium and a decrease in National Market general liability ($37 million) and workers compensation ($11 million) premium related to a multi-year construction program. Offsetting the National Market decrease in the quarter, year-to-date results reflect new business premium of approximately $43 million in general liability and $45 million in workers compensation related to a construction account with multi-year exposure. Partially offsetting the decreases in both periods is an increase in assumed voluntary reinsurance business, included in the Other Markets segment, as well as an increase in group disability business due to a broader penetration of those markets. Year-to-date results also reflect higher commercial multiple peril/fire premium due to a reduction in the utilization of ceded reinsurance as compared to 2007.

Results of Operations – Commercial Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$1,661	$1,530	8.6%	$6,804	$6,489	4.9%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	94	175	(46.3)	429	565	(24.1)
Catastrophes[1]:						
-September 2008 Hurricanes	(53)	-	NM	(209)	-	NM
-All other	12	2	NM	(59)	(3)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	(6)	(42)	(85.7)	41	(90)	NM
Current accident year re-estimation[3]	-	8	(100.0)	-	-	-
Pre-tax operating income	$47	$143	(67.1%)	$202	$472	(57.2%)

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of ($72) million and ($48) million for the three and twelve months ended December 31, 2008, and ($130) million and ($99) million for the comparable period of 2007. Net of amortization of deferred gains on retroactive reinsurance of $17 million and $55 million for the three and twelve months ended December 31, 2008, and $9 million and $63 million for the comparable period of 2007.

3 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were $1.661 billion and $6.804 billion, respectively, increases of $131 million and $315 million over the same periods in 2007. The major components of revenues are net premium earned, net investment income, and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2008 was $1.377 billion and $5.669 billion, respectively, increases of $121 million and $278 million over the same periods in 2007. The increases in both periods reflect the earned premium associated with changes in net written premium in 2007 and the first half of 2008 as well as a decrease in the estimate of prior year earned premium on loss sensitive business recorded in the three months ended December 31, 2007.

Net investment income for the three and twelve months ended December 31, 2008 was $213 million and $834 million, respectively, increases of $12 million and $60 million over the same periods in 2007. The increases in both periods primarily reflect a higher invested asset base due to the continued investment of cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and twelve months ended December 31, 2008 was $71 million and $301 million, respectively, decreases of $2 million and $23 million from the same periods in 2007. The decreases primarily reflect lower fee revenues from the Company's servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 was $1.614 billion and $6.602 billion, respectively, increases of $227 million and $585 million over the same periods in 2007. The increases in both periods primarily reflect higher catastrophe related and non-catastrophe related property losses, exposure growth and an increase in general expense reserves associated with the Middle Market reorganization. Partially offsetting these increases in both periods was a decrease in the amount of incurred losses attributable to prior years, primarily in the workers compensation line of business and a reduction in premium taxes.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
COMMERCIAL MARKETS	**2008**	**2007**	**Change (Points)**	**2008**	**2007**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	81.7%	77.0%	4.7	82.8%	79.6%	3.2
Underwriting expense ratio	23.6	21.9	1.7	21.6	21.6	-
Dividend ratio	0.5	0.3	0.2	0.6	0.4	0.2
Subtotal	105.8	99.2	6.6	105.0	101.6	3.4
Catastrophes[1]:						
-September 2008 Hurricanes	4.0	-	4.0	4.0	-	4.0
-All other	(0.9)	(0.1)	(0.8)	1.2	0.1	1.1
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	1.3	3.5	(2.2)	(0.6)	1.8	(2.4)
Current accident year re-estimation[2]	-	(0.6)	0.6	-	-	-
Total combined ratio	110.2%	102.0%	8.2	109.6%	103.5%	6.1

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes , the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007.

The Commercial Markets combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and twelve months ended December 31, 2008 was 105.8% and 105.0%, respectively, increases of 6.6 points and 3.4 points over the comparable periods in 2007. The increases in the claims and claim adjustment expense ratio in both periods primarily reflect a reduction in the assumed involuntary applied discount factor due to changes in ultimate loss estimates in 2008 associated with certain involuntary pool workers compensation loss reserves (approximately 1.4 points and 0.9 points in the quarter and year-to-date, respectively) and a more competitive rate environment. Also impacting both periods was a higher claims and claims adjustment expense ratio in the workers compensation line of business due to increasing loss trends in California and the impact of large property losses. The underwriting expense ratio in both periods was impacted by expenses associated with the Middle Market reorganization (approximately 2.3 points and 0.6 points in the quarter and year-to-date, respectively) and a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the involuntary pools, partially offset by a reduction in premium taxes.

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 twelve months ended December 31, 2008 was 110.2% and 109.6%, respectively, increases of 8.2 points and 6.1 points over the same periods in 2007. The increases in both periods reflect the changes in the combined ratio previously discussed and higher catastrophe losses attributable to the September 2008 Hurricanes. In addition the year-to-date increase reflects losses related to tornados and Midwest flooding. The increases were partially offset by favorable net incurred losses attributable to prior years in the workers compensation line of business.

PTOI for the three and twelve months ended December 31, 2008 was $47 million and $202 million, respectively, decreases of $96 million and $270 million from the same periods in 2007.

AGENCY MARKETS

Overview – Agency Markets

Agency Markets offers personal and commercial insurance coverage to individuals and businesses through independent agents throughout the United States. Products are offered through eight regional insurance companies, Safeco, Summit, and Liberty Mutual Surety. The regional companies leverage the service-oriented focus of a regional company with the cost efficiencies of a national company to deliver quality products and services to independent agents and brokers and the customers they serve. Summit provides workers compensation in the Southeast (primarily Florida). Liberty Mutual Surety provides nationwide contract and commercial surety bonds. Agency Markets expanded its personal, commercial and surety market presence with the acquisition of Safeco on September 22, 2008.

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

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
$ in Millions	**2008[1]**	**2007[2,3,4]**	**Change**	**2008[1]**	**2007[2,3,4]**	**Change**
Regional Companies Commercial Lines	$817	$828	(1.3%)	$3,541	$3,020	17.3%
Regional Companies Personal Lines	362	308	17.5	1,423	948	50.1
Safeco	1,258	-	NM	1,392	-	NM
Summit	27	49	(44.9)	537	697	(23.0)
Liberty Mutual Surety	91	84	8.3	374	312	19.9
Other[5]	40	48	(16.7)	190	135	40.7
Total net written premium	$2,595	$1,317	97.0%	$7,457	$5,112	45.9%

1 Table includes the results of Safeco subsequent to September 22, 2008.
2 Table includes the results of Ohio Casualty subsequent to August 24, 2007.
3 Effective in the first quarter 2008, net written premium associated with Ohio Casualty, previously reported separately, is included in Regional Companies Commercial Lines, Regional Companies Personal Lines, Liberty Mutual Surety and Other. The prior periods have been restated to reflect this change.
4 Effective in the first quarter 2008, net written premium associated with the run-off operations of GoAmerica, previously included in Regional Companies Personal Lines, is included in Other. The prior periods have been restated to reflect this change.
5 Includes excess casualty and other specialty products, run-off operations and internal reinsurance.
NM= Not Meaningful

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008[1]**	**2007[2]**	**Change**	**2008[1]**	**2007[2]**	**Change**
Commercial Lines						
Workers compensation total:	$260	$258	0.8%	$1,464	$1,475	(0.7%)
- Summit	27	49	(44.9)	537	697	(23.0)
- All other	233	209	11.5	927	778	19.2
Commercial multiple peril	471	339	38.9	1,567	1,233	27.1
Commercial automobile	281	186	51.1	921	669	37.7
General liability	121	84	44.0	411	246	67.1
Bond	184	84	119.0	478	312	53.2
Other	83	53	56.6	255	210	21.4
Subtotal	$1,400	$1,004	39.4%	$5,096	$4,145	22.9%
Personal Lines						
Private passenger automobile	$802	$186	NM	$1,514	$575	163.3%
Homeowners	322	107	NM	708	339	108.8
Other	71	20	NM	139	53	162.3
Subtotal	$1,195	$313	NM	$2,361	$967	144.2%
Total net written premium	$2,595	$1,317	97.0%	$7,457	$5,112	45.9%

1 Table includes the results of Safeco subsequent to September 22, 2008.
2 Table includes the results of Ohio Casualty subsequent to August 24, 2007.
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2008 was $2.595 billion and $7.457 billion, respectively, increases of $1.278 billion and $2.345 billion over the same periods in 2007. The increases reflect the impact of the Safeco ($1.258 billion and $1.392 billion in the quarter and year-to-date, respectively) and Ohio Casualty (approximately $926 million year-to-date) acquisitions and organic growth in personal lines due to strong retention and an increase in new business. These increases represent additional written premium of approximately $827 million and $1.190 billion for personal lines in the quarter and year-to-date, respectively, and approximately $431 million and $1.128 billion for commercial lines in the quarter and year-to-date, respectively. The increases in both periods were partially offset by modest rate decreases and lower retention due to a more competitive environment and a reduction in exposure due to the contraction of the Florida economy.

Results of Operations – Agency Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008[1]**	**2007[2]**	**Change**	**2008[1]**	**2007[2]**	**Change**
Revenues	$3,104	$1,643	88.9%	$8,245	$5,569	48.1%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$266	$140	90.0%	$678	$436	55.5%
Catastrophes[3]:						
-September 2008 Hurricanes	(16)	-	NM	(108)	-	NM
-All other	(41)	(24)	70.8	(242)	(90)	168.9
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	3	(100.0)	-	2	(100.0)
- All other[4]	291	199	46.2	581	486	19.5
Current accident year re-estimation[5]	-	(43)	(100.0)	-	-	-
Pre-tax operating income	$500	$275	81.8%	$909	$834	9.0%

1 Table includes the results of Safeco subsequent to September 22, 2008.
2 Table includes the results of Ohio Casualty subsequent to August 24, 2007
3 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned premiums and earned reinstatement premiums.
4 Net of earned premium attributable to prior years of ($12) million and ($23) million for the three and twelve months ended December 31, 2008, respectively, and ($12) million and ($9) million for the comparable periods of 2007.
5 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007.
NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were $3.104 billion and $8.245 billion, respectively, increases of $1.461 billion and $2.676 billion over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2008 was $2.819 billion and $7.476 billion, respectively, increases of $1.344 billion and $2.428 billion over the same periods in 2007. The increases reflect approximately $888 million of premium related to the Ohio Casualty acquisition in the year-to-date period, $1.363 billion and $1.498 billion of premium related to the Safeco acquisition in the quarter and year-to-date, respectively, and organic premium growth in 2007 and 2008. The increase in both periods was partially offset by a decrease in Summit workers compensation premium of $39 million and $128 million in the quarter and year-to-date, respectively, due to state mandated rate decreases and the contracting economy in Florida.

Net investment income for the three and twelve months ended December 31, 2008 was $252 million and $688 million, respectively, increases of $100 million and $231 million over the same periods in 2007. The increases in both periods reflect an increase in invested assets assumed from the Safeco acquisition and the continued investment of cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 were $2.604 billion and $7.336 billion, respectively, increases of $1.236 billion and $2.601 billion over the same periods in 2007. The increase in the year-to-date period primarily reflects the impact of the Ohio Casualty and Safeco acquisitions and higher catastrophe losses, which includes losses related to tornados, mainly in Tennessee, Midwest storm activity and the September 2008 Hurricanes. In addition, the increase in both periods reflects an increase in non-catastrophe property losses due in part to adverse weather conditions, and higher auto physical damage losses due to an increase in frequency and general cost increases. The increases in both periods were partially offset by better than expected frequency and severity trends together with favorable incurred loss development attributable to prior years primarily related to liability lines and the impact of the 2007 current accident year re-estimation in the quarter in liability lines.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
AGENCY MARKETS	**2008[1,2]**	**2007[2,3]**	**Change (Points)**	**2008[1,2]**	**2007[2,3]**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	65.0%	64.3%	0.7	65.9%	66.0%	(0.1)
Underwriting expense ratio	30.9	33.9	(3.0)	32.0	32.4	(0.4)
Dividend ratio	0.3	1.5	(1.2)	0.5	1.1	(0.6)
Subtotal	96.2	99.7	(3.5)	98.4	99.5	(1.1)
Catastrophes[4]:						
-September 2008 Hurricanes	0.6	-	0.6	1.4	-	1.4
-All other	1.4	1.6	(0.2)	3.2	1.8	1.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(10.3)	(13.6)	3.3	(7.7)	(9.7)	2.0
Current accident year re-estimation[5]	-	2.9	(2.9)	-	-	-
Total combined ratio	87.9%	90.6%	(2.7)	95.3%	91.6%	3.7

1 Table includes the results of Safeco subsequent to September 22, 2008.
2 One-time Safeco integration costs have been excluded from the combined ratio. The prior year has been restated to exclude one-time Ohio Casualty integration costs.
3 Table includes the results of Ohio Casualty subsequent to August 24, 2007.
4 Catastrophes include all current and prior year catastrophe losses assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned premiums and earned reinstatement premiums.
5 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007.

The Agency Markets combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation for the three and twelve months ended December 31, 2008 was 96.2% and 98.4%, respectively, decreases of 3.5 points and 1.1 point from the same periods in 2007. The increase in the claims and claim adjustment expense ratio in the quarter was driven by an increase in non-catastrophe property losses and a more competitive rate environment**.** The decrease in the claims and claim adjustment expense ratio year-to-date overall reflects favorable liability experience partially offset by an increase in non-catastrophe property losses. The decrease in the underwriting expense ratio in both periods reflect the impact of writing more personal lines business, which has a lower expense ratio and primarily lower premium assessments in the fourth quarter. The combined ratio in both periods also was impacted by a decrease in dividends incurred in Florida.

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 twelve months ended December 31, 2008 was 87.9% and 95.3%, respectively, a decrease of 2.7 points and an increase of 3.7 points versus the same periods in 2007. The decrease in the quarter primarily reflects the changes in the combined ratio previously discussed and the impact of the re-estimation of losses in 2007 related to liability lines that did not recur in the current year offset by a decrease in favorable incurred losses attributable to prior years and higher catastrophe losses. The increase in the year primarily reflects the changes in the combined ratio previously discussed offset by higher catastrophe losses and the impact of a 2.0 point decrease in favorable incurred losses attributable to prior years.

PTOI for the three and twelve months ended December 31, 2008 was $500 million and $909 million, respectively, increases of $225 million and $75 million over the same periods in 2007.

INTERNATIONAL

Overview – International

International provides insurance products and services through two distinct approaches: local businesses, which sell personal and commercial lines products in specified countries, and LIU, which sells specialty commercial lines insurance and reinsurance through broker networks worldwide. International's local business operations consist of local insurance company operations selling traditional property and casualty, health and life insurance products to individuals and small businesses in countries with a large and growing middle class. Private passenger automobile insurance is the predominant line of business. In South America, International operates in Venezuela, Argentina, Colombia, Brazil and Chile. In Asia, International writes business in Singapore, Thailand, Vietnam and China (including Hong Kong). In Europe, the Company operates in Spain, Portugal, Poland and Turkey. LIU writes casualty, specialty casualty, marine, energy, construction and aviation coverages through offices in Asia, Australia, Europe, the Middle East and North America. LIU, through its Lloyd's Syndicate 4472, also provides multi-line insurance and reinsurance, including property catastrophe reinsurance, on a worldwide basis.

International net written premium by market segment was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
International Local Businesses Total	$1,061	$931	14.0%	$4,185	$3,296	27.0%
- Latin America	684	513	33.3	2,558	1,748	46.3
- Europe	324	374	(13.4)	1,410	1,374	2.6
- Asia Pacific	53	44	20.5	217	174	24.7
Liberty International Underwriters	670	534	25.5	2,572	2,418	6.4
Total net written premium (NWP)	$1,731	$1,465	18.2%	$6,757	$5,714	18.3%
Foreign exchange effect on growth			(9.3%)			2.8%
NWP growth excluding foreign exchange			27.5%			15.5%

International's major product lines are as follows:

(1) Local businesses: personal, primarily private passenger automobile, and commercial insurance;
(2) LIU reinsurance: includes multi-line insurance and reinsurance with an emphasis on property, treaty casualty, personal accident, aviation and reinsurance through Lloyd's Syndicate 4472;
(3) LIU inland marine program: cell phone replacement coverage for lost or damaged devices;
(4) LIU third party: includes casualty, excess casualty, D&O, E&O, professional liability, environmental impairment liability , railroad and other;
(5) LIU first party: includes marine, energy, construction, aviation, and property; and
(6) LIU other: includes workers compensation, commercial automobile, surety, trade credit, crisis management and residual value.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Local businesses – private passenger auto	$646	$562	14.9%	$2,554	$1,969	29.7%
Local businesses – all other[1]	415	369	12.5	1,631	1,327	22.9
LIU reinsurance	250	184	35.9	969	1,009	(4.0)
LIU inland marine program	160	137	16.8	620	561	10.5
LIU third party	194	125	55.2	711	519	37.0
LIU first party	62	77	(19.5)	230	291	(21.0)
LIU other	4	11	(63.6)	42	38	10.5
Total net written premium	$1,731	$1,465	18.2%	$6,757	$5,714	18.3%

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

Net written premium for the three and twelve months ended December 31, 2008 was $1.731 billion and $6.757 billion, respectively, increases of $266 million and $1.043 billion over the same periods in 2007. The increases in both periods reflect organic growth in the local businesses, primarily in Latin America and the acquisition of Indiana Seguros (approximately $42 million and $207 million in the quarter and year-to-date, respectively). The increase in the quarter, which reflects higher non-natural catastrophe exposed net written premium from LIU's reinsurance business, was offset by weaker foreign currencies versus the U.S. dollar (approximately $137 million). The increase in the year reflects stronger foreign currencies versus the U.S. dollar (approximately $163 million). Growth in both periods also reflects a decrease in the amount of ceded written premium in LIU's third party business due to a change in the structure of a reinsurance program and the continued expansion of LIU's inland marine program, partially offset by a reduction in aggregate exposure in LIU reinsurance. The increases in both periods were partially offset by rate decreases in LIU's reinsurance, first party and third party businesses due to a more competitive environment as well as an increase in ceded written premium in LIU's first party business.

Results of Operations – International

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	$1,824	$1,627	12.1%	$7,049	$6,138	14.8%
PTOI before catastrophes and net incurred losses attributable to prior years	$151	$65	132.3%	$587	$403	45.7%
Catastrophes[1, 2]:						
-September 2008 Hurricanes	(66)	-	NM	(167)	-	NM
-All other	(22)	(3)	NM	(22)	(3)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	189	38	NM	285	78	NM
Pre-tax operating income	$252	$100	152.0%	$683	$478	42.9%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Assumed catastrophe losses related to the September 2008 Hurricanes reflect the impact of net catastrophe reinsurance premium earned of $16 million and $23 million for the three and twelve months ended December 31, 2008, respectively.

3 Net of earned premium attributable to prior years of ($4) million and ($6) million for the three and twelve months ended December 31, 2008, respectively, and ($2) million and $3 million for the comparable periods of 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were $1.824 billion and $7.049 billion, respectively, increases of $197 million and $911 million over the same periods in 2007. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2008 was $1.613 billion and $6.329 billion, respectively, increases of $154 million and $839 million over the same periods in 2007. The increases in both periods reflect the earned premium associated with the changes in net written premium in 2007 and 2008. The impact of foreign exchange on the growth was approximately ($127) million and $149 million in the quarter and year-to-date, respectively.

Net investment income for the three and twelve months ended December 31, 2008 was $161 million and $616 million, respectively, increases of $11 million and $81 million over the same periods in 2007. The increases in both periods primarily reflect a higher invested asset base. The impact of foreign exchange on the increase was approximately ($9) million and $14 million in the quarter and year-to-date, respectively.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 were $1.560 billion and $6.407 billion, respectively, increases of $29 million and $743 million over the same periods in 2007. The increases in both periods primarily reflect business growth in the local businesses, primarily in Latin America, including the acquisition of Indiana Seguros, and higher catastrophe losses related to the 2004, 2005 and September 2008 Hurricanes in LIU's first party and reinsurance lines of business. The increase year-to-date also reflects stronger foreign currencies versus the U.S. dollar. The increases in both periods were partially offset by an increase in the amount of favorable incurred loss development attributable to prior years primarily from the local businesses in Europe, LIU's third party, first party and reinsurance lines of business. This favorable development comes primarily from the three most recent accident years and is a result of a prudent approach to recognizing the benefit of improving loss trends. The year-to-date increase was partially offset by a reduction in severe large loss events within LIU's reinsurance business in 2008 versus 2007.

INTERNATIONAL	Three Months Ended December 31, 2008	2007	Change (Points)	Twelve Months Ended December 31, 2008	2007	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	68.7%	73.2%	(4.5)	68.3%	70.1%	(1.8)
Underwriting expense ratio	31.5	30.8	0.7	31.7	31.0	0.7
Dividend ratio	-	-	-	-	-	-
Subtotal	100.2	104.0	(3.8)	100.0	101.1	(1.1)
Catastrophes[1]:						
-September 2008 Hurricanes	4.1	-	4.1	2.7	-	2.7
-All other	1.3	0.2	1.1	0.3	0.1	0.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(11.8)	(2.6)	(9.2)	(4.6)	(1.5)	(3.1)
Total combined ratio	93.8%	101.6%	(7.8)	98.4%	99.7%	(1.3)

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. Hurricanes, the 2005 U.S. Hurricanes and the September 2008 Hurricanes. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2008 was 100.2% and 100%, respectively, decreases of 3.8 points and 1.1 points from the comparable periods in 2007. The decreases in the claims and claim adjustment expense ratio in both periods primarily reflect a decline in loss activity within LIU's reinsurance business resulting from less severe large loss events (excluding the September 2008 Hurricanes) in 2008 versus 2007, partially offset by the effects of a more competitive rate environment on LIU's reinsurance, first party and third party businesses. The year-to-date decrease in the claims and claim adjustment expense ratio is partially offset by increased loss activity within LIU's first party business. The year-to-date increase in the underwriting expense ratio was primarily due to higher acquisition costs in Latin America and Europe. The increases in the underwriting expense ratio in both periods reflect a change in the structure of a reinsurance program in LIU's third party business, which reduced the amount of ceding commissions received versus 2007.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2008 was 93.8% and 98.4%, respectively, decreases of 7.8 points and 1.3 points from the comparable periods in 2007. These movements reflect the aforementioned changes in the combined ratio components, the impact of catastrophe losses related to the 2004, 2005 and September 2008 Hurricanes in LIU's first party and reinsurance lines of business and an increase in the amount of favorable incurred loss development attributable to prior years.

PTOI for the three and twelve months ended December 31, 2008 was $252 million and $683 million, respectively, increases of $152 million and $205 million over the comparable periods in 2007.

CORPORATE AND OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Certain internal discontinued operations composed of: asbestos, environmental, toxic tort exposures, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation, certain distribution channels related to PruPac, and pre-2004 Commercial Markets assumed voluntary reinsurance business.

- Interest expense on the Company's outstanding debt.

- As part of its risk management program, the Company reinsures certain risks of its SBUs. Additionally, effective in 2007, Corporate assumes loss development associated with Commercial Markets pre-2005 fully insured workers compensation business.

- The Company reports its written premiums on workers compensation contracts on the "booked as billed" method. Commercial Markets and Agency Markets report workers compensation written premiums on the "booked at inception" method. Corporate and Other results reflect the difference between these two methods.

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

- For presentation in this MD&A, domestic property and casualty operations' investment income is allocated to the business units based on planned ordinary investment income returns by investment category. Investments are allocated to the business units in an amount equal to their respective liabilities net of insurance assets (reinsurance, premiums receivable, etc.) plus allocated statutory policyholders' surplus. The difference between allocated net investment income and actual net investment income is included in Corporate and Other.

- Income (loss) related to limited partnership and limited liability company investments.

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

- Effective January 1, 2008, individual life, previously included in Corporate and Other, is now included with the Personal Markets segment. All prior periods have been restated.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Reinsurance, net	($517)	$58	NM	($337)	$273	NM
Workers compensation[1]	48	86	(44.2%)	18	7	157.1%
Other	3	-	NM	8	4	100.0
Total net written premium	($466)	$144	NM	($311)	$284	NM

[1] Booked as billed adjustment
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2008 was ($466) million and ($311) million, respectively, decreases of $610 million and $595 million from the same periods in 2007. The decrease in the both periods is primarily driven by an increase in externally ceded reinsurance. In the quarter, the Company entered into a reinsurance contract where the Company cedes a pro rata portion of consolidated U.S. direct written homeowners premiums. For the fourth quarter and year-to-date, the impact on net written premium was $528 million. The decrease in the quarter is also driven by a decrease in the Company's workers compensation "booked as billed" adjustment. The year-to-date decrease is partially offset by an increase in internal reinsurance premiums.

Results of Operations – Corporate and Other

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2008**	**2007**	**Change**	**2008**	**2007**	**Change**
Revenues	($157)	$452	NM	$73	$1,232	(94.1%)
PTOI before catastrophes and net incurred losses attributable to prior years	($413)	($150)	175.3%	($367)	($129)	184.5%
Catastrophes[1]:						
-September 2008 Hurricanes	(37)	-	NM	(117)	-	NM
-All other	2	11	(81.8)	(9)	13	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(2)	(65)	(96.9)	(7)	(160)	(95.6)
- All other[3]	8	(157)	NM	(19)	(519)	(96.3)
Pre-tax operating loss	($442)	($361)	22.4%	($519)	($795)	(34.7%)

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472). Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums of $13 million and $19 million for the three and twelve months ended December 31, 2008 respectively and ($1) million and ($2) million for the comparable periods of 2007.

2 Net of allowance for uncollectible reinsurance reduction of zero and $7 million for the three and twelve months ended December 31, 2008, and ($14) million and ($11) million for the comparable periods of 2007.

3 Net of amortization of deferred gains on retroactive reinsurance of $12 million and $27 million for the three and twelve months ended December 31, 2008, and $6 million and $21 million for the comparable periods of 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2008 were ($157) million and $73 million, respectively, decreases of $609 million and $1.159 billion from the same periods in 2007. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2008 was $35 million and $176 million, respectively, decreases of $31 million and $69 million from the same periods in 2007. The decreases in both periods reflect an increase in external ceded reinsurance.

Net investment income (loss) gain for the three and twelve months ended December 31, 2008 was ($143) million and $31 million, respectively, decreases of $206 million and $397 million from the same periods in 2007. The decreases in both periods primarily reflect a decrease in income from investments in limited partnerships and limited liability companies due to reduced valuations and IPO/takeover activities as compared to the same periods in 2007, lower investment yields and a shift to tax-exempt securities. Partially offsetting the decreases in both periods was an increase in interest income, primarily due to a higher invested asset base resulting from the continued investment of cash flow from operations and cash proceeds received from the May 2008 debt issuance. In addition, interest income increased slightly as a result of net assets assumed from the acquisition of Safeco.

Net realized investment losses for the three and twelve months ended December 31, 2008 were $75 million and $259 million, compared to gains of $296 million and $438 million in the same periods of 2007. Both periods reflect higher impairment losses due to a change in management's ability and intent to hold certain equity investments to recovery in light of the decision to reduce the Company's exposure to the equity markets, as well as fixed maturity and equity securities deemed to be other-than-temporarily impaired due to recent market conditions (see the Investments section of this MD&A for details regarding other-than-temporary impairments). Additionally, the year-to-date change includes impairment losses on fixed maturity investments related to securities sold to raise funds for the acquisition of Safeco and lower realized gains from the Company's energy operations. Partially offsetting these losses were net derivative gains of $215 million and $331 million for the three and twelve months ended December 31, 2008, respectively, primarily related to derivative contracts the Company entered to partially hedge its equity exposure.

Fee and other revenues for the three and twelve months ended December 31, 2008 were $26 million and $125 million, a decrease of $1 million and an increase of $4 million versus the same periods in 2007. Results in both periods primarily reflect an increase in oil and gas revenues, partially offset by the loss of revenue associated with the sale of a Company owned property in 2007.

Claims, benefits and expenses for the three and twelve months ended December 31, 2008 were $360 million and $851 million, respectively, decreases of $157 million and $738 million from the same periods in 2007. The decreases in both periods primarily reflect a decrease in the amount of unfavorable incurred losses attributable to prior years primarily related to pre-2005 fully insured workers compensation business and assumed voluntary reinsurance business. In addition, variable incentive compensation and other corporate expenses decreased in both periods, partially offset by an increase in catastrophe losses primarily related to the September 2008 Hurricanes resulting from internal reinsurance programs, an increase in unfavorable variable annuity reserves development and higher interest expense as a result of the Company's March 2007 and May 2008 debt offerings. Additionally, the year-to-date change was impacted by a $90 million increase in asbestos reserves related to the Company's completion of its biennial ground-up asbestos study in the third quarter of 2007 which did not recur in 2008.

Pre-tax operating loss for the three and twelve months ended December 31, 2008 was $442 and $519 million, an increase of $81 million and a decrease of $276 million versus the same periods in 2007.

INVESTMENTS

General

The Company's investment strategy seeks long-term returns through disciplined security selection, portfolio diversity and an integrated approach to risk management. The Company selects and monitors investments to balance the goals of safety, stability, liquidity, growth and after-tax total return with its need to comply with regulatory investment requirements. A relatively safe and stable income stream is achieved by maintaining a broadly based portfolio of investment grade bonds. These holdings are supplemented by investments in additional asset types with the objective of further enhancing the portfolio's diversification and expected returns. These additional asset types include commercial mortgages and other real estate financing investments, non-investment grade bonds, including syndicated bank loans, common and preferred stock, private equity and direct investments in energy ventures. Risk management is accomplished through asset liability management (including both interest rate risk and foreign currency risk), diversification, credit limits and a careful analytic review of each investment decision.

The Company's investment policy and strategy are reviewed and approved by the Investment Committee of its Board of Directors, which meets on a regular basis to review and consider investment activities, tactics and new investment classes. In addition, the Company has an experienced team of investment personnel responsible for managing and administering the investment portfolios of its domestic and foreign insurance operations.

Invested Assets (including cash and cash equivalents)

The following table summarizes the Company's invested assets by asset category as of December 31, 2008 and December 31, 2007:

$ in Millions	**As of December 31, 2008**		**As of December 31, 2007**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$47,731	79.9%	$46,934	82.1%
Equity securities, available for sale, at fair value	1,184	2.0	3,285	5.7
Trading securities, at fair value	1	-	16	-
Limited partnerships and limited liability companies	2,534	4.2	2,134	3.7
Commercial mortgage loans	1,090	1.8	657	1.2
Short-term investments	1,193	2.0	764	1.3
Other investments	194	0.3	214	0.4
Cash and cash equivalents	5,848	9.8	3,199	5.6
Total invested assets	$59,775	100.0%	$57,203	100.0%

Total invested assets as of December 31, 2008 were $59.775 billion, an increase of $2.572 billion or 4.5% over December 31, 2007. The increase reflects $8.231 billion in invested assets as of December 31, 2008 that were acquired with the Safeco acquisition on September 22, 2008 and investment of cash from operations. Partially offsetting the increase was the liquidation of assets to fund the Safeco acquisition, an increase in unrealized losses primarily due to an increase in credit spreads and a general decline in both the fixed income and equity markets.

Fixed maturities as of December 31, 2008 were $47.731 billion, an increase of $797 million or 1.7% over December 31, 2007. The increase reflects net fixed maturities acquired from the Safeco acquisition offset by the market value declines in fixed income securities and the previously mentioned liquidation of securities to fund the acquisition.

Equity securities available for sale as of December 31, 2008 were $1.184 billion ($694 million common stock and $490 million preferred stock versus $2.692 billion common stock and $593 million preferred stock as of December 31, 2007), a decrease of $2.101 billion or 64% from December 31, 2007. Of the $694 million of common stock at December 31, 2008, $173 million relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The decrease in total equity securities available for sale primarily reflects the execution of a program to reduce the Company's existing and acquired exposure to the common equity markets as well as other-than-temporary impairments on preferred stocks. Additionally, unrealized gains decreased year-over-year related to a general decline in equity market indices.

Investments in limited partnerships and limited liability companies as of December 31, 2008 were $2.534 billion, an increase of $400 million or 18.7% over December 31, 2007. These investments consist of traditional private equity partnerships of $1.565 billion, other partnerships (primarily energy) of $502 million, and real estate partnerships of $467 million. The increase over December 31, 2007 reflects new investments across all three categories as the Company continues to diversify its private equity portfolio. The Company's investments in limited partnerships and limited liability companies are long-term in nature and highly illiquid. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Commercial mortgage loans as of December 31, 2008 were $1.090 billion (net of $1 million of loss reserve or 0.09% of the outstanding loan portfolio), an increase of $433 million or 65.9% over December 31, 2007. The increase reflects $462 million of new capital loaned, net of $29 million in principal repayments. The entire commercial loan portfolio is U.S. based. As of December 31, 2008, the average total loan size was $1.4 million and the average loan participation size was $0.5 million. The number of loans in the portfolio increased from 1,406 at December 31, 2007 to 2,257 at December 31, 2008. Approximately 90% of the loans are full or partial recourse to borrowers.

Short term investments as of December 31, 2008 were $1.193 billion, an increase of $429 million or 56.2% over December 31, 2007. This increase reflects short term assets assumed from the acquisition of Safeco, and short term assets received as collateral in connection with the Company's security lending program.

Cash and cash equivalents as of December 31, 2008 were $5.848 billion, an increase of $2.649 billion or 82.8% due primarily to cash generated from operations, the previously mentioned security sales, deliberately increasing liquidity resources, and an overall reduction in investment opportunities due to lack of new issues, market illiquidity and unprecedented volatility in the markets.

In January 2008, the Company adopted FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, which establishes a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value. As of December 31, 2008, excluding separate accounts and other assets, the Company reflected $1.688 billion as level 1 (quoted prices in active markets) and this primarily comprised 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 December 31, 2008, the Company reported $47.429 billion as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported $1.142 billion as level 3 (unobservable inputs) and this primarily comprised international and privately held securities for which a market price is not readily available.

As of December 31, 2008, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of $1.014 billion, $442 million and $503 million respectively. As of December 31, 2008, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair market value of $10 million.

As of December 31, 2008, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.15% of invested assets.

The following table summarizes the Company's fixed maturity portfolio by security type as of December 31, 2008 and December 31, 2007:

$ in Millions	**As of December 31, 2008**			**As of December 31, 2007**		
Fixed Maturities by Security Type	**Book Value**	**Market Value**	**MV % of Total**	**Book Value**	**Market Value**	**MV % of Total**
U.S. Government and agency securities	$2,105	$2,375	5.0%	$3,156	$3,318	7.1%
Mortgage and asset-backed securities	12,265	12,000	25.1	13,459	13,491	28.7
U.S. state and municipal	14,277	13,718	28.7	9,902	10,001	21.3
Corporate and other	18,637	17,007	35.7	17,636	17,438	37.2
Foreign government securities	2,618	2,631	5.5	2,695	2,686	5.7
Total fixed maturities	$49,902	$47,731	100.0%	$46,848	$46,934	100.0%

The changes in asset allocation as of December 31, 2008 compared to December 31, 2007 are primarily driven by the Safeco acquisition.

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of December 31, 2008:

$ in Millions	As of December 31, 2008							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$1,114	$-	$-	$-	$-	$-	$1,114	9.3%
GNMA residential mortgage	903	-	-	-	-	-	903	7.5
FNMA residential mortgage	2,721	-	-	-	-	-	2,721	22.6
FHLMC residential mortgage	4,065	-	-	-	-	-	4,065	33.9
Prime residential mortgage	486	16	9	5	-	-	516	4.3
Alt-A residential mortgage	130	-	15	6	-	-	151	1.3
Sub-prime residential mortgage	59	18	5	1	-	3	86	0.7
Commercial mortgage backed securities	1,881	76	14	7	-	-	1,978	16.5
Non-mortgage asset backed securities	333	48	45	34	3	3	466	3.9
Total	$11,692	$158	$88	$53	$3	$6	$12,000	100%
% of Total	97.4%	1.3%	0.7%	0.5%	-	0.1%	100%	

More than 73% of the Company's securitized portfolio is explicitly backed by the U.S. government (GNMA and SBA) or by government-sponsored entities (FHLMC and FNMA). Over 97% of these holdings remain rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with 98.9% rated AA or above, approximately 20% of the underlying collateral having been defeased with U.S. Treasuries, and less than 10% of the holdings backed by 2006 to 2008 vintage transactions.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of December 31, 2008 and December 31, 2007:

$ in Millions	As of December 31, 2008		As of December 31, 2007	
Fixed Maturities by Credit Quality[1]	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$21,786	45.6%	$24,576	52.4%
AA+, AA, AA-	9,162	19.2	7,586	16.2
A+, A, A-	9,156	19.2	7,196	15.3
BBB+, BBB, BBB-	4,776	10.0	4,405	9.4
BB+, BB, BB-	1,575	3.3	1,797	3.8
B+, B, B-	897	1.9	1,165	2.5
CCC or lower	379	0.8	209	0.4
Total fixed maturities	$47,731	100.0%	$ 46,934	100.0%

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

The Company's allocation to investment grade securities increased slightly to 94.0% at December 31, 2008 from 93.3% December 31, 2007. The change reflects the mix of securities liquidated to fund the Safeco acquisition and the assets acquired with the acquisition. Overall, the average credit quality rating stands at AA-.

The Company had 6.0% of its fixed maturity securities invested in non-investment grade securities at December 31, 2008. The Company's holdings of below investment grade securities primarily consist of an actively managed diversified portfolio of high yield securities and loans within the domestic insurance portfolios and investments in emerging market sovereign and corporate debt primarily in support of the Company's international insurance companies.

The following table summarizes the Company's allocation of fixed maturities by maturity date as of December 31, 2008 and December 31, 2007:

$ in Millions	**As of December 31, 2008**		**As of December 31, 2007**	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,669	3.5%	$1,376	3.0%
Over 1 yr through 5 yrs	9,764	20.5	9,295	19.8
Over 5 yrs through 10 yrs	9,689	20.3	9,567	20.4
Over 10 years	14,609	30.6	13,205	28.1
Mortgage and asset-backed securities	12,000	25.1	13,491	28.7
Total fixed maturities	$47,731	100.0%	$46,934	100.0%

During 2008, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company made only minor adjustments to the average life of its investment portfolio.

Net Investment Income

The following table summarizes the Company's net investment income for the three and twelve months ended December 31, 2008 and 2007:

$ in Millions	**Three Months Ended December 31,**		**Twelve Months Ended December 31,**	
Net Investment Income	**2008**	**2007**	**2008**	**2007**
Taxable interest income	$620	$580	$2,349	$2,211
Tax-exempt interest income	156	101	472	342
Dividends	25	23	98	83
Limited partnerships and limited liability companies	(124)	68	4	345
Commercial mortgage loans	22	9	58	27
Other investment income	9	2	27	7
Gross investment income	708	783	3,008	3,015
Investment expenses	(44)	(40)	(128)	(130)
Net investment income	$664	$743	$2,880	$2,885

Net investment income for the three and twelve months ended December 31, 2008 was $664 million and $2.880 billion, respectively, representing decreases of $79 million and $5 million from the same periods in 2007. The decreases in both periods are primarily driven by a decrease in income from investments in limited partnerships and limited liability companies due to reduced valuations and IPO/takeover activities as compared to the same periods in 2007, lower investment yields, and a shift to tax-exempt securities. Partially offsetting these decreases were increases in interest income, primarily due to a higher invested asset base resulting from the continued investment of cash flow from operations and cash proceeds received from the May 2008 debt issuance. In addition, interest income increased slightly as a result of net assets assumed from the acquisition of Safeco.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and twelve months ended December 31, 2008 and 2007:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Three Months Ended December 31, 2008:				
Fixed maturities	($23)	($101)	$-	($124)
Common and preferred stock	(9)	(176)	-	(185)
Other	21	(1)	215	235
Total	($11)	($278)	$215	($74)
Three Months Ended December 31, 2007:				
Fixed maturities	($11)	($11)	$-	($22)
Common and preferred stock	54	(5)	-	49
Other	265	-	-	265
Total	$308	($16)	$-	$292
Twelve Months Ended December 31, 2008:				
Fixed maturities	($57)	($270)	$-	($327)
Common and preferred stock	65	(525)	-	(460)
Other	131	(5)	331	457
Total	$139	($800)	$331	($330)
Twelve Months Ended December 31, 2007:				
Fixed maturities	($7)	($25)	$-	($32)
Common and preferred stock	158	(7)	-	151
Other	332	(15)	-	317
Total	$483	($47)	$ -	$436

$ in Millions	**Three Months Ended December 31,**		**Twelve Months Ended December 31,**	
Components of Net Realized Investment Gains (Losses)	**2008**	**2007**	**2008**	**2007**
Fixed maturities:				
Gross realized gains	$23	$42	$109	$124
Gross realized losses	(147)	(64)	(436)	(156)
Equities:				
Gross realized gains	221	85	341	199
Gross realized losses	(406)	(36)	(801)	(48)
Other:				
Gross realized gains	241	267	469	338
Gross realized losses	(6)	(2)	(12)	(21)
Total net realized investment gains (losses)	($74)	$292	($330)	$436

Net realized investment losses for the three and twelve months ended December 31, 2008 were $74 million and $330 million, respectively, compared to gains of $292 million and $436 million in the same periods in 2007. Both periods reflect higher impairment losses due to a change in management's ability and intent to hold to recovery certain equity investments in light of the decision to reduce the Company's exposure to the equity markets, as well as fixed maturity and equity securities deemed to be other-than-temporarily impaired due to recent market conditions. Additionally, the year-to-date change includes impairment losses on fixed maturity investments related to securities sold to raise funds for the acquisition of Safeco and lower realized gains from the Company's energy operations. Partially offsetting these losses were net derivative gains of $215 million and $331 million for the three and twelve months ended December 31, 2008, respectively, primarily related to derivative contracts the Company entered to partially hedge its equity exposure.

The following table summarizes the Company's significant impairments by issuer for the three and twelve months ended December 31, 2008:

$ in Millions	**Three Months Ended December 31, 2008**				
Impairments by Issuer	**Fixed Maturities**	**Preferred Stock**	**Common Stock**	**Other**	**Total by Issuer**
Allied Capital	$-	$-	($49)	$-	($49)
General Electric	-	-	(14)	-	(14)
Liberty All-Star Equity Fund[1]	-	-	(12)	-	(12)
Residential Accredit Loans	(15)	-	-	-	(15)
Clear Channel	(10)	-	(1)	-	(11)
Other	(76)	(6)	(94)	(1)	(177)
Total by Security Type	($101)	($6)	($170)	($1)	($278)

1 Not affiliated with the Company.

$ in Millions	**Twelve Months Ended December 31, 2008**				
Impairments by Issuer	**Fixed Maturities**	**Preferred Stock**	**Common Stock**	**Other**	**Total by Issuer**
FNMA	($4)	($115)	($9)	$-	($128)
FHLMC	(1)	(111)	(1)	-	(113)
Lehman Brothers	(49)	-	(1)	-	(50)
Allied Capital	-	-	(49)	-	(49)
American International Group (AIG)	(4)	-	(19)	-	(23)
Other	(212)	(34)	(186)	(5)	(437)
Total by Security Type	($270)	($260)	($265)	($5)	($800)

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment as of December 31, 2008:

$ in Millions	**Less Than 12 Months**		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($1)	$25	($1)	$9
Mortgage and asset-backed securities	(422)	2,394	(143)	732
U.S. state and municipal	(491)	7,287	(211)	1,311
Corporate and other	(831)	7,186	(1,035)	4,331
Foreign government Securities	(35)	116	(75)	300
Total fixed maturities	(1,780)	17,008	(1,465)	6,683
Common stock	(60)	308	(21)	37
Preferred stock	(29)	159	(200)	233
Total equities	(89)	467	(221)	270
Total	($1,869)	$17,475	($1,686)	$6,953

Unrealized losses increased from $934 million as of December 31, 2007 to $3.555 billion as of December 31, 2008 primarily due to an increase in credit spreads and a general decline in market values related to both fixed income and equity markets. Unrealized losses less than 12 months increased from $510 million at December 31, 2007 to $1.869 billion as of December 31, 2008 and accounted for $1.359 billion, or 51.9%, of the overall increase in unrealized losses. Unrealized losses greater than 12 months increased from $424 million to $1.686 billion at December 31, 2007 and December 31, 2008 respectively, an increase of $1.262 billion. Included in the $1.686 billion of unrealized losses were $411 million of securities that had been in an unrealized loss position of 10% or greater for more than twelve months. The Company monitors the difference between the amortized cost and estimated fair value of investments to ascertain whether declines in value are temporary in nature. The acquisition of Safeco assets in the third quarter 2008 had a minimal impact on unrealized gains and losses, as these assets were valued at fair value on the date of acquisition on September 22, 2008. The Company has the ability, through significant liquidity and liquidity facilities, and the intent to hold the fixed income securities until the recovery of fair value or maturity.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders’ equity. If the decline is believed to be “other-than-temporary,” the carrying value of the investment is written down to fair value and a realized loss is recorded. As a result of this review, the Company recorded a $101 million impairment loss related to fixed maturities in the fourth quarter 2008 and has concluded that the remaining gross unrealized losses of fixed maturity securities as of December 31, 2008 are temporary.

The gross unrealized losses recorded on equity securities at December 31, 2008 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer’s financial performance and near-term financial prospects. Therefore, these decreases are also viewed as temporary in accordance with the Company’s policy with respect to recognizing impairments in the investment portfolio. The Company recorded $176 million in equity impairment losses in the fourth quarter 2008 that were deemed to be other-than-temporary.

LIQUIDITY AND CAPITAL RESOURCES

General

The liquidity requirements of the insurance subsidiaries are met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims, claim adjustment expenses and operating expenses (underwriting and corporate benefit costs). There are certain cash outflows such as catastrophes and continued settlements of asbestos reserves that are unpredictable in nature and could create increased liquidity needs. The Company believes that the insurance subsidiaries' future business liquidity needs will be met from all the above sources.

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities 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 December 31, 2008 (including cash and cash equivalents) totaled $59.775 billion.

Short-term debt outstanding at December 31, 2008 and December 31, 2007 was as follows:

$ in Millions	**As of December 31, 2008**	**As of December 31, 2007**
Commercial paper	$-	$-
Revolving credit facilities	-	70
Current maturities of long-term debt	-	21
Total short-term debt	$-	$91

The decrease in short-term debt reflects a $70 million reduction in funds borrowed from a credit facility at the Company's Venezuelan subsidiary Inversora Segucar, C.A., a $15 million redemption of the Company's 6.70% Notes, a $4 million redemption of the Company's 5.00% Notes, and a $2 million redemption of the Company's 7.10% Medium Term Notes.

Long-term debt outstanding at December 31, 2008 and December 31, 2007 was as follows:

$ in Millions	**As of December 31, 2008**	**As of December 31, 2007**
4.875% Senior notes, due 2010[1]	$300	$-
7.25% Senior notes, due 2012[1]	204	-
8.00% Prudential notes—series B, due 2013	260	260
7.86% Medium term notes, due 2013	25	25
5.75% Senior notes, due 2014	500	500
7.30% Senior notes, due 2014[2]	200	200
6.70% Senior notes, due 2016	250	250
7.00% Junior 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% Senior notes, due 2034	250	250
6.50% Senior notes, due 2035	500	500
7.50% Senior notes, due 2036	500	500
7.80% Junior subordinated notes, due 2087[4]	700	700
10.75% Junior subordinated notes, due 2088[5]	1,250	-
7.697% Surplus notes, due 2097	500	500
Subtotal	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 million of the outstanding $300 million 4.785% notes due 2010 and $187 million of the outstanding $204 million 7.25% notes due 2012 were exchanged for a like principal amount of newly issued LMGI notes.
[2] Reflects debt originally issued by Ohio Casualty. On December 29, 2008, $180 million of the outstanding $200 million 7.30% notes due 2014 were exchanged for a like principal amount of newly issued LMGI notes.
[3] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.
[4] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.
[5] The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.
[6] Includes net purchase accounting adjustment of $8 million related to Safeco $300 million senior notes, due 2010, Safeco $204 million senior notes, due 2012, and Ohio Casualty $200 million senior notes due 2014.

The increase in long-term debt reflects the issuance of $1.25 billion of Series C junior subordinated notes and the inclusion of the $300 million Senior notes due 2010 and $204 million Senior notes due 2012 acquired with the acquisition of Safeco.

As part of its overall capital strategy, the Company may issue, repurchase or exchange debt depending on market considerations. Debt repurchases, if any, may be done through open market or other appropriate transactions.

Debt Transactions and In-force Credit Facilities

On December 29, 2008, the following transactions occurred:

- LMGI exchanged $281 million of the outstanding $300 million Safeco 4.875% Senior Notes due 2010 for a like principal amount of newly issued LMGI 4.875% Senior Notes due 2010.
- LMGI exchanged $187 million of the outstanding $204 million Safeco 7.25% Senior Notes due 2012 for a like principal amount of newly issued LMGI 7.25% Senior Notes due 2012.
- LMGI exchanged $180 million of the outstanding $200 million Ohio Casualty 7.30% Senior Notes due 2014 for a like principal amount of newly issued LMGI 7.30% Senior Notes due 2014.

Safeco and Ohio Casualty received and accepted the requisite consents to enable each to execute a supplemental indenture governing the Safeco and Ohio Casualty Senior Notes that remain outstanding. In connection with the consents, LMGI paid approximately $5.6 million in consideration to the noteholders. These costs were capitalized and will be amortized into income over the remaining term of the respective newly issued LMGI Senior Notes. The supplemental indenture eliminated substantially all restrictive covenants and eliminated or modified certain events of default.

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

On May 29, 2008, LMGI issued series C junior subordinated notes (the "Series C Notes") with a face amount of $1.25 billion. The Series C Notes are scheduled for redemption on June 15, 2058 with a final maturity of June 15, 2088. LMGI may redeem the Series C Notes in whole or in part, on June 15, 2038 and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or prior to June 15, 2038, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 10.75% up to, but excluding, the final fixed rate interest payment date. In the event the Series C Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 7.12%, payable quarterly in arrears. LMGI has the right to defer interest payments on the Series C Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Series C Notes, LMGI entered into a replacement capital covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, defease or purchase the Series C Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Series C Notes, and may not be enforced by the holders of the Series C Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036).

On June 25, 2007, LMGI increased its commercial paper program, guaranteed by LMIC, from $600 million to $1 billion. The Company issues commercial paper through LMGI. The program is backed by a $750 million five-year revolving credit facility. On January 26, 2009, a lender with a $30 million commitment under LMGI's $750 million revolving credit facility was issued, and agreed to, a cease and desist order by the Office of Thrift Supervision. On February 24, 2009, LMGI entered into a $30 million unsecured revolving credit facility which terminates on July 25, 2010. To date, no funds have been borrowed under the facility.

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

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1 billion, consisting of $700 million Series A junior subordinated notes (the "Series A Notes") and $300 million 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).

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

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

On February 10, 2009, LMIC's application for membership in the Federal Home Loan Bank of Boston was approved. The Board of Directors has approved borrowing of up to $2 billion. To date, no funds have been borrowed.

Interest Expense

Consolidated interest expense for the three and twelve months ended December 31, 2008 was $121 million and $411 million, respectively, increases of $32 million and $91 million over the same periods in 2007. The increases were principally due to the Senior C Notes and debt resulting from the Safeco acquisition. As part of its overall capital strategy, the Company may issue, repurchase or exchange debt depending on market considerations. Debt repurchases, if any, 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 December 31, 2008, the Company, through its downstream subsidiary LMGI, had $5.183 billion of debt outstanding, excluding discount.

The insurance subsidiaries' ability to pay dividends on preferred or common stock is restricted under applicable insurance laws and regulations. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Under the insurance laws of Wisconsin, the domiciliary state of Liberty Mutual Fire Insurance Company ("LMFIC") and Employers Insurance Company of Wausau ("EICOW"), an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC and EICOW could negatively affect LMGI's ability to pay principal and interest on its debt, as could a redomestication, merger or consolidation of LMIC, LMFIC or EICOW to a different domiciliary state.

The authorized control level risk-based capital (as of December 31, 2008) and 2009 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio [1]**		**Dividend Capacity[2]**
RBC Ratios and Dividend Capacity	**2008**	**2007**	**2009**
LMIC [3]	402%	519%	$1,501
LMFIC [3]	501%	507%	$97
EICOW [3]	362%	516%	$95

[1] Authorized control level risk-based capital as defined by the NAIC.
[2] Represents maximum allowable dividend without prior regulatory approval in the state of domicile.
[3] Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group. Effective January 1, 2009, the LMIC pooling percentage decreased from 75.9% to 75.0%, the LMFIC pooling percentage increased from 10.0% to 12.9%, and the EICOW pooling percentage decreased from 10.0% to 8.0%.
NA=Not Available

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

- A management services agreement with LMIC pursuant to which LMGI is entitled to collect certain costs plus a management fee of approximately $50 million in 2009 for services rendered by LMGI employees.
- Liberty Corporate Services LLC ("LCS"), which through its subsidiaries, collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three and twelve months ended December 31, 2008, LCS recorded $90 million and $289 million in pre-tax income, respectively.
- Approximately $80 million of annual dividends related to non-redeemable perpetual preferred stock issuances by LMIC and LMFIC.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $12.330 billion and $14.155 billion at December 31, 2008, and December 31, 2007, respectively. The decrease in surplus primarily reflects the impact of the Safeco acquisition that resulted in approximately $3.6 billion of non-admitted goodwill (due to the regulatory limitation of 10% of adjusted surplus) and unrealized investment losses, partially offset by a capital contribution associated with the Company's May 2008 debt offering and net income (the sum of earnings from the Company's 64 domestic insurance companies and dividends from subsidiaries).

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

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

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years;
- reinsurance recoverables and associated uncollectible reserves;
- impairments to the fair value of the investment portfolio;
- deferred acquisition costs;
- valuation of goodwill and intangible assets; and
- deferred income tax valuation allowance.

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

Certain reclassifications have been made to the 2007 tables to conform to the 2008 tables.

Adoption of New Accounting Standards

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standard 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 Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities,"* ("SFAS 133") are impacted by the application of SFAS 157. The adoption of FAS 157 did not have a material effect on the Company's results of operations, financial position or liquidity. See footnote 11 for further detail.

Effective January 1, 2008, the Company had the option to adopt 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' equity of $41 million.

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 provisions of SFAS 158 are not to be applied retrospectively. The adoption of SFAS 158 as of December 31, 2007 decreased other assets by $245 million, increased other liabilities by $198 million, increased deferred tax assets by $155 million, and decreased AOCI, a component of policyholders' equity by $288 million, 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 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. FIN 48 requires a tabular reconciliation of the change in the aggregate unrecognized tax benefits claimed, or expected to be claimed, in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Discussion also is required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next 12 months. As a result of the adoption, the Company recognized a decrease of approximately $11 million 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 million, including approximately $85 million 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 million accrued as of January 1, 2007.

Future Adoption of New Accounting Standards

None of the new accounting standards that will be adopted by the Company in 2009 is expected to have a material impact on the Company. See Note 1 in the 2008 Unaudited Consolidated Financial Statements for details.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $48.727 billion and $42.992 billion at December 31, 2008 and December 31, 2007, respectively. The increase was primarily due to acquisitions and business growth less the on-going settlement of claims.

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

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

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

Asbestos and Environmental

The Company's A&E reserves for unpaid claims and claim adjustment expenses were $1.396 billion and $1.334 billion at December 31, 2008 and December 31, 2007, respectively, net of reinsurance and including an allowance for uncollectible reinsurance. The year-to-date increase was primarily due to including Safeco A&E liabilities as of December 31, 2008, partially offset by ongoing claim settlement activity.

In the third quarter of 2007, the Company completed its biennial ground-up asbestos reserve study and increased its asbestos reserves by $90 million. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. In addition, an internationally known actuarial consulting firm performed its own independent review of the Company's asbestos reserves and confirmed the reasonableness of the reserve increase.

As part of the internal review, potential exposures of large policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with the latest published actuarial paper on asbestos reserving. Among the factors reviewed in depth by the team specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. Small policyholders were evaluated using aggregate methods that utilized information developed from the large policyholders. Additionally, a provision of pure IBNR was established for the potential emergence of first-time filers of future asbestos claims.

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's 2003 acquisition of PruPac included $190 million and $130 million of gross and net A&E reserves, respectively. Any increase in A&E reserves related to PruPac is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial, Inc.

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties; the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding asbestos and environmental related claims could result in liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

Reinsurance Recoverables

The Company reported reinsurance recoverables of $15.309 billion and $15.518 billion at December 31, 2008 and December 31, 2007, respectively, net of allowance for doubtful accounts. The decrease is primarily due to ongoing settlement activity and the release of ceded IBNR following actuarial review, partially offset by the acquisition of Safeco.

The reinsurance recoverables from Nationwide Indemnity Company have been fully guaranteed by its parent, Nationwide Mutual Insurance Company, which has a financial strength rating of A+ from Standard & Poor's and A+ from A.M. Best. The reinsurance recoverables from state mandated involuntary pools and associations represent the Company's servicing carrier business. As a servicing carrier, the Company retains no direct underwriting risk but instead cedes 100% of the involuntary market premium and losses back to the pool. Payment of losses is shared by the pool participants in proportion to their pool participation. Credit risk with respect to this servicing carrier business is the composite of the cumulative creditworthiness of all participants in their respective pools.

As part of its reinsurance security oversight, the Company has established a Reinsurance Credit Committee that meets quarterly to monitor and review the credit quality of the existing reinsurance portfolio, discuss emerging trends in the reinsurance marketplace, and ensure that the current portfolio of reinsurance is in compliance with the Committee's security standards. The Committee is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company's purchase and use of reinsurance.

Approximately 95% of the Company's reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at December 31, 2008. Collateral held against outstanding gross reinsurance recoverable balances was $4.906 billion and $4.584 billion at December 31, 2008 and December 31, 2007, respectively.

The remaining 5% of the Company's net reinsurance recoverable balance is well diversified. No single reinsurer rated B++ or below by A.M. Best accounts for more than 2% of statutory surplus as regards policyholders. In addition, the average net reinsurance recoverable balance from individual reinsurers rated below A- or not rated by A.M. Best was approximately $1 million as of December 31, 2008.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The Company evaluates and monitors the financial condition of its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. The Company reports its reinsurance recoverables net of an allowance for estimated uncollectible reinsurance recoverables. The allowance is based upon the Company's ongoing review of amounts outstanding, length of collection periods, changes in reinsurer credit standing and other relevant factors. Accordingly, the establishment of reinsurance recoverables and the related allowance for uncollectible reinsurance recoverables is also an inherently uncertain process involving estimates. Changes in these estimates could result in additional income statement charges.

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million) that are amortized into income using the effective interest method over the estimated settlement periods. Deferred gains related to these reinsurance arrangements for the years ended December 31, 2008, and 2007 were $725 million and $786 million, 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, and 2007 was $115 million and $114 million, respectively. Deferred gain amortization for the years ended December 31, 2008, and 2007 was $77 million and $57 million, respectively. Reinsurance recoverables related to these transactions for the years ended December 31, 2008, and 2007, including experience related profit accruals, were $2.165 billion and $2.222 billion, 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. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph. Approximately $1 million and $1 million of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2008, with additional premium of $0 million and $1 million, respectively. Approximately ($2) million and $1 million of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2007, with additional premium of $1 million and $1 million, 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 for GAAP purposes and is amortized into income using the effective interest method over the estimated settlement period.

In 2006, the Company entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 million of additional reinsurance coverage for the Company in the event of a Northeast hurricane. The reinsurance agreements 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 million of additional reinsurance coverage for the Company 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 million of the original $525 million of Mystic Re matured. As no events attached, the respective collateral was released during the 4th quarter of 2008. With respect to all Mystic Re transactions, $350 million of collateral remains in place at December 31, 2008.

Impairment Losses on Investments

The total impairment losses on investments for the three and twelve months ended December 31, 2008 were $278 million and $800 million, respectively, an increase of $262 million and $753 million compared to the same periods in 2007. Unrealized losses that are deemed to be other-than-temporary are recognized as realized losses. The Company's accounting policy for other-than-temporary impairment recognition requires other-than-temporary impairment charges to be recorded when it is determined that the Company is unlikely to recover its cost basis in an investment in the near-term. Among the factors considered in evaluating whether a decline in value is other-than-temporary are: (a) the length of time and extent to which the fair value has been below cost; (b) the financial condition and near-term prospects of the issuer; and (c) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

The Company employs a systematic methodology to evaluate declines in fair value below the book value for equity securities and other investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below carrying value is evaluated in a disciplined manner. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy. Continued turbulence in the financial markets subsequent to the quarter end has not resulted in any additional material other-than-temporary impairments. However, the Company reserves the flexibility to trade any investment as deemed appropriate based on changes in credit or other market factors in managing the invested assets positions of the Company.

Variable Interest Entities

In December 2003, the FASB issued a revision to Interpretation No. 46, *"Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51"* ("FIN 46 (R)"). The Company's exposure to investment structures subject to analysis under FIN 46(R) relate primarily to investments in energy, private equity, and real estate limited partnerships that are accounted for under the equity method. The Company has been deemed to be the primary beneficiary for 2 VIEs in the energy investment sector, therefore it consolidates those 2 VIEs in its financial statements. In addition, the Company has investments in 62 and 40 VIEs for which it is not the primary beneficiary at December 31, 2008 and December 31, 2007, respectively. The Company's investments in VIEs were $623 million and $386 million at December 31, 2008 and December 31, 2007, respectively. The Company's maximum exposure to losses from VIEs was $1.267 billion and $786 million as of December 31, 2008 and December 31, 2007, respectively, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Derivatives

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. As of December 31, 2008, the Company had one interest rate swap remaining that was acquired with the assets and liabilities of the Genesis life insurance business, with a value of approximately $0.3 million. As of December 31, 2007, the Company had two interest rate swaps that were related to the Genesis life insurance business with a value of approximately ($5) million. During 2008, the Company terminated one of these interest rate swaps and realized a $13 million gain on the transaction.

Beginning in January 2008, the Company, as part of its risk management program, diversification, and economic hedging strategies, entered into several futures contracts related to the equities market with notional amounts totaling $599 million. All futures contracts expired in March 2008 and the Company realized gains of $26 million on these transactions. In March 2008, the Company entered into an equity swap agreement with a notional amount of $600 million. This contract was terminated in December 2008 and the Company realized gains of $187 million on this transaction. In August 2008, the Company entered into two equity swap agreements with a total notional amount of $335 million. For the period ending December 31, 2008, these contracts remain outstanding and have incurred a $99 million net gain. These contracts expire in January 2009.

As part of the acquisition of Safeco, the Company acquired an interest rate swap contract hedging Safeco Corporation debt that was terminated on October 1, 2008, and the Company recorded a gain of $6 million on the contract.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were $2.541 billion and $2.045 billion as of December 31, 2008 and December 31, 2007, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses. Acquired in-force policy intangibles are costs associated with the acquisitions of Ohio Casualty and Safeco that equal the fair value of in-force insurance contracts at the date of acquisition.

Goodwill

Goodwill assets were $4.645 billion and $1.962 billion at December 31, 2008 and December 31, 2007, respectively. The increase was due to the acquisitions of Safeco and Indiana Seguros.

Deferred Income Taxes

The net deferred income tax asset was $3.166 billion and $1.469 billion as of December 31, 2008 and December 31, 2007, respectively, net of a valuation allowance of $131 million and $112 million, respectively. The net increase in the Company's valuation allowance is primarily due to increases in the uncertainty of the realization of certain foreign net operating losses, foreign currency translation adjustments and changes in foreign statutory tax rates, offset by decreases due to positive expectations for future realization of certain foreign net operating losses. Management believes it is more likely than not that the Company's net deferred income tax asset will be realized based on the Company's ability and likelihood of generating future taxable income.

The income tax provision is calculated under the liability method. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax bases of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are unrealized capital gains and losses on certain investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs, employee benefits and net operating losses.

The liability for unrecognized tax benefits at January 1, 2008 was $175 million. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (amounts in millions):

Balance at January 1, 2008	$175
Additions based on tax positions related to current year	1
Additions for tax positions of prior years	34
Reductions for tax positions of prior years	(89)
Settlements	(11)
Increases in unrecognized tax benefits acquired or assumed in a business combination	15
Balance at December 31, 2008	$125

Included in the tabular rollforward of unrecognized tax benefits is interest in the amount of $56 million and $17 million at January 1, 2008 and December 31, 2008 respectively.

Included in the balance at December 31, 2008, are $17 million related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. During the years ended December 31, 2008 and 2007, the Company recognized approximately ($40) million and $10 million in interest and penalties. The Company had approximately $12 million and $53 million of interest and penalties accrued at December 31, 2008 and 2007, respectively.

On October 15, 2008, the Company prevailed in its suit for refund of overpaid federal income tax for the 1990 tax year, based on the treatment of salvage and subrogation. The United States District Court, District of Massachusetts, in *Liberty Mutual Insurance Co. v. United States* and *Liberty Mutual Fire Ins. Co. v. United States,* ruled that the amount of income tax refund due and deficiency interest refund due was $42 million and $40 million respectively, plus statutory interest on the income tax and deficiency interest refunds until paid. The Government has the right to appeal the decision.

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

The IRS is currently reviewing the Company's federal tax returns for the 1999 through 2005 tax years. Any adjustments that may result from the IRS examination of these income tax returns are not expected to have a material impact on the financial position, liquidity or results of operations of the Company.

About the Company

Boston-based Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of entities ("LMG" or the "Company"), is a diversified global insurer and sixth largest property and casualty insurer in the U.S. based on 2007 direct written premium. The Company also ranks 94th on the Fortune 500 list of largest corporations in the United States based on 2007 revenue. As of December 31, 2008, LMG had $104.316 billion in consolidated assets, $94.156 billion in consolidated liabilities, and $28.855 billion in annual consolidated revenue.

LMG, through its subsidiaries and affiliated companies, offers a wide range of property-casualty insurance products and services to individuals and businesses alike. In 2001 and 2002, the Company formed a mutual holding company structure, whereby the three principal mutual insurance companies, LMIC, LMFIC and EICOW, each became separate stock insurance companies under the ownership of Liberty Mutual Holding Company Inc.

Functionally, the Company conducts substantially all of its business through four strategic business units: Personal Markets, Commercial Markets, Agency Markets and International. Each business unit operates independently of the others and has dedicated sales, underwriting, claims, actuarial, financial and certain information technology resources. Management believes this structure allows each business unit to execute its business strategy and/or to make acquisitions without impacting or disrupting the operations of the Company's other business units.

LMG employs more than 45,000 people in more than 900 offices throughout the world. For a full description of the Company's business operations, products and distribution channels, please visit Liberty Mutual's Investor Relations web site at www.libertymutual.com/investors.