Liberty Mutual Holding Company Inc.

Fourth Quarter 2009

Consolidated Financial Statements

Liberty Mutual Holding Company Inc.

Consolidated Statements of Income

(dollars in millions)

	Years Ended December 31,		
	2009	**2008**	**2007**
Revenues			
Premiums earned	$ 27,791	$ 25,524	$ 21,887
Net investment income	2,482	2,880	2,885
Fee and other revenues	795	781	744
Net realized investment gains (losses)	26	(330)	436
Total revenues	31,094	28,855	25,952
Claims, Benefits and Expenses			
Benefits, claims and claim adjustment expenses	20,188	18,894	16,118
Insurance operating costs and expenses	4,317	4,105	3,863
Amortization of deferred policy acquisition costs	4,692	3,989	3,281
Interest expense	483	411	320
Interest credited to policyholders	204	203	198
Total claims, benefits and expenses	29,884	27,602	23,780
Income before income tax expense	1,210	1,253	2,172
Income tax expense	187	140	671
Net income	$ 1,023	$ 1,113	$ 1,501

Net Realized Investment Gains (Losses)			
Other-than-temporary impairment losses:	**2009**	**2008**	**2007**
Total other-than-temporary impairment losses (Note 1)	$ (244)	$ (800)	$ (47)
Change in portion of loss recognized in other comprehensive income	13	-	-
Other-than-temporary impairment losses	(231)	(800)	(47)
Other net realized investment gains	257	470	483
Net realized investment gains (losses)	$ 26	$ (330)	$ 436

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Balance Sheets

(dollars in millions)

	December 31, 2009	December 31, 2008
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of $54,789 and $49,902)	$ 56,439	$ 47,731
Equity securities, available for sale, at fair value (cost of $1,077 and $1,279)	1,188	1,184
Short-term investments	575	1,193
Mortgage loans	1,121	1,090
Other investments	2,619	2,729
Total investments	61,942	53,927
Cash and cash equivalents	4,847	5,848
Premium and other receivables (net of allowance of $121 and $136)	7,629	7,834
Reinsurance recoverables (net of allowance of $434 and $344)	14,749	15,163
Deferred income taxes (net of valuation allowance of $160 and $131)	1,691	3,035
Deferred acquisition costs and acquired in-force policy intangibles	2,636	2,541
Goodwill	4,748	4,645
Prepaid reinsurance premiums	1,317	1,565
Separate account assets	3,557	3,062
Other assets	6,359	6,419
Total assets	$ 109,475	$ 104,039
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	$ 48,355	$ 48,311
Life	6,586	6,258
Other policyholder funds and benefits payable	3,300	3,031
Unearned premiums	13,224	12,944
Funds held under reinsurance treaties	1,819	1,855
Short-term and current maturities of long-term debt	305	-
Long-term debt	5,635	6,089
Separate account liabilities	3,557	3,062
Other liabilities	12,180	12,086
Total liabilities	94,961	93,636
Policyholders' equity:		
Unassigned equity	14,014	12,963
Accumulated other comprehensive income (loss)	500	(2,560)
Total policyholders' equity	14,514	10,403
Total liabilities and policyholders' equity	$ 109,475	$ 104,039

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Changes in Policyholders' Equity

(dollars in millions)

	Unassigned Equity	Accumulated Other Comprehensive Income (Loss)	Policyholders' Equity
Balance, January 1, 2007	$ 10,092	$ 803	$ 10,895
Cumulative effect of adoption of ASC 740 at January 1, 2007	11		11
Cumulative effect of accounting change (Note 1)	287	-	287
Comprehensive income			
Net income	1,501	-	1,501
Other comprehensive income, net of taxes:			
Unrealized gains on securities	-	213	213
Less: reclassification adjustment for gains			-
and losses included in net income	-	(283)	(283)
Minimum pension liability adjustment	-	23	23
Foreign currency translation and other adjustments	-	277	277
Other comprehensive income, net of taxes	-	230	230
Total comprehensive income			1,731
Cumulative effect of adoption of ASC 715 at December 31, 2007 (Note 1)		(288)	(288)
Balance, December 31, 2007	$ 11,891	$ 745	$ 12,636
Cumulative effect of adoption of ASC 715 at January 1, 2008 (Note 1)	(41)		(41)
Comprehensive loss			
Net income	1,113	-	1,113
Other comprehensive loss, net of taxes:			
Unrealized losses on securities	-	(2,246)	(2,246)
Less: reclassification adjustment for gains			
and losses included in net income	-	215	215
Change in pension and post retirement plans funded status	-	(869)	(869)
Foreign currency translation and other adjustments	-	(405)	(405)
Other comprehensive loss, net of taxes	-	(3,305)	(3,305)
Total comprehensive loss			(2,192)
Balance, December 31, 2008	$ 12,963	$ (2,560)	$ 10,403
Cumulative effect of adoption of ASC 320 at January 1, 2009 (Note 1)	28	(28)	-
Comprehensive income			
Net income	1,023	-	1,023
Other comprehensive income, net of taxes:			
Unrealized gains on securities	-	2,589	2,589
Less: reclassification adjustment for gains			
and losses included in net income	-	(17)	(17)
Change in pension and post retirement plans funded status	-	298	298
Foreign currency translation and other adjustments	-	218	218
Other comprehensive income, net of taxes	-	3,088	3,088
Total comprehensive income			4,111
Balance, December 31, 2009	$ 14,014	$ 500	$ 14,514

See accompanying notes to the unaudited consolidated financial statements.

Liberty Mutual Holding Company Inc.

Consolidated Statements of Cash Flows

(dollars in millions)

	Years Ended December 31,		
	2009	2008	2007
Cash flows from operating activities:			
Net income	$ 1,023	$ 1,113	$ 1,501
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	350	313	260
Realized investment (gains) losses	(26)	330	(436)
Undistributed private equity investment losses (gains)	423	5	(324)
Premium, other receivables, and reinsurance recoverables	526	572	743
Deferred policy acquisition costs	(131)	(16)	(126)
Liabilities for insurance reserves	197	1,775	2,304
Taxes payable, net of deferred	(173)	(220)	247
Other, net	298	(1,127)	(127)
Total adjustments	1,464	1,632	2,541
Net cash provided by operating activities	2,487	2,745	4,042
Cash flows from investing activities:			
Purchases of investments	(18,874)	(13,668)	(19,719)
Sales and maturities of investments	14,928	18,257	18,405
Property and equipment purchased, net	(355)	(143)	(259)
Payment for purchase of companies, net of cash acquired	-	(5,414)	(2,700)
Other investing activities	173	(185)	(430)
Net cash used in investing activities	(4,128)	(1,153)	(4,703)
Cash flows from financing activities:			
Net activity in policyholder accounts	122	62	34
Debt financing, net	(84)	1,121	889
Net security lending activity and other financing actitivites	621	(65)	(602)
Net cash provided by financing activities	659	1,118	321
Effect of exchange rate changes on cash	(19)	(61)	27
Net (decrease) increase in cash and cash equivalents	(1,001)	2,649	(313)
Cash and cash equivalents, beginning of year	5,848	3,199	3,512
Cash and cash equivalents, end of year	$ 4,847	$ 5,848	$ 3,199
Supplemental disclosure of cash flow information:			
Income taxes paid	$ 366	$ 310	$ 563

See accompanying notes to the unaudited consolidated financial statements.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2008 and 2007 consolidated financial statements to conform with the 2009 presentation. All material intercompany transactions and balances have been eliminated.

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

Nature of Operations
The Company conducts substantially all of its business through four strategic business units: Agency Markets, International, Personal Markets, and Commercial Markets.

The Agency Markets business unit, with $11,928 of revenues in 2009, distributes products through independent agents and brokers. It consists of: eight regionally branded insurance companies that offer commercial insurance coverage to small businesses; personal lines products sold under the Safeco brand; Liberty Mutual Surety (nationwide contract and commercial surety bonds); and Summit, (mono-line workers compensation in the Southeast, primarily Florida).

The Company's International business unit, with $7,589 of revenues in 2009, provides insurance products and services through local businesses outside the United States, which sell personal and small commercial lines products, and Liberty International Underwriters ("LIU") which sells specialty commercial lines worldwide. The local businesses consist of local insurance operations selling property, casualty, health and life insurance products to individuals and businesses in countries with a large and growing middle class. Automobile insurance is the predominant line of business. International operates local businesses in Latin America (Venezuela, Argentina, Colombia, Brazil and Chile); Asia (Singapore, Thailand, Vietnam and China); and Europe (Spain, Portugal, Turkey and Poland). LIU, a global specialty commercial lines insurance and reinsurance business with operations principally based in 18 countries: United States, Canada, Brazil, United Kingdom, Germany, France, the United Arab Emirates, the Netherlands, Spain, Switzerland, Ireland, Australia, Hong Kong, China, Singapore, Malaysia, India and Vietnam. LIU operations provide a variety of specialty products including casualty, marine, construction, energy, inland marine, directors and officers, professional liability, aviation, property, surety and crisis management insurance, together with multi-line insurance and reinsurance written through Lloyd's of London, Syndicate 4472.

The Company's Personal Markets business unit, with $7,001 of revenues in 2009, writes U.S. property and casualty insurance covering personal risks, primarily automobile and homeowners, as well as life and annuity products. Products are distributed through licensed captive sales representatives, telesales counselors, third-party producers, and the Internet.

The Commercial Markets business unit, with $6,028 of revenues in 2009, is organized into separate marketing and underwriting groups focusing on a particular customer base or product grouping to provide tailored products and services that specifically address customers' needs. The Commercial Markets business unit includes National Market, Middle Market, Liberty Mutual Property, Group Benefits, and Other Markets. Other Markets include Liberty Mutual Reinsurance and state-mandated involuntary market workers compensation and automobile assigned risk plans. The Commercial Markets coverages include workers compensation, commercial automobile, general liability, including product liability, commercial multiple peril and fire, group disability and life insurance, property, and a variety of other coverages. Commercial Markets is also a servicing carrier for workers compensation involuntary market pools. In January 2009, the Company established Liberty Mutual Middle Market, a new market segment that combined the Business Market and Wausau Insurance market segments, distributing products through independent agents and brokers. Note 2 contains more detail on this transaction.

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

Effective January 1, 2009, the Company adopted new guidance for determining whether a market is inactive, and if so, whether a transaction in that market is distressed. The new guidance is now part of ASC 820, *Fair Value Measurements and Disclosures*. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Effective January 1, 2008, the Company adopted the guidance related to the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements as codified in ASC 715, *Compensation – Retirement Plans*. The adoption of this guidance resulted in a decrease to policyholders' unassigned equity of $41 (net of tax).

Effective December 31, 2007, the Company adopted the guidance related to accounting for defined benefit pension and other postretirement plans as codified in ASC 715, *Compensation – Retirement Plans*. This guidance 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," a component of policyholders' equity), 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. 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 guidance related to 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 continues to apply. The adoption of this guidance as of December 31, 2007 resulted in a decrease in other assets of $245, an increase in deferred tax assets of $155, an increase in other liabilities of $198, and a decrease in AOCI of $288 (net of tax). The adoption of this guidance did not affect the Company's results of operations or liquidity as it did not affect the determination of net periodic benefit costs.

Future Adoption of New Accounting Standards
In June 2009, the FASB issued revised guidance on the accounting for variable interests. The revised guidance, as codified in ASC 810, *Consolidations,* reflects the elimination of the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has (1) the power to direct the activities of an entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. The Company is adopting this guidance effective January 1, 2010. The adoption will not have a material impact on the Company.

Change in Accounting Principle
In 2009, the Company changed its method of accounting for the discounting of the long-term indemnity portion of workers compensation claims from tabular discount rates based on insurance regulations as approved by the respective jurisdictions to risk-free discount rates determined by reference to the U.S. Treasury yield curve. The weighted average discount rates were 5.5%, 5.7% and 5.9% for 2009, 2008. and 2007, respectively. The Company believes that the use of a risk-free discount rate is more reflective of market rates being earned on the assets supporting the respective liabilities and is therefore preferable to use rather than the imposed regulatory discount rates. The Company applied this change in method by retrospective application to the prior years' financial statements.

The cumulative effect of the change in the method of accounting resulted in an increase in the opening balance of unassigned equity as of January 1, 2007 of $287, net of tax. As of and for the year ended December 31, 2009, the accounting change resulted in increases in reinsurance recoverables (net), deferred taxes (net), unpaid claims and claim adjustment expense – property and casualty, other liabilities, and benefits, claims and claim adjustment expense of $25, $12, $48, $12, and $35, respectively, and decreases in unassigned equity, income tax expense and net income of $23, $12 and $23, respectively. As of and for the year ended December 31, 2008, the accounting change resulted in the following changes to previously reported balances (as a result of retrospective application of the accounting change): decreases in reinsurance recoverables (net), deferred taxes (net), unpaid claims and claim adjustment expense – property and casualty, other liabilities, income tax expense, and net income of $146, $131, $416, $104, $15 and $27, respectively, and increases in unassigned equity and benefits, claims and claims adjustment expense of $243 and $42, respectively. For the year ended December 31, 2007, the accounting change resulted in the following changes to previously reported balances (as a result of retrospective application of the accounting change): an increase in benefits, claims and claims adjustment expense of $26 and decreases in income tax expense and net income of $9 and $17, respectively.

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

(dollars in millions, except per share amounts)

The components of accumulated other comprehensive income (loss), net of related deferred acquisition costs and taxes, for the years ended December 31, 2009, 2008, and 2007 are as follows:

	2009	2008	2007
Unrealized gains (losses) on securities	$1,115	$(1,457)	$574
Foreign currency translation and other adjustments	269	51	456
Pension liability funded status	(856)	(1,154)	(285)
Cumulative effect of adoption of ASC 320 at January 1, 2009	(28)	-	-
Accumulated other comprehensive income (loss)	$ 500	$(2,560)	$745

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation

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

The total purchase price was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was primarily determined using the income approach, which discounts expected cash flows to present value using estimates and assumptions determined by management.

The opening balance sheet was as follows:

Assets:	
Total investments	$ 8,600
Cash and cash equivalents	971
Premium and other receivables	1,071
Reinsurance recoverables	427
Goodwill	2,683
Other assets	1,732
Total assets	$15,484
Liabilities:	
Unpaid claims and claim adjustment expenses	$ 5,314
Unearned premiums	2,301
Long-term debt	505
Other liabilities	1,120
Total liabilities	$ 9,240

In 2009, refinements to the purchase accounting were completed, resulting in a net increase to goodwill of $51, principally attributed to unpaid claims and claim adjustment expenses, reinsurance, and tax adjustments.

(dollars in millions, except per share amounts)

Intangible Assets

	Carrying Value December 31, 2009	Carrying Value December 31, 2008	Period (Years)	Method
Agency relationship	$564	$605	15	Straight-line
Trademarks	229	229	Not subject to amortization	Not subject to amortization
State licenses	63	63	Not subject to amortization	Not subject to amortization
Other (2)	17	4	10	Present Value Mid-year Convention
Total intangible assets(1) (3)	$873	$901		

(1) The above table excludes the acquired in-force policy intangible, which is included in deferred acquisition costs and acquired in-force policy intangibles on the consolidated balance sheet.
(2) In addition to the amortization, as of December 31, 2009, the above table reflects a purchase accounting adjustment to other intangibles of $10.
(3) Net of accumulated amortization of $47 and $9 as of December 31, 2009 and 2008, respectively.

For the years ended December 31, 2009 and 2008, the Company recognized $38 and $9, respectively, of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. Estimated amortization for the years ended December 31, 2010 through 2014 is $42, $42, $43, $44, and $44 respectively.

Integration Activities
As part of the Safeco acquisition, management conducted integration efforts that resulted in employment reductions, contract terminations, systems integrations and other transitional activities. Total integration costs incurred for the years ended December 31, 2009 and 2008, were $65 and $103, respectively, of which $42 and $70, respectively, were recognized as assumed liabilities as part of purchase accounting for the acquisition. Integration costs not directly associated with the acquisition were included in insurance operating costs and expenses in the consolidated statements of income. $77 and $62 of the costs were paid in 2009 and 2008, respectively.

Indiana Seguros, S.A.
On January 9, 2008, the Company, through its Brazilian subsidiary, Liberty International Brazil Ltda., acquired Indiana Seguros, S.A., a writer of auto insurance in Brazil for $143. Goodwill recognized from the transaction was $103. The results of operations of Indiana Seguros, S.A. are included in the Company's financial statements subsequent to January 9, 2008. In 2008, net income for Indiana Seguros, S.A., subsequent to acquisition was $8.

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

The total purchase price was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was primarily determined using the income approach, which discounts expected cash flows to present value using estimates and assumptions determined by management.

(dollars in millions, except per share amounts)

The opening balance sheet was as follows:

Assets:	
Total investments	$4,176
Cash and cash equivalents	105
Premium and other receivables	396
Reinsurance recoverables	584
Goodwill	1,054
Other assets	608
Total assets	$6,923
Liabilities:	
Unpaid claims and claim adjustment expenses	$2,698
Unearned premiums	698
Funds held under reinsurance treaties	113
Long-term debt	207
Other liabilities	427
Total liabilities	$4,143

Intangible Assets

	Carrying Value December 31, 2009	Carrying Value December 31, 2008	Period (Years)	Method
Agency relationship	$132	$140	20	Straight-line
Non-compete agreements	-	1	2	Straight-line
Trademarks	33	33	Not subject to amortization	Not subject to amortization
State licenses	22	22	Not subject to amortization	Not subject to amortization
Total intangible assets(1) (2) (3)	$187	$196		

(1) The above table excludes the acquired in-force policy intangible, which is included in deferred acquisition costs and acquired in-force policy intangibles on the consolidated balance sheet.
(2) In addition to amortization, the December 31, 2008 agency relationship amount reflects a purchase accounting adjustment of $87.
(3) Net of accumulated amortization of $22 and $13 as of December 31, 2009 and 2008, respectively.

For the years ended December 31, 2009 and 2008, the Company recognized $9 and $8, respectively, of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. For each of the years ended December 31, 2010 through 2014, estimated amortization is $8.

Integration Activities
As part of the Ohio Casualty acquisition, management conducted integration efforts, resulting in employment reductions and contract terminations. Total integration costs incurred for the years ended December 31, 2008 and 2007, were $(1) and $38, respectively, of which $0 and $26, respectively, were recognized as assumed liabilities as part of purchase accounting for the acquisition. Integration costs not directly associated with the acquisition were included in insurance operating costs and expenses in the consolidated statements of income. $8, $18 and $11 of the costs were paid in 2009, 2008, and 2007, respectively.

Dispositions
On January 22, 2009, the Company established Liberty Mutual Middle Market, a new market segment in Commercial Markets that combined the former 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. This transaction has been deemed to be a migration of business. 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.

The Company recognized $35 related to restructuring efforts, principally related to employee and contract terminations with respect to the Business Market and Wausau Insurance market segments within Commercial Markets. These costs are primarily included in insurance operating costs and expenses in the 2008 statement of income. Payments under restructuring activities were substantially completed in 2009.

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

(dollars in millions, except per share amounts)

(3) INVESTMENTS

Components of Net Investment Income

	Years Ended December 31,		
	2009	**2008**	**2007**
Taxable interest income	$2,301	$2,349	$2,211
Tax-exempt interest income	623	472	342
Dividends	41	98	83
Limited partnerships and limited liability companies	(411)	4	345
Commercial mortgage loans	68	58	27
Other investment income	9	27	7
Gross investment income	2,631	3,008	3,015
Investment expenses	(149)	(128)	(130)
Net investment income	$2,482	$2,880	$2,885

Components of Net Realized Investment Gains (Losses)

	Years Ended December 31,		
	2009	**2008**	**2007**
Fixed maturities			
Gross realized gains	$173	$109	$124
Gross realized losses	(259)	(436)	(156)
Equities			
Gross realized gains	146	341	199
Gross realized losses	(64)	(801)	(48)
Other			
Gross realized gains	84	469	388
Gross realized losses	(54)	(12)	(21)
Net realized investment gains (losses)	$26	$(330)	$436

As of December 31, 2009, other-than-temporary impairments recognized through accumulated other comprehensive income were $30.

During the years ended December 31, 2009, 2008, and 2007, proceeds from sales of fixed maturities available for sale were $4,859, $7,013, and $8,006, respectively. The gross realized gains and (losses) on such sales totaled $145 and $(67) in 2009, $85 and $(122) in 2008, and $60 and $(81) in 2007.

Components of Change in Net Unrealized Investment Gains (Losses)

	2009	**2008**	**2007**
Fixed maturities	$3,864	$(2,257)	$(35)
Equities	206	(962)	(88)
Other	18	(5)	3
Adjustments to deferred policy acquisition costs	(169)	145	33
Net change in unrealized investment gains (losses)	3,919	(3,079)	(87)
Deferred income tax (expense) benefit	(1,347)	1,048	17
Net change in unrealized investment gains (losses), net of tax	$2,572	$(2,031)	$(70)

(dollars in millions, except per share amounts)

Available for Sale Investments

The gross unrealized gains and losses and fair values of available for sale investments as of December 31, 2009 and 2008, are as follows:

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,324	$149	$(8)	$2,465
Residential mortgage and ABS securities	10,725	404	(140)	10,989
Commercial mortgage and ABS securities	2,163	46	(49)	2,160
Other mortgage and ABS securities	1,849	80	(27)	1,902
U.S. state and municipal	14,910	716	(116)	15,510
Corporate and other	19,134	933	(384)	19,683
Foreign government securities	3,684	128	(82)	3,730
Total fixed maturities	54,789	2,456	(806)	56,439
Common stock	525	196	(33)	688
Preferred stock	552	34	(86)	500
Total equity securities	1,077	230	(119)	1,188
Total securities available for sale	$55,866	$2,686	$(925)	$57,627

December 31, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$2,105	$272	$(2)	$2,375
Residential mortgage and ABS securities	8,406	268	(232)	8,442
Commercial mortgage and ABS securities	2,242	6	(270)	1,978
Other mortgage and ABS securities	1,617	26	(63)	1,580
U.S. state and municipal	14,277	143	(702)	13,718
Corporate and other	18,637	236	(1,866)	17,007
Foreign government securities	2,618	123	(110)	2,631
Total fixed maturities	49,902	1,074	(3,245)	47,731
Common stock	589	186	(81)	694
Preferred stock	690	29	(229)	490
Total equity securities	1,279	215	(310)	1,184
Total securities available for sale	$51,181	$1,289	$(3,555)	$48,915

Of the $688 and $694 of common stock as of December 31, 2009 and 2008, respectively, $275 and $173, respectively, related to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk.

As of December 31, 2009 and 2008, securities carried at $4,051 and $3,701, respectively, were on deposit with regulatory authorities as required by law.

As of December 31, 2009 and 2008, the fair values of fixed maturities loaned were approximately $1,547 and $771, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately $1,352 and $682 as of December 31, 2009 and 2008, respectively. Other investments received as collateral in connection with the loaned securities was approximately $247 and $119 as of December 31, 2009 and 2008, respectively.

(dollars in millions, except per share amounts)

The amortized cost and fair value of fixed maturities as of December 31, 2009, by contractual maturity are as follows:

	Amortized Cost	**Fair Value**
Due to mature:		
One year or less	$2,515	$2,556
Over one year through five years	12,171	12,678
Over five years through ten years	10,256	10,633
Over ten years	15,110	15,521
Mortgage and asset-backed securities of government and corporate agencies	14,737	15,051
Total fixed maturities	$54,789	$56,439

Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table shows a schedule of the Company's unrealized losses and fair value by security type and by duration that individual securities have been in a continuous unrealized loss position as of December 31, 2009, that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		**Greater Than 12 Months**	
	Unrealized Losses	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. government and agency securities	$(6)	$386	$(2)	$10
Residential mortgage and ABS securities	(17)	1,190	(123)	425
Commercial mortgage and ABS securities	(2)	266	(47)	464
Other mortgage and ABS securities	(7)	303	(20)	48
U.S. state and municipal	(36)	1,215	(80)	591
Corporate and other	(31)	1,395	(353)	2,607
Foreign government securities	(49)	884	(33)	150
Common stock	(3)	34	(30)	132
Preferred stock	-	-	(86)	351
Total	$(151)	$5,673	$(774)	$4,778

The following table shows a schedule of the Company's unrealized losses and fair value by security type and by duration that individual securities have been in a continuous unrealized loss position as of December 31, 2008, that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		**Greater Than 12 Months**	
	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
Residential mortgage and ABS securities	(180)	582	(52)	218
Commercial mortgage and ABS securities	(192)	1,396	(78)	454
Other mortgage and ABS securities	(50)	394	(13)	57
U.S. state and municipal	(491)	7,287	(211)	1,311
Corporate and other	(831)	7,168	(1,035)	4,322
Foreign government securities	(35)	116	(75)	300
Common stock	(60)	238	(21)	28
Preferred stock	(29)	159	(200)	233
Total	$(1,869)	$17,365	$(1,686)	$6,932

The above table for 2009 includes $159 of unrealized losses related to securities issued and guaranteed by the United States government, its agencies, government sponsored enterprises and state and municipal governments. Included in the $774 of unrealized losses greater than twelve month were $421 of unrealized losses on securities that had been in an unrealized position of 10% or greater for more than twelve months. Unrealized losses as of December 31, 2009 decreased by $2,630 from December 31, 2008, primarily due to a decrease in credit spreads. 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. Based on that evaluation and the Company's intent not to sell these investments and given that it is not more likely than not that the Company will be required to sell these investments before an anticipated recovery in value, the Company views the decline in fair value of these investments as being temporary.

More than 78% 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 95% of these holdings remain rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with 95% rated AA or above.

As of December 31, 2009, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1% of invested assets.

Variable Interest Entities
The Company invests in energy, private equity and real estate limited partnerships and other entities subject to variable interest entity (VIE) analysis under the VIE subsections of ASC 810. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder to and the extent of the Company's variable interest in the VIE. The Company has determined that it is the primary beneficiary of two VIEs in the energy investment sector, and as such, these VIEs have been consolidated in the Company's 2009, 2008, and 2007 financial statements. The carrying value of assets and liabilities, and the Company's maximum exposure to loss of the consolidated VIEs is immaterial to the Company. VIEs in which the Company is not the primary beneficiary but holds a variable interest, are accounted for under the equity method in accordance with ASC 323.

The Company has variable interests in VIEs for which it is not the primary beneficiary. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. For these VIEs, the Company absorbs a portion, but not majority, of this variability. The carrying value of assets was $87 and $88 and the Company's maximum exposure to loss of was $99 and $104 for the years ending December 31, 2009 and 2008, respectively for unconsolidated VIEs in which the Company has a significant variable interest. The assets are included in Other Investments on the Consolidated Balance Sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. There is no recourse provision to the general credit of the Company for any VIE beyond the full amount of the Company's loss exposure.

Investments in Mortgage Loans
As of December 31, 2009 and 2008, the carrying values of commercial mortgage loans were $1,121 and $1,090 respectively. The carrying values reflect allowances of $6 and $1 as of December 31, 2009 and 2008, respectively. Additionally, the Company's participation in any one commercial mortgage loan acquired does not exceed 49% of the loan value. As of December 31, 2009, the average total loan size was $2, and the average loan participation size was $1. The number of loans in the portfolio increased from 2,257 as of December 31, 2008, to 2,469 as of December 31, 2009. Approximately 91% of the loans are full or partial recourse to borrowers.

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. 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. All futures contracts expired in March 2008, and the Company realized gains of $26 on these transactions. In March 2008, the Company entered into an equity swap agreement with a notional amount of $600. This contract was terminated in December 2008, and the Company realized gains of $187 on this transaction. In August 2008, the Company entered into two equity swap agreements with a total notional amount of $335. For the year ended December 31, 2008, these contracts incurred a $99 net gain. These contracts expired in January 2009, resulting in realized gains of $25 for the year ended December 31, 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 on the contract.

(4) ASBESTOS AND ENVIRONMENTAL RESERVES

In the third quarter of 2009, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal review, potential exposures of certain policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with published actuarial papers on asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. The remaining policyholders (those with less potential exposure) were evaluated using aggregate methods that utilized information and experience specific to these insureds. The study resulted in an increase to reserves of $383, which included an increase of $70 to the allowance for uncollectible reinsurance. The previous comprehensive study was completed in 2007. Between comprehensive studies, the Company monitors asbestos activity to determine whether or not any adjustment to reserves is warranted. The Company also completed its annual study on the environmental claims liability, resulting in immaterial adjustments to held reserves.

(5) REINSURANCE

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195) that are amortized into income using the effective interest method over the estimated settlement periods. As of December 31, 2009 and 2008, deferred gains related to these reinsurance arrangements were $592 and $620, 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, 2009, 2008, and 2007 was $117, $115, and $114, respectively. Deferred gain amortization was $72, $77, and $57 for the years ended December 31, 2009, 2008, and 2007, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2,019 and $2,060 as of December 31, 2009 and 2008, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002, renewal, any premium and loss activity subsequent to December 31, 2001, is accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods. Activity related to each of these retroactive and prospective contracts was immaterial in 2009, 2008, and 2007. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph.

In 2007, the Company entered into multi-year property catastrophe reinsurance agreement with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 of reinsurance coverage for the Company and its affiliates in the event of a Northeast and/or Florida hurricane event. In the first quarter 2009, the Company entered into another agreement with Mystic Re II to provide $225 of additional reinsurance coverage for the Company in the event of a U.S. hurricane or earthquake event. The reinsurance agreements are collateralized through a trust and guarantee received by Mystic Re II from the issuance of catastrophe bonds and provide coverage for hurricane or earthquake-related losses based on industry insured losses as reported by Property Claim Services along with Company specific losses on the event. The Company has not recorded any recoveries under these programs. Mystic Re II does not have any other reinsurance in force.

(dollars in millions, except per share amounts)

(6) DEBT OUTSTANDING

Debt outstanding as of December 31, 2009 and 2008 includes the following:

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

	2009	2008
Commercial paper	$ -	$ -
Revolving credit facilities	4	-
Current maturities of long-term debt	301	-
Total short-term and current maturities of long-term debt	$ 305	$ -

Long-term debt:

	2009	2008
4.875% Notes, due 2010	$ -	$ 300
7.25% Notes, due 2012	204	204
8.00% Notes, due 2013	260	260
7.86% Medium Term Notes, due 2013	25	25
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014	200	200
5.588% Mortgage Loan due 2015	49	-
6.70% Notes, due 2016	249	250
7.00% Junior Subordinated Notes, due 2067[1]	300	300
8.50% Surplus Notes, due 2025	140	150
7.875% Surplus Notes, due 2026	227	250
7.625% Notes, due 2028	3	3
7.00% Notes, due 2034	231	250
6.50% Notes, due 2035	471	500
7.50% Notes, due 2036	440	500
7.80% Junior Subordinated Notes, due 2087[2]	700	700
10.75% Junior Subordinated Notes, due 2088[3]	1,250	1,250
7.697% Surplus Notes, due 2097	435	500
	5,684	6,142
Unamortized discount	(49)	(53)
Total long-term debt excluding current maturities	$5,635	$6,089

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

Short-term and current maturities of long-term debt

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

The Company places commercial paper through a program issued by LMGI and guaranteed by Liberty Mutual Insurance Company ("LMIC"), Effective December 14, 2009, the $1,000 commercial paper program was reduced to $400 and is backed by the three-year $400 unsecured revolving credit facility.

On September 1, 2009, LMIC renewed its existing $750, 364-day committed repurchase agreement facility for general corporate purposes. To date, no funds have been borrowed under the facility.

On March 11, 2009, LMIC became a member of the Federal Home Loan Bank of Boston. To date, no funds have been borrowed.

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a $20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of December 31, 2009, $4 was outstanding under the facility.

Long-term debt

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

As part of its overall capital strategy, the Company previously announced that it may issue, repurchase or exchange debt depending on market considerations. Debt repurchases may be done through open market or other appropriate transactions. For the year ended December 31, 2009, the Company repurchased $65 of the 7.697% Surplus Notes due 2097, $60 of the 7.50% Notes due 2036, $29 of the 6.50% Notes due 2035, $23 of the 7.875% Notes due 2026, $19 of the 7.00% Notes due 2034, $10 of the 8.50% Surplus Notes due 2025, and $1 of the 6.70% Notes due 2016. A gain of $59 was recorded on the transactions and is included in fee and other revenues in the consolidated statements of income.

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

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

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

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1,000, consisting of $700 Series A junior subordinated notes (the "Series A Notes") and $300 Series B junior subordinated notes (the "Series B Notes"). The Notes are scheduled for redemption on March 15, 2037; the Series A notes have a par value call date and final fixed rate interest payment date of March 15, 2037, and a final maturity date of March 7, 2087; and the Series B notes have a par value call date and final fixed rate interest payment date of March 15, 2017, and a final maturity date of March 7, 2067. LMGI may redeem (a) the Series B Notes in whole or in part, on March 15, 2017, and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or (b) prior to March 15, 2037, for the Series A Notes or March 15, 2017, for the Series B Notes, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 7.800% for the Series A Notes and 7.000% for the Series B Notes up to, but excluding, the final fixed rate interest payment date. In the event the Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 3.576% for the Series A Notes and three-month LIBOR plus 2.905% for the Series B Notes, payable quarterly in arrears. LMGI has the right to defer interest payments on the Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Notes, LMGI entered into an 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).

Capital lease obligations as of December 31, 2009 and 2008, were $105 and $149, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. Amortization of the lease obligation was $49 and $17 for the years ended December 31, 2009 and 2008, respectively. In 2008, the Company entered into an arrangement to sell and leaseback certain furniture and equipment. The weighted average interest rate on the lease is 4.88%. The transactions are accounted for as capital leases. As of December 31, 2009, the Company's amortization of the lease obligation under the sale-leaseback agreement through maturity is approximately $15 for 2010, $16 for 2011, $17 for 2012, $17 for 2013, and $1 for 2014.

(dollars in millions, except per share amounts)

Interest
The Company paid $468, $406, and $299 of interest in 2009, 2008, and 2007, respectively.

(7) INCOME TAXES

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

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance as of January 1, 2007[1]	$ 194
Additions based on tax positions related to the current year	1
Additions for tax positions of prior years	34
Reductions for tax positions of prior years	(12)
Settlement	(11)
Increases in unrecognized tax benefits acquired or assumed in a business combination	15
Balance as of December 31, 2008	221
Additions based on tax positions related to the current year	16
Additions for tax positions of prior years	7
Reductions for tax positions of prior years	(22)
Settlements	(1)
Balance as of December 31, 2009	$ 221

[1] The beginning balance has been adjusted to remove anticipated tax recoverables.

Included in the tabular rollforward of unrecognized tax benefits is interest in the amount of $85 and $72 as of December 31, 2009 and 2008, respectively.

Included in the December 31, 2009 balance above are $119 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, 2009, 2008, and 2007, the Company recognized approximately $18, $8, and $10 in interest and penalties. The Company had approximately $82 and $66 of interest and penalties accrued as of December 31, 2009 and 2008, respectively.

(8) BENEFIT PLANS

The net benefit costs for the years ended December 31, 2009, 2008, and 2007, include the following components:

December 31, 2009	**Pension**	**Supplemental Pension**	**Postretirement**
Components of net periodic benefit costs			
Service costs	$200	$12	$28
Interest costs	278	19	46
Expected return on plan assets	(251)	-	-
Settlement charge	2	-	-
Amortization of unrecognized:			
Net loss (gain)	55	10	2
Prior service cost	6	2	(3)
Net transition (assets) obligation	(5)	-	9
Net periodic benefit costs	**$285**	**$43**	**$82**

(dollars in millions, except per share amounts)

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

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

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

Plan Assets

The assets of the domestic Plan represent 93% of the total Plan assets as of December 31, 2009. The Company's overall investment strategy for the domestic Plans' assets is to achieve a mix of approximately 65% of investments for near-term benefit payments and 35% for long-term growth with a wide diversification of asset types, fund strategies, and fund managers. The domestic Plan's goal is to achieve a total return in the range of 6%-8% annually with sufficient liquidity to meet the benefit needs of the domestic Plan.

The majority of the domestic Plans' assets are managed through separate accounts sponsored by Liberty Life Assurance Company of Boston, a wholly owned indirect subsidiary of the Company.

The target allocation for domestic Plans assets are 62% bonds, 20% diversified public equities, 15% private equity and real estate investments, and 3% cash and short-term investments.

Bonds include investment grade and high yield corporate bonds of companies from diversified industries, residential and commercial mortgage backed securities (RMBS and CMBS), asset backed securities (ABS) and collateralized mortgage obligations (CMO) along with U.S. Treasuries and Agencies (FNMA and FHLMC). Equity securities primarily include investments in large-cap and small-cap companies primarily located in the United States but also with exposures to Europe and Asia. Private equity and real estate investments include investments in private equity funds that follow several different strategies and real estate funds.

The investment strategy for each category of domestic Plans assets is as follows:

Bonds - Achieve superior performance against Barclay's Aggregate Bond Index and Merrill High Yield Index over a 3 to 5 year period.

U.S large cap equities – Mirror performance of the Standard and Poor's Index ("S&P 500").

U.S mid and small cap equities – Achieve superior performance against the Russell 2000 Index over a 3 to 5 year period.

European equities – Achieve superior performance against the MSCI - Europe Index over a 3 to 5 year period.

(dollars in millions, except per share amounts)

Asian equities – Achieve superior performance against the MSCI Asia ex Japan Index over a 3 to 5 year period.

Other equities – Represents other foreign equities.

Private equity investments – Achieve long-term returns in excess of liquid equity securities and provide diversification to domestic Plan's assets. Performance is targeted to outperform the S&P 500, Russell 2000, NASDAQ and private equity benchmarks or other relative benchmarks. Exposures are targeted at 80 percent to U.S. partnerships and 20 percent to International partnerships diversified by geography, manager, industry, stage and single vintage year.

Real estate investments – Achieve attractive risk-adjusted total returns through investment primarily in U.S. real estate funds diversified by geography, sector and single vintage year.

The domestic Plans' assets are administered by the Liberty Mutual Retirement Board who has the fiduciary responsibility for management of the domestic Plans' assets in accordance with the Liberty Mutual Retirement Benefit Plan Investment Policy. This policy has been approved by the Liberty Mutual Board of Directors.

Fair Value Measurements as of December 31, 2009

Asset Category	Total	Quoted prices in active markets for identical assets Level 1[1]	Significant Observable Inputs Level 2[1]	Significant Unobservable Inputs Level 3[1]
Cash, cash equivalents and short-term investments	$ 465	$ 465	$ -	$ -
Bonds:				
U.S. government and agencies	301	292	9	-
RMBS/CMO/ABS/CMBS	945	-	945	
Corporate and other	853	23	830	-
U.S. large cap equities	513	513	-	-
U.S. mid and small cap equities	122	122	-	-
European equities	153	150	-	3
Asian equities	184	184	-	-
Other equities	19	12	3	4
Private equity investments	83	-	-	83
Real estate investments	2	-	-	2
Total	$3,640	$1,761	$1,787	$ 92

[1] See Note 9 for descriptions of the three levels of fair value presentation.

(dollars in millions, except per share amounts)

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)				
	European Equities	**Private Equity**	**Real Estate**	**Other Equities**	**Total**
Beginning balance as of December 31, 2008	$2	$95	$2	$4	$103
Actual return on plan assets:					
Relating to assets still held at the reporting date	-	(15)	-	-	(15)
Relating to assets sold during the year	-	5	-	-	5
Purchases, sales & settlements	1	(2)	-	-	(1)
Transfers in/(out) of Level 3	-	-	-	-	-
Balance as of December 31, 2009	$3	$83	$2	$4	$92

The valuation of the Plan's investments in real estate and private equity are determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth and other business and market sector fundamentals.

Cash Flows

Contributions

The Company contributed $201 to the qualified plans, and directly funded $25 to retirees in the supplemental pension plans in 2009. In addition, the Company directly funded $28 to the postretirement benefit plans in 2009.

The Company expects to contribute approximately $241 to the qualified plans, and directly fund $14 to retirees in the supplemental pension plans in 2010. In addition, the Company expects to directly fund $42 to the postretirement benefit plans gross of the Medicare Subsidy in 2010.

(9) FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820 establishes a framework for measuring fair value and disclosures about fair value measurements. It provides guidance on how to measure fair value when required under existing accounting standards and 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 are impacted by the application of this guidance. The Company has variable annuity contracts containing embedded derivatives.

(dollars in millions, except per share amounts)

The hierarchy requires the use of market observable information when available for assessing fair value. The following tables summarize the Company's assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2009 and 2008 along with a brief description of the valuation technique for each type of asset and liability:

	As of December 31, 2009			
Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. government and agency securities	$1,504	$ 917	$ 44	$ 2,465
Mortgage and asset-backed securities:				
Residential	-	10,983	6	10,989
Commercial	-	2,145	15	2,160
Other mortgage and asset-backed securities	-	1,849	53	1,902
U.S. state and municipal	-	15,489	21	15,510
Corporate and other	-	18,835	848	19,683
Foreign government securities	-	3,723	7	3,730
Total fixed maturities, available for sale	1,504	53,941	994	56,439
Common stock	630	44	14	688
Preferred stock	-	497	3	500
Total equity securities, available for sale	630	541	17	1,188
Short-term investments	147	369	59	575
Other investments	-	62	64	126
Separate account assets	1,628	1,742	187	3,557
Other assets	15	75	19	109
Total assets	$3,924	$56,730	$1,340	$61,994
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$(143)	$ (143)
Total liabilities	$ -	$ -	$(143)	$ (143)

	As of December 31, 2008			
Assets, at Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed maturities, available for sale	$1,052	$45,782	$ 897	$47,731
Equity securities, available for sale	582	492	110	1,184
Short-term investments	54	1,066	73	1,193
Other investments	-	98	62	160
Separate account assets	1,582	1,292	188	3,062
Other assets	18	51	27	96
Total assets	$3,288	$48,781	$1,357	$53,426
Liabilities, at Fair Value				
Life insurance obligations	$ -	$ -	$(223)	$ (223)
Total liabilities	$ -	$ -	$(223)	$ (223)

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

Equity and trading securities are recorded at fair value in the Company's financial statements. The fair value of common stocks are generally based on quoted prices in active markets. As such, common stocks are generally categorized as Level 1 of the fair value hierarchy. The fair value of preferred stocks are generally determined by quoted prices for similar instruments in active markets, hence they are categorized as Level 2 of the fair value hierarchy. Additionally, in some instances where equity securities use significant inputs that are unobservable, they are categorized as Level 3 of the hierarchy.

(dollars in millions, except per share amounts)

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

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

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

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

The following tables set forth the fair values of assets on a recurring basis classified as Level 3 within the fair value hierarchy:

	Balance January 1, 2009	**Net Realized Gains (Losses)**	**Net Unrealized Gains (Losses)**	**Net Purchases, (Sales) and (Maturities)**	**Transfer in and/ or out of Level 3**	**Balance December 31, 2009**
U.S. government and agency securities	$ 31	$ -	$ 1	$ (3)	$ 15	$ 44
Mortgage and asset-backed securities:						
Residential	4	-	-	-	2	6
Commercial	18	-	2	(1)	(4)	15
Other mortgage and asset backed securities	44	1	-	(9)	17	53
U.S. state and municipal	9	-	1	(1)	12	21
Corporate and other	781	9	81	72	(95)	848
Foreign government securities	10	-	1	(3)	(1)	7
Total fixed maturities	897	10	86	55	(54)	994
Common stock	110	(5)	8	(16)	(83)	14
Preferred stock	-	-	-	3	-	3
Total equity securities	110	(5)	8	(13)	(83)	17
Short-term investments	73	-	-	(14)	-	59
Other investments	62	(2)	4	(1)	1	64
Separate account assets	188	(1)	5	(3)	(2)	187
Other assets	27	(12)	-	4	-	19
Total assets	$1,357	$(10)	$103	$ 28	$(138)	$1,340
Life insurance obligations	$(223)	$ -	$(36)	$(44)	$ -	$(143)
Total liabilities	$(223)	$ -	$(36)	$(44)	$ -	$(143)

(dollars in millions, except per share amounts)

	Balance January 1, 2008	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer in and/ or out of Level 3	Balance December 31, 2008
Fixed maturities	$ 825	$ (9)	$(48)	$ 70	$59	$ 897
Equity securities	43	(3)	(13)	82	1	110
Short-term investments	70	-	(19)	22	-	73
Other investments	41	12	7	2	-	62
Separate account assets	172	35	(4)	(17)	2	188
Other assets	13	12	-	2	-	27
Total assets	$1,164	$ 47	$(77)	$161	$62	$1,357
Life insurance obligations	$(105)	$(151)	$ -	$ 33	$ -	$(223)
Total liabilities	$(105)	$(151)	$ -	$ 33	$ -	$(223)

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held as of December 31, 2009 and 2008.

For the years ended December 31, 2009, 2008, and 2007, there were impairments of $36, $29, and $40, respectively, recognized for items measured at fair value on a nonrecurring basis (principally direct investments in oil and gas production ventures, which are based on independent external studies). Impairment charges for the above are reflected in insurance operating costs and expenses in the consolidated statements of income.

The Company has not applied ASC 820 to non-financial assets and liabilities.

(10) COMMITMENTS AND CONTINGENT LIABILITIES

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

Until recently, the Company has been in various insurance coverage disputes with Armstrong World Industries ("Armstrong") for over twenty years relating to asbestos liabilities and insurance covering the period of 1973 to 1981. In October 2009, Liberty Mutual executed a settlement agreement with the Armstrong World Industries Asbestos Personal Injury Trust (the "Trust"), as successor to certain of Armstrong's rights under certain of the Liberty Mutual insurance policies, to resolve all disputes regarding Liberty Mutual's alleged coverage obligations with respect to asbestos bodily injury claims, including but not limited to all actions pending in the United States District Court for the Eastern District of Pennsylvania, and related civil actions more recently filed in state court in Illinois, for a payment of $300. The parties also agreed to a further contingent payment of $115 payable no earlier than the first day of the sixth year anniversary of the "effective date" of the agreement, only if a certain aggregate value of qualified claims has been accepted by the Trust by that time or within a two year period thereafter. The settlement, which has been finalized and is effective, affords Liberty Mutual the full benefits and protections of the Section 524(g) channeling injunction issued to Armstrong in the bankruptcy proceedings which concluded in 2006. Armstrong, the Trust Advisory Committee, and the Futures Representative, in addition to the Trust, have all concurred in the settlement.

As of December 31, 2009, the Company had unfunded capital commitments related to traditional private equity partnerships of $1,104, other partnerships (primarily energy) of $952, and real estate partnerships of $596.

As of December 31, 2009, the Company had commitments to purchase various mortgage-backed securities settling in 2010, at a cost of $222 with a fair value of $221, which are included as fixed maturities in the consolidated balance sheets.

(11) SUBSEQUENT EVENTS

Management has assessed material subsequent events through March 2, 2010, the date of the fourth quarter 2009 earnings release.

Effective January 1, 2010, the Company's Venezuelan operations began applying hyper-inflationary accounting, utilizing the U.S. dollar as the functional currency, which had no impact on consolidated policyholders' equity at January 1, 2010. However, on January 8, 2010, the Venezuelan government devalued its currency, announcing that the fixed official exchange rate would be changed to a dual exchange rate system. This dual exchange rate system for the fixed official exchange rate includes a 2.60 Bolivar Fuertes (BsF) rate to 1 U.S. dollar for food and other items as mandated by the Venezuelan government, and a 4.30 BsF to 1 U.S dollar rate for all other items. While it is expected that the devaluation will reduce net written premium and claims and claim adjustment expense reserves in 2010, the anticipated impact to consolidated policyholders' equity is not expected to be material. Had the devaluation occurred effective January 1, 2009, net written premium and claims and claim adjustment expense reserves would have been reduced by $825 and $232, respectively.