Liberty Mutual®

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

Year Ended December 31, 2009

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, 2009 and 2008. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2008 Annual Report, 2009 Unaudited Consolidated Financial Statements and Fourth Quarter 2009 Financial Supplement located on the Company's Investor Relations website at www.libertymutual.com/investors. The Company's discussions related to net income are presented in conformity with U.S. generally accepted accounting principles ("GAAP") on an after-tax basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

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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; recessionary 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 stress in financial markets and economic conditions; 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; adverse developments in the cost, availability and/or ability to collect reinsurance, which may be adversely affected by current economic conditions; the Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the acquisition of Safeco Corporation ("Safeco") and its subsidiaries; 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 proposed Federal legislation related to natural catastrophe funds and financial services regulation 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 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 website at www.libertymutual.com/investors. The Company undertakes no obligation to update these forward looking statements.

EXECUTIVE SUMMARY

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

Three Months Ended December 31, 2009 - Consolidated Results of Operations

- Revenues for the three months ended December 31, 2009 were $7.942 billion, a decrease of $209 million or 2.6% from the same period in 2008.
- Net written premium for the three months ended December 31, 2009 was $7.119 billion, an increase of $733 million or 11.5% over the same period in 2008.
- Pre-tax operating income before private equity loss for the three months ended December 31, 2009 was $501 million, a decrease of $148 million or 22.8% from the same period in 2008.
- Pre-tax operating income for the three months ended December 31, 2009 was $488 million, a decrease of $37 million or 7.0% from the same period in 2008.
- Net income for the three months ended December 31, 2009 was $456 million, an increase of $9 million or 2.0% over the same period in 2008.
- Cash flow from operations for the three months ended December 31, 2009 was $919 million, an increase of $746 million over the same period in 2008.
- The combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2] for the three months ended December 31, 2009 was 99.9%, an increase of 1.3 points over the same period in 2008. 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, 2009 increased 4.0 points to 99.3%.

Twelve Months Ended December 31, 2009 - Consolidated Results of Operations

- Revenues for the twelve months ended December 31, 2009 were $31.094 billion, an increase of $2.239 billion or 7.8% over the same period in 2008.
- Net written premium for the twelve months ended December 31, 2009 was $28.258 billion, an increase of $2.791 billion or 11.0% over the same period in 2008.
- Pre-tax operating income before private equity (loss) income for the twelve months ended December 31, 2009 was $1.595 billion, an increase of $16 million or 1.0% over the same period in 2008.
- Pre-tax operating income for the twelve months ended December 31, 2009 was $1.184 billion, a decrease of $399 million or 25.2% from the same period in 2008.

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[1] Catastrophes include all current and prior year catastrophe losses including assessments from the Texas Windstorm Insurance Association ("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 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.

- Net income for the twelve months ended December 31, 2009 was $1.023 billion, a decrease of $90 million or 8.1% from the same period in 2008.

- Cash flow from operations for the twelve months ended December 31, 2009 was $2.487 billion, a decrease of $258 million or 9.4% from the same period in 2008.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the twelve months ended December 31, 2009 was 98.4%, an increase of 0.8 points over the same period in 2008. 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, 2009 decreased 0.2 points to 99.9%.

Financial Condition as of December 31, 2009

- Total assets were $109.475 billion as of December 31, 2009, an increase of $5.436 billion over December 31, 2008.

- Policyholders' equity was $14.514 billion as of December 31, 2009, an increase of $4.111 billion over December 31, 2008.

- Total debt was $5.940 billion as of December 31, 2009, a decrease of $149 million from December 31, 2008.

Subsequent Events

- 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 million and $232 million, respectively.

- On February 1, 2010, the Company redeemed its $300 million, 4.875% Notes at maturity.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI"), PTOI before private equity (loss) income 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 before private equity (loss) income is defined as PTOI excluding limited partnership results recognized on the equity method. PTOI before private equity (loss) income and PTOI are considered by the Company to be appropriate indicators of underwriting and operating results and is consistent with the way the Company internally evaluates performance. Net realized investment gains (losses) and private equity (loss) income 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 and 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. 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	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Private passenger automobile	$2,476	$2,330	6.3%	$9,814	$7,913	24.0%
Workers compensation	947	930	1.8	4,025	4,699	(14.3)
Homeowners	799	227	NM	2,388	1,873	27.5
Commercial multiple peril / fire	529	573	(7.7)	2,333	2,032	14.8
International local businesses	514	416	23.6	1,862	1,652	12.7
Commercial automobile	359	395	(9.1)	1,543	1,415	9.0
General liability	226	216	4.6	1,148	1,108	3.6
LIU[1] reinsurance	194	252	(23.0)	983	1,018	(3.4)
Bond	169	185	(8.6)	707	478	47.9
LIU third party	189	207	(8.7)	702	760	(7.6)
LIU inland marine program	154	160	(3.8)	627	620	1.1
Group disability and life	154	136	13.2	607	553	9.8
Individual life	95	80	18.8	313	265	18.1
LIU first party	81	70	15.7	290	270	7.4
Assumed voluntary reinsurance	54	47	14.9	179	166	7.8
Other[2]	179	162	10.5	737	645	14.3
Total net written premium[3]	$7,119	$6,386	11.5%	$28,258	$25,467	11.0%

1 Liberty International Underwriters ("LIU").
2 Primarily includes net written premium from allied lines and domestic inland marine.
3 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business.
NM = Not Meaningful

Consolidated net written premium by SBU was as follows:

$ in Millions	Three Months Ended December 31, 2009	2008	Change	Twelve Months Ended December 31, 2009	2008	Change
Agency Markets	$2,555	$2,595	(1.5%)	$10,862	$7,457	45.7%
International	1,949	1,731	12.6	7,080	6,757	4.8
Personal Markets	1,536	1,442	6.5	6,346	5,969	6.3
Commercial Markets	894	1,084	(17.5)	4,605	5,595	(17.7)
Corporate and Other[1]	185	(466)	NM	(635)	(311)	(104.2)
Total net written premium (NWP)	$7,119	$6,386	11.5%	$28,258	$25,467	11.0%
Foreign exchange effect on growth			1.9			(1.3)
NWP growth excluding foreign exchange			9.6%			12.3%

1 Includes internal and external reinsurance including homeowners quota share reinsurance treaties entered into in 2009 and 2008 of 30% and 31.725%, respectively.
NM = Not Meaningful

Major drivers of net written premium growth were as follows:

$ in Millions	Three Months Ended December 31, 2009	2008	$ Change	Pts. Attribution	Twelve Months Ended December 31, 2009	2008	$ Change	Pts. Attribution
LMG NWP	$7,119	$6,386	$733	11.5	$28,258	$25,467	$2,791	11.0
Components of Growth:								
Safeco	$1,258	$1,258	$-	-	$5,033	$1,392	$3,641	14.3
International local businesses (excluding foreign exchange)	1,216	1,062	154	2.4	4,795	4,211	584	2.3
Domestic personal auto[1]	1,090	1,105	(15)	(0.2)	4,886	4,719	167	0.7
Workers Compensation booked as billed adjustment	211	48	163	2.6	205	18	187	0.7
Group disability and life	154	136	18	0.3	607	553	54	0.2
Individual life	95	80	15	0.2	313	265	48	0.2
Bond[1]	75	91	(16)	(0.3)	343	372	(29)	(0.1)
-Domestic homeowners[1]	611	556	55	0.9	2,323	2,181	142	0.6
-Homeowners quota share	(11)	(528)	517	8.1	(835)	(528)	(307)	(1.2)
Total Homeowners	600	28	572	9.0	1,488	1,653	(165)	(0.6)
Foreign exchange	119	-	119	1.9	(328)	-	(328)	(1.3)
Other commercial lines[1]	2,301	2,578	(277)	(4.4)	10,916	12,284	(1,368)	(5.4)
Total LMG NWP	$7,119	$6,386	$733	11.5	$28,258	$25,467	$2,791	11.0

1 Excludes Safeco premium.

Net written premium for the three and twelve months ended December 31, 2009 was $7.119 billion and $28.258 billion, respectively, increases of $733 million and $2.791 billion over the same periods in 2008. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $146 million and $1.901 billion in the quarter and year, respectively. The increases in the quarter and year primarily reflect organic growth in International's local businesses in Latin America mostly due to inflation in Venezuela, as well as new business growth and rate increases in Personal Markets. Also contributing to the increase in the quarter were stronger foreign currencies versus the U.S. dollar (approximately $64 million) as compared to the prior period. The increases in both periods were partially offset by a decline in Europe as a result of the region's general economic contraction. The increase for the year was impacted by approximately $1.591 billion of premium related to the Safeco acquisition made on September 22, 2008, partially offset by weaker foreign currencies versus the U.S. dollar (approximately $32 million) versus the prior year.

- Workers compensation net written premium increased $17 million and decreased $674 million in the quarter and year, respectively. The increase in the quarter primarily reflects the increase in the Corporate and Other segment for the "booked as billed" method of accounting for net written premium, higher premium in the Summit segment due to a premium reduction in 2008 related to estimated future audits attributable to 2008 and prior years that did not recur in 2009 and higher rates in the Regional Companies. Partially offsetting the increase in the quarter are lower rates and retention in Commercial Markets primarily due to the change from direct distribution to third party in the Middle Market segment. The decrease for the year is attributable to the change from direct distribution to third party in the Commercial Markets Middle Market segment and a decrease in premium in the Summit segment due to state mandated rate decreases of 18.9% in Florida. Partially offsetting the decrease for the year is an increase in premium due to the Corporate and Other "booked as billed' adjustment and approximately $56 million of premium related to the Safeco acquisition.
- Homeowners net written premium increased $572 million and $515 million in the quarter and year, respectively. The increase in the quarter is primarily driven by the non-renewal of a portion of the homeowners quota share reinsurance treaty of $517 million. The increase for the year reflects approximately $679 million of premium related to the Safeco acquisition and strong customer retention, new business growth in non-coastal areas and rate increases in Personal Markets. Partially offsetting the increase for the year is an increase of ceded premium related to the homeowners quota share reinsurance treaty of $307 million.
- Commercial multiple peril / fire net written premium decreased $44 million and increased $301 million in the quarter and year, respectively. The decrease in the quarter reflects lower new business and retention in Agency Markets, lower retention in Commercial Markets, and a decrease in exposures due to economic contraction in Agency Markets and Commercial Markets. Partially offsetting the decrease is an increase in rates in Agency Markets. The increase for the year primarily reflects approximately $400 million of premium related to the Safeco acquisition and higher rates in Agency Markets and Commercial Markets. Partially offsetting the increase for the year were lower retention levels and new business in Commercial Markets due to a more competitive environment and reduced exposures due to economic contraction.
- International local businesses net written premium (excluding private passenger automobile), increased $98 million and $210 million in the quarter and year, respectively. The increase in both periods was driven largely by organic growth in Latin America, primarily due to inflation in Venezuela, and to a lesser extent, Asia, partially offset by a decline in Europe due to the region's general economic contraction. Also impacting the increase in the quarter were stronger foreign currencies versus the U.S. dollar (approximately $41 million) as compared to the prior period. Partially offsetting the increase for the year was the impact of weaker foreign currencies versus the U.S. dollar (approximately $199 million) as compared to the prior period.
- Commercial automobile net written premium decreased $36 million and increased $128 million in the quarter and year, respectively. The decrease in the quarter primarily reflects lower retention and new business in Agency Markets and rate decreases in Commercial Markets. The increase for the year primarily reflects approximately $200 million of premium related to the Safeco acquisition and rate increases in Commercial Markets. Partially offsetting the increase for the year were lower retention and new business writings in Commercial Markets due to a more competitive environment and the Middle Market change from direct distribution to third party.
- General liability net written premium increased $10 million and $40 million in the quarter and year, respectively. The increase in the quarter primarily reflects higher retention in Commercial Markets and a 2008 fourth quarter reduction in prior policy period premium of $37 million in the National Market segment. The increase for the year primarily reflects approximately $135 million of premium related to the Safeco acquisition and increased rate and retention in Commercial Markets. The increase for the year is partially offset by a reduction in premium in the National Market segment of Commercial Markets of $43 million driven by a multi-year construction account written in 2008 that did not recur in 2009.

- LIU reinsurance net written premium decreased $58 million and $35 million in the quarter and year, respectively. The decrease in the quarter is primarily driven by the general economic slowdown within the United Kingdom. The decrease for the year reflects a stronger U.S. dollar relative to select foreign currencies.
- Bond net written premium decreased $16 million in the quarter and increased $229 million for the year. The decrease in the quarter primarily reflects reduced exposures due to economic conditions. The increase for the year primarily reflects approximately $258 million of premium related to the Safeco acquisition, partially offset by reduced exposures due to economic conditions.
- LIU third party net written premium decreased $18 million and $58 million in the quarter and year, respectively. The decreases in the quarter and year primarily reflect an increase in ceded written premium due to a change in the structure of certain reinsurance programs. Also contributing to the decrease for the year is the impact of weaker foreign currencies versus the U.S. dollar (approximately $26 million).
- Group disability and life net written premium increased $18 million and $54 million in the quarter and year, respectively. The increase in both periods reflects broader market penetration in those markets.
- Individual life net written premium increased $15 million and $48 million in the quarter and year, respectively. The increase in both periods primarily reflects higher structured settlement sales.
- Other net written premium increased $17 million and $92 million in the quarter and year, respectively. The increase for the year primarily reflects higher allied lines net written premium of $74 million, primarily related to the Safeco acquisition.

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	**2009**	**2008[1]**	**Change**	**2009**	**2008[1]**	**Change**
Revenues	$7,942	$8,151	(2.6%)	$31,094	$28,855	7.8%
PTOI before catastrophes, net incurred losses attributable to prior years and private equity (loss) income	$406	$416	(2.4%)	$2,050	$2,186	(6.2%)
Catastrophes[2]:						
-September 2008 Hurricanes	(6)	(174)	(96.6%)	(22)	(871)	(97.5%)
-All other[3]	(109)	(115)	(5.2%)	(869)	(705)	23.3%
Net incurred losses attributable to prior years:						
- Asbestos & environmental[4]	(2)	(2)	-	(388)	(7)	NM
- All other[5]	212	512	(58.6%)	824	976	(15.6%)
Current accident year re-estimation[6]	-	12	(100.0%)	-	-	-
Pre-tax operating income before private equity (loss) income	501	649	(22.8%)	1,595	1,579	1.0%
Private equity (loss) income[7]	(13)	(124)	(89.5%)	(411)	4	NM
Pre-tax operating income	488	525	(7.0%)	1,184	1,583	(25.2%)
Realized gains (losses), net	12	(74)	NM	26	(330)	NM
Income tax (expense) benefit	(44)	(4)	NM	(187)	(140)	33.6%
Net income	$456	$447	2.0%	$1,023	$1,113	(8.1%)
Cash flow from operations	$919	$173	NM	$2,487	$2,745	(9.4%)

1 2008 results have been restated for the retrospective accounting change related to the change in the discount rate applied to the long-term indemnity portion of the settled unpaid workers compensation claims. See the Critical Accounting Policy section of the MD&A for further details.

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 Catastrophe losses ceded under the homeowners quota share treaty are included to the extent that the ceded combined ratio exceeds 100.0%.

4 Net of change in allowance for uncollectible reinsurance (increase) decrease of zero and ($70) million for the three and twelve months ended December 31, 2009, and zero and $7 million for the comparable periods of 2008.

5 Net of earned premium attributable to prior years of ($14) million and ($85) million for the three and twelve months ended December 31, 2009, and ($88) million and ($77) million for the comparable periods of 2008. Net of amortization of deferred gains on retroactive reinsurance of $22 million and $74 million for the three and twelve months ended December 31, 2009, and $29 million and $82 million for the comparable periods of 2008.

6 Year-end re-estimation of 2008 accident year loss reserves for the nine months ended September 30, 2008.

7 Private equity (loss) income is included in net investment income in the accompanying statements of income.

NM = Not Meaningful

PTOI for the three and twelve months ended December 31, 2009 was $488 million and $1.184 billion, respectively, decreases of $37 million and $399 million from the same periods in 2008. The decreases in both periods reflect less favorable incurred losses attributable to prior years, partially offset by less catastrophe losses. Partially offsetting the decrease in the quarter was a reduction in net investment losses due to improved market valuations for investments. The decrease for the year was also impacted by lower net investment losses primarily due to reduced valuations for investments in limited partnerships (recorded three months in arrears) and limited liability companies, higher corporate benefit expenses related to pension plans and the impact of a stronger U.S. dollar versus foreign currencies. Partially offsetting the decrease for the year were gains on early extinguishment of debt.

Revenues for the three and twelve months ended December 31, 2009 were $7.942 billion and $31.094 billion respectively, a decrease of $209 million and an increase of $2.239 billion versus the same periods in

2008. 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, 2009 was $7.008 billion and $27.791 billion, respectively, a decrease of $356 million and an increase of $2.267 billion versus the same periods in 2008. The decrease in the quarter primarily reflects the impact of ceded premium related to the homeowners quota share treaty of approximately $270 million and the changes in business conditions previously discussed, partially offset by the impact of stronger foreign currencies versus the U.S. dollar of approximately $138 million. The increase for the year primarily reflects approximately $3.6 billion of premium related to the acquisition of Safeco and $826 million of organic growth in the operations within International. Partially offsetting the increase for the year were $1.043 billion of ceded premium related to the homeowners quota share treaty, approximately $322 million reflecting the impact of weaker foreign currencies versus the U.S. dollar, reduced exposures due to economic contraction, a competitive commercial lines market, and a decline in premium in the Middle Market segment of Commercial Markets primarily due to the change from direct distribution to third party.

Net investment income for the three and twelve months ended December 31, 2009 was $738 million and $2.482 billion, respectively, an increase of $74 million and a decrease of $398 million versus the same periods in 2008. The increase in the quarter reflects the decrease in limited partnerships and limited liability companies loss of $111 million as a result of improved market valuations over the same period in 2008 and continued reinvestment of cash flows from operations. Offsetting the increase were declines in taxable interest income and dividend income as a result of lower investment yields and the change in investment strategy to reduce the total equity portfolio exposure. The decrease for the year was the result of limited partnership losses (recorded three months in arrears) reflecting reduced market valuations, a decrease in dividend income due to the reduction in the equity portfolio, higher investment expenses due to the Safeco acquisition in the third quarter of 2008, strategic initiatives and variable compensation costs. Partially offsetting the decrease was an increase in interest income due to a higher invested asset base from the Safeco acquisition as well as the continued reinvestment of cash flow from operations.

Net realized investment gains for the three and twelve months ended December 31, 2009 were $12 million and $26 million, respectively, compared to losses of $74 million and $330 million for the same periods in 2008. The change in both periods primarily reflects impairment losses recorded in 2008 on fixed maturity and equity investments related to securities deemed to be other than temporarily impaired due to market conditions that did not recur to the same extent in 2009. Partially offsetting the increases were gains recorded in 2008 that did not recur related to derivative contracts the Company used to hedge its equity exposure and a 2008 gain from the sale of an investment property.

Fee and other revenues for the three and twelve months ended December 31, 2009 were $184 million and $795 million, respectively, a decrease of $13 million and an increase of $14 million versus the same periods in 2008. The decrease in the quarter was driven by less fee revenue from the Company's servicing carrier operations due to lower involuntary market premium and less oil and gas revenues due to price and production declines from the Company's energy operations. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members. The increase for the year reflects gains of $59 million on early extinguishment of debt and higher installment fees in Agency Markets due to the acquisition of Safeco, partially offset by the decline in oil and gas revenues and fee revenue from the Company's servicing carrier operations.

Claims, benefits and expenses for the three and twelve months ended December 31, 2009 were $7.442 billion and $29.884 billion, respectively, a decrease of $258 million and an increase of $2.282 billion versus the same periods in 2008. The decrease in the quarter primarily reflects lower workers compensation losses in Commercial Markets due to a decline in premium volume, ceded losses and expenses associated with the homeowners quota share reinsurance treaty and lower catastrophe losses. Partially offsetting the decrease in the quarter were business growth and inflation in International's Latin American operations, primarily in Venezuela, less net favorable incurred losses attributable to prior years and the impact of stronger foreign currencies versus the U.S. dollar. The increase for the year primarily reflects the acquisition of Safeco, business growth and inflation in International's Latin American operations, primarily in Venezuela, less net favorable incurred losses attributable to prior years and higher corporate benefit expenses related to pension plans. Partially offsetting the increase for the year were lower catastrophe losses, lower workers compensation losses in Commercial Markets due to a decline in premium volume, the impact of weaker foreign currencies versus the U.S. dollar and ceded losses and expenses associated with the homeowners quota share reinsurance treaty.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
CONSOLIDATED	**2009**	**2008**	**Change (Points)**	**2009**	**2008**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	70.3%	69.4%	0.9	69.7%	69.6%	0.1
Underwriting expense ratio[1]	29.5	29.0	0.5	28.5	27.7	0.8
Dividend ratio	0.1	0.2	(0.1)	0.2	0.3	(0.1)
Subtotal	99.9	98.6	1.3	98.4	97.6	0.8
Catastrophes[2]:						
-September 2008 Hurricanes	0.1	2.4	(2.3)	0.1	3.6	(3.5)
-All other	1.6	1.6	-	3.2	2.8	0.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	1.2	0.1	1.1
- All other	(2.3)	(7.1)	4.8	(3.0)	(4.0)	1.0
Current accident year re-estimation[3]	-	(0.2)	0.2	-	-	-
Total combined ratio[4]	99.3%	95.3%	4.0	99.9%	100.1%	(0.2)

1 One-time Safeco integration costs have been excluded from the combined ratio.

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 Year-end re-estimation of 2008 accident year loss reserves for the nine months ended September 30, 2008.

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 and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2009 was 99.9% and 98.4% respectively, increases of 1.3 points and 0.8 points over the same periods in 2008. The increase in the claims and claim adjustment expense ratio in both periods reflects unfavorable loss trends in Personal Markets homeowners line of business, increasing loss trends in Commercial Markets workers compensation and general liability lines of business, an increase in loss activity in LIU's reinsurance business resulting from several large loss events and a higher loss ratio in Summit due to a decrease in rates. Substantially offsetting the increase for the year were the impact of favorable Agency Markets results across property and liability lines and greater weighting of personal lines results from the acquired Safeco personal lines business. The increase in the underwriting expense ratio in both periods primarily reflects a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the involuntary pools, the impact of the acquired Safeco personal lines, which has higher distribution costs relative to other segments of the business and higher corporate benefit costs related to pension benefits.

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, 2009 was 99.3% and 99.9%, respectively, an increase of 4.0 points and a decrease of 0.2 points versus the same periods in 2008. The increase in the quarter reflects the changes in the combined ratio components previously discussed and less favorable net incurred losses attributable to prior years, partially offset by lower catastrophe losses. The decrease in the combined ratio for the year includes the items previously discussed and lower catastrophe losses partially offset by less favorable net incurred losses attributable to prior years.

Income tax expense for the three and twelve months ended December 31, 2009 was $44 million and $187 million, respectively, increases of $40 million and $47 million over the same periods in 2008. The Company's effective tax rate for the three and twelve months ended December 31, 2009 was 9% and 15%, respectively, compared to 1% and 11% for the same periods in 2008. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-exempt investment income, goodwill and foreign taxes.

Net income for the three and twelve months ended December 31, 2009 was $456 million and $1.023 billion, respectively, an increase of $9 million and a decrease of $90 million versus the same periods in 2008.

Cash flow from operations for the three and twelve months ended December 31, 2009 was $919 million and $2.487 billion, respectively, an increase of $746 million and a decrease of $258 million versus the same periods in 2008. The increase in the quarter is driven by higher premium collections and higher investment income, as well as a decrease in ceded premium associated with the homeowners quota share treaty, and higher catastrophe and non-catastrophe paid losses. The decrease for the year primarily reflects lower premium collections, pension contributions in 2009 that did not occur in 2008, an increase in external reinsurance not related to the homeowners quota share treaty and higher catastrophe and non-catastrophe paid losses.

AGENCY MARKETS

Overview – Agency Markets

Agency Markets delivers personal and commercial insurance products and services to individuals and small businesses through independent agents throughout the United States. Commercial lines products are offered through eight regional insurance companies that combine their local underwriting, market knowledge and service orientation with the cost efficiencies of a national company. Personal lines products are distributed nationally using the Safeco brand, with a focus on product and pricing sophistication. Liberty Mutual Surety is a leading provider of nationwide contract and commercial surety bonds. Summit provides workers compensation in the Southeast (primarily Florida).

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009[1]**	**2008[1]**	**Change**	**2009[1]**	**2008[1]**	**Change**
Personal Lines (Safeco)	$1,181	$1,202	(1.7%)	$4,916	$2,346	109.5%
Regional Companies Group	1,062	1,156	(8.1%)	4,585	3,967	15.6%
Liberty Mutual Surety	169	183	(7.7%)	707	479	47.6%
Summit	98	27	NM	487	537	(9.3%)
Other[2]	45	27	66.7%	167	128	30.5%
Total net written premium	$2,555	$2,595	(1.5%)	$10,862	$7,457	45.7%

1 Effective in the first quarter 2009, net written premium of both legacy Safeco and Regional Companies Group have been reclassified as follows: a) commercial lines operations are reflected in the Regional Companies Group segment; this segment also includes excess casualty operations previously reflected in Other, b) personal lines results are reflected in the Personal Lines (Safeco) segment and c) surety and fidelity operations are reflected in the Liberty Mutual Surety segment. The prior periods have been restated to reflect these changes.

2 Includes 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	**2009**	**2008[1]**	**Change**	**2009**	**2008[1]**	**Change**
Commercial Lines						
Commercial multiple peril	$447	$471	(5.1%)	$1,896	$1,567	21.0%
Workers compensation total:	311	260	19.6%	1,393	1,464	(4.8%)
- Summit	98	27	NM	487	537	(9.3%)
- All other	213	233	(8.6%)	906	927	(2.3%)
Commercial automobile	255	281	(9.3%)	1,119	921	21.5%
Bond	169	184	(8.2%)	707	478	47.9%
General liability	111	108	2.8%	500	398	25.6%
Other	72	83	(13.3%)	290	255	13.7%
Subtotal	$1,365	$1,387	(1.6%)	$5,905	$5,083	16.2%
Personal Lines						
Private passenger automobile	$746	$802	(7.0%)	$3,128	$1,514	106.6%
Homeowners	345	322	7.1%	1,412	708	99.4%
Other	99	84	17.9%	417	152	174.3%
Subtotal	$1,190	$1,208	(1.5%)	$4,957	$2,374	108.8%
Total net written premium	$2,555	$2,595	(1.5%)	$10,862	$7,457	45.7%

[1] Restated to reflect adjustments within lines of business related to premium acquired from Safeco
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2009 was $2.555 billion and $10.862 billion, respectively, a decrease of $40 million and an increase of $3.405 billion versus the same periods in 2008. The decrease in the quarter reflects lower new business and retention across most lines of business due to weak economic conditions, partially offset by rate increases as well as an increase in Summit's workers compensation premium due to a premium reduction in 2008 related to estimated future audits attributable to 2008 and prior years that did not recur in 2009. The increase for the year reflects the impact of the Safeco acquisition and rate increases partially offset by exposure reductions due to economic contraction, lower new business and retention due to competitive market conditions and state mandated rate decreases of 18.9% in Florida workers compensation. The Safeco acquisition contributed approximately $3.6 billion of premium for the year, including approximately $2.5 billion of personal lines and approximately $1.1 billion of commercial lines premium.

Results of Operations – Agency Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Revenues	$2,936	$3,104	(5.4%)	$11,928	$8,245	44.7%
PTOI before catastrophes and net incurred losses attributable to prior years	$335	$266	25.9%	$1,300	$678	91.7%
Catastrophes[1]:						
-September 2008 Hurricanes	(8)	(16)	(50.0%)	(24)	(108)	(77.8%)
-All other	(84)	(41)	104.9%	(496)	(242)	105.0%
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	111	291	(61.9%)	692	581	19.1%
Pre-tax operating income	$354	$500	(29.2%)	$1,472	$909	61.9%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. 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 ($6) million and ($74) million for the three and twelve months ended December 31, 2009, respectively, and ($12) million and ($23) million for the comparable periods of 2008.

PTOI for the three and twelve months ended December 31, 2009 was $354 million and $1.472 billion, respectively, a decrease of $146 million and an increase of $563 million versus the same periods in 2008. The decrease in the quarter is primarily due to less favorable net incurred losses attributable to prior years, increased catastrophe losses, lower audit premium, and lower investment income, partially offset by lower restructuring and integration costs and cost efficiencies resulting from the Safeco acquisition**.** The increase in PTOI for the year is primarily attributable to operating earnings and cost efficiencies associated with the Safeco acquisition, favorable incurred losses attributable to prior years and decreased restructuring and integration costs, partially offset by unfavorable catastrophe activity.

Revenues for the three and twelve months ended December 31, 2009 were $2.936 billion and $11.928 billion, respectively, a decrease of $168 million and an increase of $3.683 billion versus the same periods in 2008. The major components of revenues are net premium earned, net investment income, and fee and other income.

Net premiums earned for the three and twelve months ended December 31, 2009 were $2.680 billion and $10.924 billion, respectively, a decrease of $139 million and an increase of $3.448 billion versus the same periods in 2008. The decrease in the quarter is primarily associated with the changes in net written premium previously discussed, as well as lower audit premium. The increase for the year reflects approximately $3.7 billion of premium related to the Safeco acquisition, partially offset by lower audit premium and the earned premium associated with the changes in net written premium previously discussed.

Net investment income for the three and twelve months ended December 31, 2009 was $223 million and $882 million, respectively, a decrease of $29 million and an increase of $194 million versus the same periods in 2008. The decrease in the quarter reflects lower invested assets and yields in the fourth quarter of 2009 compared to 2008, partially offset by the continued investment of cash flow from operations. The increase for the year reflects an increase in invested assets due to the Safeco acquisition and 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, 2009 were $33 million and $122 million, unchanged for the quarter and an increase of $41 million in the year. The increase for the year reflects increased installment fees due to the Safeco acquisition.

Claims, benefits and expenses for the three and twelve months ended December 31, 2009 were $2.582 billion and $10.456 billion, respectively, a decrease of $22 million and an increase of $3.120 billion versus the same periods in 2008. The decrease in the quarter was primarily due to decreased restructuring and integration costs, efficiencies resulting from the Safeco acquisition and lower claims and claim adjustment expenses driven by lower premium and favorable frequency trends. These were partially offset by an increase in catastrophe losses, mainly winter storm activity and some additional development occurring earlier in the year, less favorable incurred losses attributable to prior years, and a premium assessment refund relating to Florida workers compensation in the previous period. The increase in the year reflects the impact of the Safeco acquisition net of efficiencies achieved through integration, higher catastrophe losses related to winter and Midwest storms, and lower premium assessments relating to Florida workers compensation in the previous period. These were partially offset by favorable incurred losses attributable to prior years due to better than expected frequency and severity trends across most commercial and personal lines, decreased restructuring and integration costs, and lower current year claims and claim adjustment expenses driven by frequency trends.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
AGENCY MARKETS	**2009**	**2008**	**Change (Points)**	**2009**	**2008**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	63.0%	65.0%	(2.0)	63.9%	65.9%	(2.0)
Underwriting expense ratio[1]	31.7	31.2	0.5	30.9	32.1	(1.2)
Dividend ratio	0.2	0.3	(0.1)	0.3	0.5	(0.2)
Subtotal	94.9	96.5	(1.6)	95.1	98.5	(3.4)
Catastrophes:[2]						
-September 2008 Hurricanes	0.3	0.6	(0.3)	0.2	1.4	(1.2)
-All other	3.1	1.4	1.7	4.5	3.2	1.3
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.1)	(10.3)	7.2	(6.3)	(7.7)	1.4
Total combined ratio	95.2%	88.2%	7.0	93.5%	95.4%	(1.9)

1 One-time Safeco integration costs have been excluded from the combined ratio.

2 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

The Agency Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2009 was 94.9% and 95.1%, respectively, decreases of 1.6 points and 3.4 points from the same periods in 2008. The decrease in the quarter is primarily due to lower claims and claim adjustment expense ratios across both property and liability lines of business, partially offset by a higher underwriting expense ratio due to a premium assessment refund at Summit in the previous period. The decrease in the ratio for the year reflects a lower claims and claim adjustment expense ratio due to favorable personal lines property and liability results, favorable commercial lines property results and business mix change due to the Safeco acquisition, partially offset by higher loss ratios in Summit due to the decrease in rates. The decrease for the year in the underwriting expense ratio reflects the impact of writing more personal lines business, which typically has a lower expense ratio, and increased efficiencies resulting from the Safeco acquisition.

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, 2009 was 95.2% and 93.5%, respectively, an increase of 7.0 points in the quarter and a decrease of 1.9 points in the year. The increase in the quarter is primarily due to less favorable incurred losses attributable to prior years, principally in commercial liability lines and higher catastrophe losses, mainly winter storm activity with some additional development of events occurring earlier in the year. These were partially offset by the changes in the quarter previously discussed. The decrease in the ratio for the year primarily reflects the claims and claim adjustment expense ratio and underwriting ratio decreases previously discussed, partially offset by less favorable losses attributable to prior years.

INTERNATIONAL

Overview – International

International provides insurance products and services through two distinct approaches: local businesses, which sell personal and small commercial lines products, and Liberty International Underwriters ("LIU") which sells specialty commercial lines worldwide. International's local business operations consist of local insurance operations selling property, casualty, health and life insurance products (primarily auto) to individuals and businesses in countries with a large and growing middle class. In Latin 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, International operates in Spain, Portugal, Turkey and Poland. LIU writes casualty, specialty casualty, marine, energy, construction, aviation and property coverages through offices in Asia, Australia, Europe, the Middle East, North America and Latin 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	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
International Local Businesses Total	$1,320	$1,061	24.4%	$4,541	$4,185	8.5%
- Latin America	903	684	32.0	3,010	2,558	17.7
- Europe	352	324	8.6	1,282	1,410	(9.1)
- Asia	65	53	22.6	249	217	14.7
Liberty International Underwriters	629	670	(6.1)	2,539	2,572	(1.3)
Total net written premium (NWP)	$1,949	$1,731	12.6%	$7,080	$6,757	4.8%
Foreign exchange effect on growth			6.9%			(4.8%)
NWP growth excluding foreign exchange			5.7%			9.6%

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: handset protection coverage for lost or damaged devices;
(4) LIU third party: includes casualty, excess casualty, D&O, E&O, 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 and crisis management.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Local businesses – private passenger auto	$807	$646	24.9%	$2,698	$2,554	5.6%
Local businesses – all other[1]	513	415	23.6	1,843	1,631	13.0
LIU reinsurance	199	250	(20.4)	940	969	(3.0)
LIU inland marine program	154	160	(3.8)	627	620	1.1
LIU third party	189	194	(2.6)	685	711	(3.7)
LIU first party	74	62	19.4	252	230	9.6
LIU other	13	4	NM	35	42	(16.7)
Total net written premium	$1,949	$1,731	12.6%	$7,080	$6,757	4.8%

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

Net written premium for the three and twelve months ended December 31, 2009 was $1.949 billion and $7.080 billion, respectively, increases of $218 million and $323 million over the same periods in 2008. The increases in both periods reflect growth in the local businesses, partially offset by a decline within LIU. The increase in the local businesses was driven largely by organic growth in Latin America, primarily due to inflation in Venezuela, and to a lesser extent, Asia, partially offset by a decline in Europe as a result of the region's general economic contraction. While LIU has seen increased competition and declining exposures over the course of 2009, the decline in LIU in both periods was primarily driven by LIU reinsurance. Also contributing to the decline in LIU for the year is LIU Third Party. The decline in LIU reinsurance in the quarter was primarily the result of reduced volume within certain lines following a general economic slowdown within the United Kingdom. However, the decrease for the year is driven by a stronger U.S. dollar relative to select foreign currencies. The decline in LIU also reflects an increase in the amount of ceded written premium in LIU's inland marine and third party businesses due to a change in the structure of certain reinsurance programs. Partially offsetting the decrease in LIU was growth in LIU's first party business, as well as a reduction in the amount of ceded written premium due to less hurricane activity in 2009 versus 2008. Overall, the weakening of the U.S. dollar versus foreign currencies contributed to the growth in the quarter (approximately $120 million). However, the impact of a stronger U.S. dollar over the course of 2009 versus the prior year partially offset the increase for the year (approximately $325 million).

Results of Operations – International

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Revenues	$2,071	$1,824	13.5%	$7,589	$7,049	7.7%
PTOI before catastrophes and net incurred losses attributable to prior years	$121	$151	(19.9%)	$463	$587	(21.1%)
Catastrophes:[1, 2]						
-September 2008 Hurricanes	(3)	(66)	(95.5%)	(12)	(167)	(92.8%)
-All other	(1)	(22)	(95.5%)	(4)	(22)	(81.8%)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	11	189	(94.2%)	33	285	(88.4%)
Pre-tax operating income	$128	$252	(49.2%)	$480	$683	(29.7%)

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) 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 are reported net of estimated net catastrophe reinsurance premium earned of zero for the three and twelve months ended December 31, 2009, and $16 million and $23 million for the comparable periods of 2008.

3 Net of earned premium attributable to prior years of $17 million and $20 million for the three and twelve months ended December 31, 2009, respectively, and ($4) million and ($6) million for the comparable periods of 2008.

PTOI for the three and twelve months ended December 31, 2009 was $128 million and $480 million, respectively, decreases of $124 million and $203 million from the comparable periods in 2008. The decreases in both periods mainly reflect lower favorable incurred loss development attributable to prior years and increased loss activity, primarily in LIU, as well as select countries within Latin America. Slightly offsetting the decrease in the quarter was the impact of a weaker U.S. dollar versus the prior year (approximately $9 million). The decrease for the year includes the strengthening of the U.S. dollar versus foreign currencies (approximately $17 million).

Revenues for the three and twelve months ended December 31, 2009 were $2.071 billion and $7.589 billion, respectively, increases of $247 million and $540 million over the same periods in 2008. The primary components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2009 was $1.873 billion and $6.833 billion, respectively, increases of $260 million and $504 million over the same periods in 2008. The increases in both periods reflect the organic growth in net written premium in 2008 and 2009. The increase in the quarter also reflects the weakening of the U.S. dollar versus foreign currencies (approximately $138 million). The increase for the year was partially offset by the impact of a stronger U.S. dollar versus the prior year (approximately $322 million).

Net investment income for the three and twelve months ended December 31, 2009 was $159 million and $604 million, respectively, decreases of $2 million and $12 million from the same periods in 2008. The decreases in both periods reflect the impact of a decline in yield, partially offset by an increase associated with a higher invested asset base.

Claims, benefits and expenses for the three and twelve months ended December 31, 2009 were $1.947 billion and $7.108 billion, respectively, increases of $387 million and $701 million over the same periods in 2008. The increases in both periods reflect lower favorable incurred loss development attributable to prior years, partially offset by a decrease in catastrophe losses related to the 2004, 2005 and September 2008 Hurricanes in LIU's first party and reinsurance lines of business. The increases in both periods also reflect growth in the local businesses, primarily in Latin America, and inflation in Venezuela. The increase in the quarter also reflects the weakening of the U.S. dollar versus foreign currencies. The increase for the year, however, was partially offset by the impact of a stronger U.S. dollar versus the prior year.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
INTERNATIONAL	**2009**	**2008**	**Change (Points)**	**2009**	**2008**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	69.5%	68.7%	0.8	70.3%	68.3%	2.0
Underwriting expense ratio	31.3	31.5	(0.2)	30.5	31.7	(1.2)
Dividend ratio	-	-	-	-	-	-
Subtotal	100.8	100.2	0.6	100.8	100.0	0.8
Catastrophes:[1]						
-September 2008 Hurricanes	0.2	4.1	(3.9)	0.2	2.7	(2.5)
-All other	-	1.3	(1.3)	-	0.3	(0.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(0.6)	(11.8)	11.2	(0.4)	(4.6)	4.2
Total combined ratio	100.4%	93.8	6.6	100.6%	98.4%	2.2

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.

The International combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2009 was 100.8%, increases of 0.6 points and 0.8 points over the same periods in 2008, respectively. The increases in the claims and claim adjustment expense ratio in both periods primarily reflect an increase in loss activity within LIU's reinsurance business resulting from several large loss events. The increase for the year in the claims and claim adjustment expense ratio also reflects higher loss activity in the local businesses, mainly in certain countries within Latin America, and to a lesser extent, Asia. The increases in both periods were partially offset by a lower underwriting expense ratio in the local businesses, primarily in Latin America and Europe, as a result of effective expense management. The decrease for the year in the underwriting expense ratio also reflects a lower commission expense ratio primarily due to a change in the structure of a reinsurance program in LIU's inland marine business.

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, 2009 was 100.4% and 100.6%, respectively, increases of 6.6 points and 2.2 points over the same periods in 2008. These movements reflect the previously mentioned changes in the combined ratio components, a decrease in the amount of favorable incurred loss development attributable to prior years in 2009 as compared to the same periods in 2008 partially offset by the impact of catastrophe loss development related to the 2004, 2005 and September 2008 Hurricanes in LIU's first party and reinsurance businesses that occurred in 2008.

PERSONAL MARKETS

Overview – Personal Markets

Personal Markets sells 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 1,900 licensed captive sales representatives, approximately 500 licensed telesales counselors, third-party producers and the Internet. Personal Markets' largest source of new business is through its more than 12,000 sponsored affinity groups (including employers, professional associations and alumni associations, credit unions, and other partnerships).

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Private passenger automobile	$923	$882	4.6%	$3,983	$3,837	3.8%
Homeowners and other	534	480	11.3	2,066	1,867	10.7
Individual life	79	80	(1.3)	297	265	12.1
Total net written premium	$1,536	$1,442	6.5%	$6,346	$5,969	6.3%

Net written premium for the three and twelve months ended December 31, 2009 was $1.536 billion and $6.346 billion, respectively, increases of $94 million and $377 million over the same periods in 2008.

Private passenger automobile net written premium for the three and twelve months ended December 31, 2009 was $923 million and $3.983 billion, respectively, increases of $41 million and $146 million over the same periods in 2008. The increases in both periods reflect a 3.6% increase in voluntary policies in-force as compared to December 31, 2008 due to strong customer retention and new business growth, and positive rate action.

Homeowners and other net written premium for the three and twelve months ended December 31, 2009 was $534 million and $2.066 billion, respectively, increases of $54 million and $199 million over the same periods in 2008. The increases in both periods reflect a 6.4% increase in policies in-force (1.3 points related to renters policies) as compared to December 31, 2008 due to strong customer retention and new business growth, primarily in non-coastal areas, as well as positive rate increases. 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 the Company’s homeowners products to its automobile prospects and customers through the Internet and call centers.

Individual life net written premium for the three and twelve months ended December 31, 2009 was $79 million and $297 million, respectively, a decrease of $1 million and an increase of $32 million versus the same periods in 2008. The increase for the year reflects higher structured settlement sales.

Results of Operations – Personal Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Revenues	$1,814	$1,719	5.5%	$7,001	$6,684	4.7%
PTOI before catastrophes and net incurred losses attributable to prior years	$172	$236	(27.1%)	$912	$905	0.8%
Catastrophes:[1]						
-September 2008 Hurricanes	-	(2)	(100.0%)	21	(270)	NM
-All other	(29)	(66)	(56.1%)	(338)	(373)	(9.4%)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	66	30	120.0%	59	88	(33.0%)
Current accident year re-estimation [2]	-	12	(100.0%)	-	-	-
Pre-tax operating income	$209	$210	(0.5%)	$654	$350	86.9%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Year-end re-estimation of 2008 accident year loss reserves for the nine months ended September 30, 2008.
NM = Not Meaningful

PTOI for the three and twelve months ended December 31, 2009 was $209 million and $654 million, respectively, a decrease of $1 million and an increase of $304 million versus the same periods in 2008. The decrease in the quarter was primarily attributable to increased non-catastrophe losses. PTOI in both periods reflect higher net premium earned as well as decreased catastrophe losses.

Revenues for the three and twelve months ended December 31, 2009 were $1.814 billion and $7.001 billion, respectively, increases of $95 million and $317 million over the same periods in 2008. 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, 2009 was $1.589 billion and $6.149 billion, respectively, increases of $69 million and $275 million over the same periods in 2008. 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 2009, and an increase in sales of structured settlement products in individual life.

Net investment income for the three and twelve months ended December 31, 2009 was $187 million and $727 million, respectively, increases of $6 million and $16 million over the same periods in 2008. Both periods reflect a 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, 2009 were $1.601 billion and $6.354 billion, respectively, an increase of $81 million and a decrease of $10 million versus the same periods in 2008. The increase in the quarter primarily reflects increased automobile liability and property losses. Both periods reflect a decrease in catastrophe losses and reduced corporate overhead absorption due to the impact of the Safeco acquisition, which were partially offset by business growth and general cost increases. The decrease for the year also includes a subrogation recovery related to the 2007 California wildfires, favorable development on the September 2008 Hurricanes, and lower profit share expense related to business acquired from Prudential Financial, Inc. ("PruPac").

	Three Months Ended December 31,			Twelve Months Ended December 31,		
PERSONAL MARKETS	**2009**	**2008**	**Change (Points)**	**2009**	**2008**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	69.8%	64.7%	5.1	65.4%	63.4%	2.0
Underwriting expense ratio	24.9	24.9	-	25.0	26.1	(1.1)
Dividend ratio	-	-	-	-	-	-
Subtotal	94.7	89.6	5.1	90.4	89.5	0.9
Catastrophes[1]:						
-September 2008 Hurricanes	-	0.1	(0.1)	(0.4)	4.8	(5.2)
-All other	2.0	4.6	(2.6)	5.8	6.7	(0.9)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(2.8)	(2.1)	(0.7)	(1.0)	(1.6)	0.6
Current accident year re-estimation [2]	-	(0.9)	0.9	-	-	-
Total combined ratio	93.9%	91.3%	2.6	94.8%	99.4%	(4.6)

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

2 Year-end re-estimation of 2008 accident year loss reserves for the nine months ended September 30, 2008.

The Personal Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2009 was 94.7% and 90.4%, respectively, increases of 5.1 points and 0.9 points over the same periods in 2008. The increase in the claims and claim adjustment expense ratio in both periods is primarily related to unfavorable trends in the homeowners line of business as a result of higher severity (consistent with industry trends) and higher frequency (below industry trends). The underwriting expense ratio remained flat in the quarter, as higher variable compensation and sales costs were offset by reduced corporate overhead absorption due to the impact of the Safeco acquisition. In addition to the reduced corporate overhead, the decrease in the underwriting expense ratio for the year reflects lower profit share expense related to PruPac compared to 2008.

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, 2009 was 93.9% and 94.8%, respectively, an increase of 2.6 points and a decrease of 4.6 points versus the same periods in 2008. The increase in the quarter reflects the changes previously discussed, partially offset by lower catastrophe losses. The decrease for the year reflects changes previously discussed and lower catastrophe losses, partially offset by a decrease in the amount of favorable prior year loss development on automobile liability business as compared to 2008.

COMMERCIAL MARKETS

Overview – Commercial Markets

Commercial Markets offers a wide array of commercial insurance coverages to mid-sized and large businesses (with an annual cost of risk of $150,000 or more) through independent agents, brokers and benefit consultants throughout the United States. The Commercial Markets business unit is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base or product grouping 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 involuntary market pools.

On January 22, 2009, Commercial Markets established Middle Market, a new market segment that combined the Business Market and Wausau Insurance market segments. As part of this change, Commercial Markets eliminated its direct distribution channel to its mid-sized commercial lines customers and retired the Wausau brand. Middle Market provides 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 directly distributed 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	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Middle Market[1,2]	$354	$464	(23.7%)	$1,773	$2,359	(24.8%)
National Market[2]	179	251	(28.7)	1,142	1,512	(24.5)
Group Benefits	154	136	13.2	607	553	9.8
Specialty Lines[3]	52	59	(11.9)	347	327	6.1
Liberty Mutual Property	44	51	(13.7)	311	348	(10.6)
Other Markets	111	123	(9.8)	425	496	(14.3)
Total net written premium	$894	$1,084	(17.5%)	$4,605	$5,595	(17.7%)

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 November 1, 2008, certain accounts with available premium and premium equivalents greater than $1.5 million, previously reported as part of Middle Market, have been transferred upon renewal to National Market. The prior periods have been restated to reflect this change.

3 Effective in the fourth quarter 2008, net written premium associated with Commercial Affinity, previously reported as part of Wausau Insurance, is now included in Specialty Lines. 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	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Workers compensation	$417	$615	(32.2%)	$2,391	$3,184	(24.9%)
Group disability and life	154	136	13.2	607	553	9.8
General liability	73	66	10.6	465	588	(20.9)
Commercial automobile	103	112	(8.0)	419	487	(14.0)
Commercial multiple peril / Fire	53	62	(14.5)	342	390	(12.3)
Assumed voluntary reinsurance	54	45	20.0	179	161	11.2
Other	40	48	(16.7)	202	232	(12.9)
Total net written premium	$894	$1,084	(17.5%)	$4,605	$5,595	(17.7%)

Net written premium for the three and twelve months ended December 31, 2009 was $894 million and $4.605 billion, respectively, decreases of $190 million and $990 million from the same periods in 2008. The decreases reflect a decrease in exposures due to weak economic conditions and lower retention levels across most lines of business and market segments, most pronounced in the Middle Market segment due to the impact of a competitive rate environment and the change from direct distribution to third party. Also contributing to the decreases in both periods were a reduction in audit premium driven by a decline in exposures and a decline in assumed workers compensation premium from the state based involuntary market pools included in the Other Markets segment. The decline in the involuntary market pools is due to shrinking pools as insureds have been able to find insurance in the voluntary market. The decrease for the year also reflects lower new business writings across most lines of business and market segments. In addition, workers compensation premium and general liability premium in the National Market segment decreased by $45 million and $43 million for the year, respectively, driven by a multi-year construction account written in 2008 that did not recur. Partially offsetting the decreases in both periods was an increase in group disability and life business due to a broader penetration of those markets, an increase in assumed voluntary reinsurance included in the Other Markets segment and a fourth quarter 2008 reduction in prior policy period general liability and workers compensation premium on a multi-year construction program of $37 million and $11 million respectively, included in the National Market segment. For the year, the Specialty Lines segment had an increase in workers compensation, general liability and commercial automobile premium due to lower ceded premium.

Results of Operations – Commercial Markets

$ in Millions	Three Months Ended December 31, 2009	2008	Change	Twelve Months Ended December 31, 2009	2008	Change
Revenues	$1,401	$1,661	(15.7%)	$6,028	$6,804	(11.4%)
PTOI before catastrophes and net incurred losses attributable to prior years	$62	$94	(34.0%)	$318	$429	(25.9%)
Catastrophes[1]:						
-September 2008 Hurricanes	5	(53)	NM	5	(209)	NM
-All other	7	12	(41.7)	(32)	(59)	(45.8)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	23	(6)	NM	61	41	48.8
Pre-tax operating income	$97	$47	106.4%	$352	$202	74.3%

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's assumed voluntary reinsurance 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 ($25) million and ($31) million for the three and twelve months ended December 31, 2009, and ($72) million and ($48) million for the comparable periods of 2008. Net of amortization of deferred gains on retroactive reinsurance of $17 million and $54 million for the three and twelve months ended December 31, 2009, and $17 million and $55 million for the comparable periods of 2008.

PTOI for the three and twelve months ended December 31, 2009 was $97 million and $352 million, respectively, increases of $50 million and $150 million over the same periods in 2008. The increases in both periods reflect lower catastrophe and non-catastrophe property losses, favorable incurred losses attributable to prior years, and lower fixed expenses, primarily as a result of the Middle Market reorganization, partially offset by declining earned premium and deteriorating loss trends primarily in the workers compensation, general liability, and group disability and life lines of business. The increase for the year also reflects an increase in net investment income.

Revenues for the three and twelve months ended December 31, 2009 were $1.401 billion and $6.028 billion, respectively, decreases of $260 million and $776 million from the same periods in 2008. 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, 2009 was $1.128 billion and $4.913 billion, respectively, decreases of $249 million and $756 million from the same periods in 2008. The decreases in both periods reflect the decrease in net written premium during 2009 and the fourth quarter of 2008.

Net investment income for the three and twelve months ended December 31, 2009 was $212 million and $846 million, respectively, a decrease of $1 million and an increase of $12 million versus the same periods in 2008. The increase for the year primarily reflects 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, 2009 were $62 million and $270 million, respectively, decreases of $9 million and $31 million from the same periods in 2008. The decreases in both periods 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, 2009 were $1.305 billion and $5.677 billion, respectively, decreases of $309 million and $925 million from the same periods in 2008. The decreases in both periods primarily reflect lower catastrophe and non-catastrophe property losses, lower workers compensation losses due to a decline in premium volumes, and reserve weakening from the involuntary market workers compensation pools, partially offset by deteriorating loss trends in workers compensation and general liability. Compensation related expenses decreased in both periods, primarily as a result of the Middle Market reorganization. In addition, general expenses declined due to less corporate overhead absorption due to the impact of the Safeco acquisition. Finally, a decline in exposures and net written premium resulted in declining claims and premium tax expense in both periods.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
COMMERCIAL MARKETS	**2009**	**2008**	**Change (Points)**	**2009**	**2008**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	85.5%	81.7%	3.8	85.2%	82.8%	2.4
Underwriting expense ratio	23.6	23.6	-	22.1	21.6	0.5
Dividend ratio	0.3	0.5	(0.2)	0.5	0.6	(0.1)
Subtotal	109.4	105.8	3.6	107.8	105.0	2.8
Catastrophes[1]:						
-September 2008 Hurricanes	(0.5)	4.0	(4.5)	(0.1)	4.0	(4.1)
-All other	(0.7)	(0.9)	0.2	0.7	1.2	(0.5)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(2.2)	1.3	(3.5)	(1.3)	(0.6)	(0.7)
Total combined ratio	106.0%	110.2%	(4.2)	107.1%	109.6%	(2.5)

1 Catastrophes include all current and prior year catastrophe losses including assessments from TWIA and exclude losses related to the Company's assumed voluntary reinsurance 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 Commercial Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2009 was 109.4% and 107.8%, respectively, increases of 3.6 points and 2.8 points over the same periods in 2008. The increase in the claims and claim adjustment expense ratio reflects a higher claims and claim adjustment expense ratio in the workers compensation and general liability lines of business due to increasing loss trends, partially offset by favorable non-catastrophe property losses. The increase in the underwriting expense ratio for the year is due to declining earned premium 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 reduced corporate overhead absorption due to the impact of the Safeco acquisition and significant staffing reductions due to the Middle Market reorganization and other actions taken to control expenses. Despite the decrease in expenses, the underwriting expense ratio is impacted by premium declining at a greater rate than expenses. In addition, the underwriting expense ratios in both periods of 2008 were impacted by an increase in expenses associated with the Middle Market reorganization that drove 2.3 points and 0.6 points in the fourth quarter and full year, respectively.

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, 2009 was 106.0% and 107.1%, respectively, decreases of 4.2 points and 2.5 points from the same periods in 2008. The decreases in both periods reflect lower catastrophe losses and favorable net incurred losses attributable to prior years, partially offset by the changes in the combined ratio previously discussed. Net incurred losses attributable to prior years were impacted by involuntary pool workers compensation reserve weakening, partially offset by a reduction in prior year earned premium due to a state workers compensation reinsurance association ceded premium assessment and a reduction in earned but not reported premium due to the economic downturn.

CORPORATE AND OTHER

Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Certain internal discontinued operations composed of: asbestos, environmental, and toxic tort exposures, the run-off of certain Agency Markets business, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation, certain distribution channels related to PruPac, pre-2004 Commercial Markets assumed voluntary reinsurance business and Commercial Markets pre-2005 fully insured workers compensation business.

- Interest expense on the Company's outstanding long–term debt.

- Certain risks of its SBUs that the Company reinsures as part of its risk management program.

- 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.

- The Company discounts the long-term indemnity portion of its settled unpaid workers compensation claims. In the fourth quarter of 2009, the Company changed its method of accounting for discounting from tabular discount rates based on insurance regulations as approved by the respective jurisdictions to a risk-free discount rate. Commercial Markets and Agency Markets report their discount based on a tabular rate of 4%. Corporate and Other results reflect the difference between the tabular and risk free rate.

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

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

- Income (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.

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	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Reinsurance, net	($44)	($517)	91.5%	($860)	($337)	(155.2%)
Workers compensation[1]	211	48	NM	205	18	NM
Other	18	3	NM	20	8	150.0%
Total net written premium	$185	($466)	NM	($635)	($311)	(104.2%)

[1] Booked as billed adjustment
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2009 was $185 million and ($635) million, respectively, an increase of $651 million and a decrease of $324 million versus the same periods in 2008. The increase in the quarter is attributable to a decrease in externally ceded reinsurance. In the fourth quarter of 2008, the Company entered into a reinsurance contract where the Company ceded a pro rata portion of consolidated U.S. direct written homeowners premiums. In the fourth quarter of 2009, the Company renewed a portion of the previously mentioned reinsurance contract, resulting in a decrease in ceded premium versus the comparable period of 2008. The impact of this contract on net written premium was $517 million in the quarter. Partially offsetting the increase in reinsurance is a reduction in internal reinsurance and an increase in external reinsurance, excluding the previously mentioned treaty, of $44 million. The decrease for the year reflects an increase in externally ceded reinsurance due to the previously mentioned contract. The year-over-year impact of the contract on net written premium was ($307) million. Also impacting the decrease for the year is a reduction in internal reinsurance and an increase in external reinsurance, excluding the previously mentioned treaty, of $216 million. In addition, net written premium in both periods includes a decrease in the Company's workers compensation "booked as billed" adjustment due to declining written premium in the Commercial Markets Middle Market segment.

Results of Operations – Corporate and Other

$ in Millions	**Three Months Ended December 31, 2009**	**2008[1]**	**Change**	**Twelve Months Ended December 31, 2009**	**2008[1]**	**Change**
Revenues	($280)	($157)	(78.3%)	($1,452)	$73	NM
Pre-tax operating loss before catastrophes, net incurred losses attributable to prior years and private equity (loss) income:	($284)	($331)	(14.2%)	($943)	($413)	128.3%
Catastrophes[2]:						
-September 2008 Hurricanes	-	(37)	(100.0%)	(12)	(117)	(89.7%)
-All other[3]	(2)	2	NM	1	(9)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental[4]	(2)	(2)	-	(388)	(7)	NM
- All other[5]	1	8	(87.5)	(21)	(19)	10.5%
Pre-tax operating loss before private equity (loss) income	(287)	(360)	(20.3%)	(1,363)	(565)	141.2%
Private equity (loss) income[6]	(13)	(124)	(89.5%)	(411)	4	NM
Pre-tax operating loss	($300)	($484)	(38.0%)	($1,774)	($561)	NM

1 2008 results have been restated for the retrospective accounting change related to the change in the discount rate applied to the long-term indemnity portion of the settled unpaid workers compensation claims. See the Critical Accounting Policy section of the MD&A for further details.

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). Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums of ($1) million and $2 million for the three and twelve months ended December 31, 2009 and $13 million and $19 million for the comparable periods of 2008.

3 Catastrophe losses ceded under the homeowners quota share treaty are included to the extent that the ceded combined ratio exceeds 100.0%.

4 Net of allowance for uncollectible reinsurance (increase) decrease of zero and ($70) million for the three and twelve months ended December 31, 2009, and zero and $7 million for the comparable periods of 2008.

5 Net of amortization of deferred gains on retroactive reinsurance of $5 million and $20 million for the three and twelve months ended December 31, 2009 and $12 million and $27 million for the comparable periods of 2008.

6 Private equity (loss) income is included in net investment income in the accompanying statements of income.

NM = Not Meaningful

Pre-tax operating loss for the three and twelve months ended December 31, 2009 was $300 million and $1.774 billion, a decrease of $184 million and an increase of $1.213 billion versus the same periods in 2008. The decrease in the quarter is driven by a reduction in net investment losses due to improved valuations for investments in limited partnerships and limited liability companies from the comparable period of 2008 and favorable variable annuity reserve development versus the prior period, partially offset by the net of premium, losses and expenses related to the restructuring of internal and external treaties in the Company's reinsurance program. The increase for the year is driven by higher net investment loss due to reduced valuations for investments in limited partnerships and limited liability companies, an increase in asbestos reserves in the third quarter of 2009, higher employee benefit costs, the net of premium, losses and expenses related to the restructuring of internal and external treaties in the Company's reinsurance program and higher interest expense, partially offset by favorable variable annuity reserve development versus unfavorable development in the prior period.

Revenues for the three and twelve months ended December 31, 2009 were ($280) million and ($1.452) billion, respectively, compared to ($157) million and $73 million in the same periods in 2008. The major components of revenues include net premium earned, net investment income, and fee and other revenues.

Net (ceded) premium earned for the three and twelve months ended December 31, 2009 was ($262) million and ($1.028) billion, respectively, decreases of $297 million and $1.204 billion from the same periods in

2008. The decreases in both periods primarily reflect ceded premium related to the homeowners quota share treaty and the restructuring of other treaties in the Company's reinsurance program.

Net investment loss for the three and twelve months ended December 31, 2009 was $43 million and $577 million, respectively, versus a net investment loss of $143 million and income of $31 million in the same periods in 2008. The decrease of the loss in the quarter primarily reflects a decrease in limited partnerships and limited liability companies losses reflecting improved market valuations from the same period in 2008 and continued reinvestment of cash flows from operations. Partially offsetting the decrease of the loss were declines in taxable interest income and less dividend income reflecting a change in investment strategy to reduce the total equity portfolio exposure. The decrease for the year primarily reflects an increase in limited partnerships and limited liability companies losses reflecting reduced market valuations over the comparable period in 2008, decreased dividend income due to a reduction in the equity portfolio, higher investment expenses due to the Safeco acquisition in the third quarter of 2008, strategic initiatives and variable compensation costs. Partially offsetting the increase for the year was the impact of a higher invested asset base from the Safeco acquisition and continued reinvestment of cash flows from operations.

Fee and other revenues for the three and twelve months ended December 31, 2009 were $12 million and $120 million, decreases of $14 million and $5 million from the same periods in 2008. The decreases in both periods primarily reflect less oil and gas revenues due to price and production declines. Partially offsetting the decrease for the year are gains on early extinguishment of debt of $59 million.

Claims, benefits and expenses for the three and twelve months ended December 31, 2009 were $7 million and $289 million, respectively, decreases of $395 million and $604 million from the same periods in 2008. The decreases in both periods are primarily driven by the ceded losses and expenses associated with the restructuring of treaties in the Company's reinsurance program, favorable variable annuity reserve development versus unfavorable development in prior periods and decreased variable incentive compensation. Partially offsetting the decreases for the year are increases in asbestos reserves, other corporate expenses primarily related to employee pension benefits and higher interest expense as a result of the Company's May 2008 debt offering.

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, 2009 and 2008:

$ in Millions	**As of December 31, 2009**		**As of December 31, 2008**	
Invested Assets by Type	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$56,439	84.5%	$47,731	79.9%
Equity securities, available for sale, at fair value	1,188	1.7	1,184	2.0
Limited partnerships and limited liability companies	2,455	3.7	2,534	4.2
Commercial mortgage loans	1,121	1.7	1,090	1.8
Short-term investments	575	0.9	1,193	2.0
Other investments	164	0.2	195	0.3
Cash and cash equivalents	4,847	7.3	5,848	9.8
Total Invested Assets	$66,789	100.0%	$59,775	100.0%

Total invested assets as of December 31, 2009 were $66.789 billion, an increase of $7.014 billion or 11.7% over December 31, 2008. The increase reflects investment of cash from operations and an increase in unrealized gains primarily due to a decrease in credit spreads. Partially offsetting the increase was a decline in the valuations of private equity investments.

Fixed maturities as of December 31, 2009 were $56.439 billion, an increase of $8.708 billion or 18.2% over December 31, 2008. The increase reflects market value increases, securities denominated in strengthening foreign currencies, and additional purchases of fixed income securities.

Equity securities available for sale as of December 31, 2009 were $1.188 billion ($688 million common stock and $500 million preferred stock versus $694 million common stock and $490 million preferred stock as of December 31, 2008), an increase of $4 million or 0.3% over December 31, 2008. Of the $688 million of common stock at December 31, 2009, $275 million relates to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk. The increase in total equity securities available for sale primarily reflects market appreciation partially offset by the sale of existing and acquired exposure to common equities.

Investments in limited partnerships and limited liability companies as of December 31, 2009 were $2.455 billion, a decrease of $79 million or 3.1% from December 31, 2008. These investments consist of traditional private equity partnerships of $1.547 billion, other partnerships (primarily energy) of $547 million, and real estate partnerships of $361 million. The decrease primarily reflects a decline in market value partially offset by new investments. 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, 2009 were $1.121 billion (net of $6 million of loan loss reserves or 0.6% of the outstanding loan portfolio), an increase of $31 million or 2.8% over December 31, 2008. The increase primarily reflects $84 million of new capital loaned, net of $48 million in principal repayments and an increase of $5 million to the loan loss reserves. The entire commercial loan portfolio is U.S. based. As of December 31, 2009, the average total loan size was $1.5 million and the average loan participation size was $0.5 million. The number of loans in the portfolio increased from 2,257 at December 31, 2008 to 2,469 at December 31, 2009. Approximately 91% of the loans are full or partial recourse to borrowers.

Short term investments as of December 31, 2009 were $575 million, a decrease of $618 million or 51.8% from December 31, 2008. This decrease reflects a decline in short term assets held as collateral in connection with the Company's security lending program and the acquisition of longer duration securities.

Cash and cash equivalents as of December 31, 2009 were $4.847 billion, a decrease of $1.001 billion or 17.1% from December 31, 2008. This decrease reflects the purchase of long-term securities partially offset by cash generated from operations and the previously mentioned equity security sales.

Regarding fair value measurements, as of December 31, 2009, excluding separate accounts and other assets, the Company reflected $2.281 billion as level 1 (quoted prices in active markets) primarily comprised of U.S. Treasuries and common equity securities. The majority of the Company's invested assets are reported as level 2 (quoted prices from other observable inputs). As of December 31, 2009, the Company reported $54.913 billion as level 2, consisting primarily of various fixed maturity securities. Finally, the Company reported $1.134 billion as level 3 (unobservable inputs), primarily comprised of international and privately held securities for which a market price is not readily available.

As of December 31, 2009, the Company had unfunded commitments in traditional private equity partnerships, real estate, and energy and other of $1.104 billion, $596 million and $952 million respectively. As of December 31, 2009, the Company had commitments to purchase various residential mortgage-backed securities at a cost of $222 million (fair value of $221 million).

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.

The following table summarizes the Company's available for sale portfolio by security type as of December 31, 2009 and 2008:

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
Mortgage and asset-backed securities:				
Residential	10,725	404	(140)	10,989
Commercial	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
Mortgage and asset-backed securities:				
Residential	8,406	268	(232)	8,442
Commercial	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

The following table summarizes the Company's mortgage and asset-backed fixed maturity portfolio by credit quality as of December 31, 2009:

$ in Millions	**As of December 31, 2009**							
Mortgage & Asset-Backed Fixed Maturities by Credit Quality	**AAA**	**AA**	**A**	**BBB**	**BB**	**B or Lower**	**Total**	**% of Total**
SBA loans	$1,521	$-	$-	$-	$-	$-	$1,521	10.1%
GNMA residential mortgage	4,453	-	-	-	-	-	4,453	29.6
FNMA residential mortgage	2,330	-	-	-	-	-	2,330	15.5
FHLMC residential mortgage	3,536	-	-	-	-	-	3,536	23.5
Prime residential mortgage	210	-	21	24	19	150	424	2.8
Alt-A residential mortgage	59	4	2	1	12	110	188	1.2
Sub-prime residential mortgage	11	6	11	3	12	15	58	0.4
Commercial mortgage backed securities	1,915	141	55	49	-	-	2,160	14.4
Non-mortgage asset backed securities	273	29	33	24	18	4	381	2.5
Total	$14,308	$180	$122	$101	$61	$279	$15,051	100%
% of Total	95.1%	1.2%	0.8%	0.7%	0.3%	1.9%	100%	

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). During 2009, the Company has moved some of its liquidity into longer-term mortgage backed securities. GNMA's increased $3.550 billion, reflecting acquisitions in 2009 as part of the Company's overall strategy to improve liquidity and reduce credit risk. Over 95% of the mortgage and asset-backed holdings are rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with over 95% rated AA or above, approximately 18% 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, 2009 and 2008:

$ in Millions	**As of December 31, 2009**		**As of December 31, 2008**	
Fixed Maturities by Credit Quality[1]	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
AAA	$24,896	44.2%	$21,786	45.6%
AA+, AA, AA-	10,185	18.0	9,162	19.2
A+, A, A-	10,206	18.1	9,156	19.2
BBB+, BBB, BBB-	6,599	11.7	4,776	10.0
BB+, BB, BB-	2,089	3.7	1,575	3.3
B+, B, B-	1,767	3.1	897	1.9
CCC or lower	697	1.2	379	0.8
Total fixed maturities	$56,439	100%	$ 47,731	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 decreased slightly to 92% at December 31, 2009 from 94% at December 31, 2008. The Company had 8% of its fixed maturity securities invested in non-investment grade securities at December 31, 2009, an increase of 2% primarily due to significant tightening of non-investment grade credit spreads and downgrades on investment grade securities. Overall, the average credit quality rating stands at AA- as of December 31, 2009.

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, 2009 and 2008:

$ in Millions	**As of December 31, 2009**		**As of December 31, 2008**	
Fixed Maturities by Maturity Date	**Fair Value**	**% of Total**	**Fair Value**	**% of Total**
1 year or less	$2,556	4.5%	$1,669	3.5%
Over 1 year through 5 years	12,678	22.5	9,764	20.5
Over 5 years through 10 years	10,633	18.8	9,689	20.3
Over 10 years	15,521	27.5	14,609	30.6
Mortgage and asset-backed securities	15,051	26.7	12,000	25.1
Total fixed maturities	$56,439	100%	$47,731	100.0%

During 2009, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company shortened the average duration 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, 2009 and 2008:

$ in Millions	**Three Months Ended December 31,**		**Twelve months Ended December 31,**	
Net Investment Income	**2009**	**2008**	**2009**	**2008**
Taxable interest income	$604	$620	$2,301	$2,349
Tax-exempt interest income	157	156	623	472
Dividends	9	25	41	98
Limited partnerships and limited liability companies	(13)	(124)	(411)	4
Commercial mortgage loans	18	22	68	58
Other investment income	1	9	9	27
Gross investment income	776	708	2,631	3,008
Investment expenses	(38)	(44)	(149)	(128)
Net investment income	$738	$664	$2,482	$2,880

Net investment income for the three and twelve months ended December 31, 2009 was $738 million and $2.482 billion, respectively, an increase of $74 million and a decrease of $398 million versus the same periods in 2008. The increase for the three months ended December 31, 2009 over the same period in 2008 reflects the reduction of limited partnerships and limited liability companies losses of $111 million as a result of improved market valuations from the same period in 2008 and continued reinvestment of cash flows from operations. Offsetting these increases were declines in taxable interest income and dividend income as a result of lower investment yields and the change in investment strategy to reduce the total equity portfolio exposure. The decrease in net investment income for the twelve months ended December 31, 2009 compared to the same period in 2008 was the result of limited partnership income reflecting reduced market valuations, a decrease in dividend income due to the reduction in the equity portfolio and higher investment expenses due to the Safeco acquisition in the third quarter of 2008, strategic initiatives and variable compensation costs. Partially offsetting the decrease was an increase in interest income due to a higher invested asset base from the Safeco acquisition as well as the continued reinvestment of cash flows from operations.

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, 2009 and 2008:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Derivatives Value**	**Total**
Three Months Ended December 31, 2009:				
Fixed maturities	$39	($17)	$-	$22
Common and preferred stock	13	(1)	-	12
Other	(4)	(3)	(15)	(22)
Total	$48	($21)	($15)	$12
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)
Twelve months ended December 31, 2009:				
Fixed maturities	$92	($178)	$-	($86)
Common and preferred stock	127	(45)	-	82
Other	28	(8)	10	30
Total	$247	($231)	$10	$26
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)

$ in Millions	**Three Months Ended December 31,**		**Twelve months Ended December 31,**	
Components of Net Realized Investment Gains (Losses)	**2009**	**2008**	**2009**	**2008**
Fixed maturities:				
Gross realized gains	$45	$23	$173	$109
Gross realized losses	(23)	(147)	(259)	(436)
Equities:				
Gross realized gains	13	221	146	341
Gross realized losses	(1)	(406)	(64)	(801)
Other:				
Gross realized gains	6	241	84	469
Gross realized losses	(28)	(6)	(54)	(12)
Total net realized investment gains (losses)	$12	($74)	$26	($330)

Net realized investment gains for the three and twelve months ended December 31, 2009 were $12 million and $26 million, respectively, versus losses of $74 million and $330 million in the same periods in 2008. The increase in both periods reflects impairment losses recorded in 2008 on fixed maturity and equity investments related to securities deemed to be other than temporarily impaired due to the market conditions. Partially offsetting this were gains recorded in 2008 related to derivative contracts the Company used to hedge its equity exposure and a 2008 gain from the sale of an investment property.

Effective January 1, 2009, the Company adopted FASB Staff Position FAS 115-2 and 124-2 *Recognition and Presentation of Other-Than-Temporary Impairments* as codified in FASB Accounting Standards Codification (ASC) 320, *Investments – Debt and Equity Securities.* See Footnote 1 to the Unaudited Financial Statements as of and for the three and twelve months ended December 31, 2009 for details. In the first quarter of 2009, the Company recorded a cumulative effect adjustment, net of income taxes, in the amount of $28 million. The adjustment was an increase to policyholders' unassigned equity and a corresponding decrease to accumulated other comprehensive income.

The following table summarizes the Company's unrealized losses and fair value by security type by duration of potential impairment as of December 31, 2009:

$ 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	($6)	$386	($2)	$10
Mortgage and asset-backed securities:				
Residential	(17)	1,190	(123)	425
Commercial	(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
Total fixed maturities	(148)	5,639	(658)	4,295
Common stock	(3)	34	(30)	132
Preferred stock	-	-	(86)	351
Total equities	(3)	34	(116)	483
Total	($151)	$5,673	($774)	$4,778

Unrealized losses decreased from $3.555 billion as of December 31, 2008 to $925 million as of December 31, 2009 primarily due to a decrease in credit spreads. Unrealized losses less than 12 months decreased from $1.869 billion at December 31, 2008 to $151 million as of December 31, 2009 and accounted for $1.718 billion of the overall decrease in unrealized losses. Unrealized losses greater than 12 months decreased from $1.686 billion to $774 million at December 31, 2008 and December 31, 2009 respectively, a decrease of $912 million. Included in the $774 million of unrealized losses were $421 million of unrealized losses on 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 debt securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed income securities before they recover their fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be "other-than-temporary," and the Company believes that it will not be able to collect all cash flows due on its fixed income securities, then the carrying value of the investment is written down to the expected cash flow amount and a realized loss is recorded as a credit impairment. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes as the difference between expected cash flow and fair value. As a result of the Company's quarterly other-than-temporary impairment review, total impairment losses for the three and twelve months ended December 31, 2009 were $21 million and $231 million, respectively, a decrease of $257 million and $569 million versus the same periods in 2008.

For the three and twelve months ended December 31, 2009, the Company recorded $17 million and $178 million, respectively, of fixed maturity impairment losses, of which ($3) million and $13 million, respectively, were recognized as changes to non-credit impairments. The Company has concluded that the remaining gross unrealized losses of fixed maturity securities as of December 31, 2009 are temporary.

For equity securities, if the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to fair value and a realized loss is recorded. The gross unrealized losses recorded on equity securities at December 31, 2009 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. For the three and twelve months ended December 31, 2009, the Company recorded $1 million and $45 million, respectively, of impairment losses related to equity securities and has concluded that the remaining gross unrealized losses of equity securities as of December 31, 2009 are temporary.

LIQUIDITY AND CAPITAL RESOURCES

General

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

Net cash flows are generally invested in marketable securities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. The Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of December 31, 2009 (including cash and cash equivalents) totaled $66.789 billion.

Short-term debt and current maturities of long-term debt outstanding as of December 31, 2009 and 2008 were as follows:

$ in Millions	**As of December 31, 2009**	**As of December 31, 2008**
Commercial paper	$-	$-
Revolving credit facilities	4	-
Current maturities of long-term debt[1]	301	-
Total short-term debt and current maturities of long-term debt obligations	$305	$-

[1] Includes $300 million of debt originally issued by Safeco. On December 29, 2008, $281 million of the outstanding $300 million 4.875% notes due 2010 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.

The increase in short-term debt primarily reflects an increase in current maturities of long-term debt related to the 4.875% notes that matured in February of 2010.

Long-term debt outstanding as of December 31, 2009 and 2008 was as follows:

$ in Millions	As of December 31, 2009	As of December 31, 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% 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% Subordinated notes, due 2087[2]	700	700
10.75% Subordinated notes, due 2088[3]	1,250	1,250
7.697% Surplus notes, due 2097	435	500
Subtotal	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.

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

Debt Transactions and In-force Credit Facilities

On December 14, 2009, LMGI entered into a three-year $400 million 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 million three-year unsecured revolving credit facility and its two revolving credit facilities totaling $750 million.

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 billion commercial paper program was reduced to $400 million and is backed by the three-year $400 million unsecured revolving credit facility.

On December 10, 2009, Berkeley/St. James Real Estate LLC, a wholly-owned affiliate of the Company, entered into a five-year $50 million 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.

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

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

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 note holders. 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 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 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, 2009, there was $4 million outstanding under the facility.

Interest Expense

Consolidated interest expense for the three and twelve months ended December 31, 2009 was $119 million and $483 million, respectively, a decrease of $2 million and an increase of $72 million versus the same periods in 2008. The decrease in the quarter reflects previously mentioned debt repurchases occurring in 2009. The full year increase is principally due to the Series C Notes and debt resulting from the Safeco acquisition partially offset by the previously mentioned debt repurchases. As previously discussed, the

Company continues to evaluate market conditions and may periodically effect transactions in its debt, subject to applicable limitations. Future debt repurchases may be done through open market or other appropriate transactions.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, the subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of December 31, 2009, the Company, through its downstream subsidiary LMGI, had $5.073 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 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, 2009) and 2010 available dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio[1]**		**Dividend Capacity[2]**	**Dividends Paid**
RBC Ratios and Dividend Capacity	**2009**	**2008**	**2010**	**2009**
LMIC [3]	479%	402%	$907	$342
LMFIC	451%	501%	$92	$15
EICOW	467%	362%	$108	-

[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, 2010, the LMIC pooling percentage is expected to decrease from 75.0% to 73.8%, subject to regulatory approval.

LMGI also has access to the following sources of funding:

- A management services agreement with LMIC pursuant to which LMGI is entitled to collect certain costs plus a management fee for services rendered by LMGI employees, with annual fee estimated to be approximately $50 million.
- Investment management agreements with affiliated entities pursuant to which LMGI is entitled to recover approximately $54 million in annual expenses for investment management services performed 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 30, 2009, LCS recorded $88 million and $384 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 $14.704 billion and $12.330 billion at December 31, 2009, and December 31, 2008, respectively. The increase in surplus primarily reflects net income of $916 million (the sum of earnings from the Company's 60 domestic insurance companies and dividends from subsidiaries), unrealized gains of $881 million, and an increase in other changes in surplus of $674 million primarily related to change in non-admitted goodwill from acquisitions and deferred tax assets, partially offset by surplus note repurchases of $97 million.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP 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 2008 amounts to conform to the 2009 presentation.

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 million (net of tax) to policyholders' unassigned equity and a corresponding decrease to accumulated 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 million (net of tax).

None of the other accounting standards adopted by the Company through the fourth quarter of 2009 had a material impact on the Company. See Note 1 in the Audited Consolidated Financial Statements as of and for the twelve months ended December 31, 2009 for further discussion of the Company's policies.

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 required to adopt this guidance effective January 1, 2010. The adoption of will not have a material impact on the Company.

Change in Accounting Principles

In 2009, the Company changed its method of accounting for the discounting of the long-term indemnity portion of settled 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% and 5.7% for 2009 and 2008, 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 million, 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 million, $12 million, $48 million, $12 million, and $35 million, respectively, and decreases in unassigned equity, income tax expense and net income of $23 million, $12 million and $23 million, 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 million, $131 million, $416 million, $104 million, $15 million and $27 million, respectively, and increases in unassigned equity and benefits, claims and claims adjustment expense of $243 million and $42 million, respectively.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $48.355 billion and $48.311 billion at December 31, 2009 and 2008, respectively. The increase was primarily due to business growth less the on-going settlement of claims and a reduction in net incurred losses attributable to prior years.

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

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

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

Asbestos and Environmental

The Company's asbestos and environmental (A&E) reserves for unpaid claims and claim adjustment expenses, net of reinsurance and including uncollectible reinsurance increased $184 million from $1.396 billion as of December 31, 2008 to $1.580 billion as of December 31, 2009. The increase is primarily due to the completion of the Company's biennial ground-up asbestos reserve study and the settlement of the Company's remaining tier one or two exposures, partially offset by payments during the period.

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 million. 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 completed its annual study on the environmental claims liability, resulting in immaterial adjustments to held reserves.

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

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties; the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding 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 $14.749 billion and $15.163 billion at December 31, 2009 and 2008, respectively, net of allowance for doubtful accounts. The decrease is primarily due to ongoing settlement activity, partially offset by the purchase of additional quota share protection for 2009.

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 94% 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, 2009. Collateral held against outstanding gross reinsurance recoverable balances was $5.774 billion and $5.418 billion at December 31, 2009 and 2008, respectively.

The remaining 6% 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, 2009.

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. At December 31, 2009, and 2008, deferred gains related to these reinsurance arrangements were $592 million and $620 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, 2009, 2008, and 2007 was $117 million, $115 million, and $114 million, respectively. Deferred gain amortization was $72 million, $77 million, and $57 million 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 billion and $2.060 billion 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 a multi-year property catastrophe reinsurance agreement with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 million 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 million 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 provides 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.

Impairment Losses on Investments

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in policyholders' equity. If the decline is believed to be "other-than-temporary," and the Company believes that it will not be able to collect all cash flows due on its fixed income securities, then the carrying value of the investment is written down to the expected cash flow amount and a realized loss is recorded as a credit impairment. A non-credit impairment loss is recognized in other comprehensive income, net of applicable taxes as the difference between expected cash flow and fair value.

The Company reviews fixed income, public equity securities and private equity and private equity co-investment securities for impairment on a quarterly basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to: (a) the extent of the decline in fair value below book value, (b) the duration of the decline, (c) significant adverse changes in the financial condition or near term prospects of the investment or issuer, (d) significant change in the business climate or credit ratings of the issuer, (e) general market conditions and volatility, (f) industry factors, and (g) the past impairment of the security holding or the issuer. For fixed income securities where the Company does not expect to recover the entire amortized cost basis of the security, the Company will evaluate whether the other-than-temporary is a credit or a non-credit impairment. The factors considered in making an evaluation for credit versus non-credit other-than-temporary impairment include the following: (a) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the debt security and the likelihood the issuer will be able to make payments that increase in the future), (b) performance indicators of the underlying assets in the security (including default and delinquency rates), (c) vintage, (d) geographic concentration, (e) industry analyst reports, sector credit ratings, and volatility of the security's fair value. In addition, the Company's accounting policy for other-than-temporary impairment recognition requires an other-than-temporary impairment charge be recorded when it is determined the security will be sold or it is more likely than not that the Company will be required to sell the security before recovery of the security's amortized cost basis (all debt securities and certain preferred equity securities) or the Company's intent and ability to hold certain equity securities for a period of time that is sufficient to allow for any anticipated recovery in market value.

Subsequent to December 31, 2009, the Company has not recognized any additional material other-than-temporary impairments.

Variable Interest Entities

The Company invests in energy, private equity and real estate limited partnerships and other entities subject to variable interest entity (VIE) analysis under the VIE subsections of ASC 810. 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 and 2008 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 million and $88 million and the Company's maximum exposure to loss was $99 million and $104 million 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.

Derivatives

During 2009, the Company recognized a $15 million loss on a terminated interest rate swap related to the acquired Genesis life insurance business. As of December 31, 2009 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 $0.4 million.

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each domestic 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 and diversification strategy, entered into several futures contracts related to the equities market with notional amounts totaling $599 million. All futures contracts concluded in March 2008 and the Company realized gains of $26 million on these transactions. Subsequent to the above transactions, the Company entered into a $600 million notional equity swap agreement. The 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 additional equity swap agreements with a total notional amount of $335 million. For the period ended December 31, 2008, the contracts incurred a $99 million net gain. These contracts matured in January 2009 resulting in realized gains of $25 million for the period ended December 31, 2009.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were $2.636 billion and $2.541 billion as of December 31, 2009 and 2008, 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. Amortization of these assets will occur over the remaining policy term.

Goodwill

Goodwill assets were $4.748 billion and $4.645 billion at December 31, 2009 and 2008, respectively. Goodwill is tested for impairment at least annually (performed in the fourth quarter) using a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount is not recoverable from the discounted cash flows using a "market" rate and is measured as the difference between the carrying amount and the implied fair value. No impairments were recorded in 2009 or 2008. Other changes in the carrying amount of goodwill are primarily caused by foreign currency translation adjustments and adjustments to valuation allowances for acquired tax losses.

Deferred Income Taxes

The net deferred income tax asset was $1.691 billion and $3.035 billion as of December 31, 2009 and 2008, respectively, net of a valuation allowance of $160 million and $131 million, respectively. The net decrease in the Company's net deferred income tax asset is primarily due to the change in net unrealized capital gains and losses on certain investments. The net increase in the Company's valuation allowance is primarily due to foreign currency translation adjustments. 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 net unrealized capital gains and losses on certain investments, insurance loss reserves, unearned premiums, deferred policy acquisition costs, employee benefits, net operating losses and intangible assets.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (amounts in millions):

Balance at January 1, 2009	$221
Additions based on tax positions related to current year	16
Additions for tax positions of prior years	7
Reductions for tax positions of prior years	(22)
Settlements	(1)
Balance at December 31, 2009	$221

The beginning balance has been adjusted to remove anticipated tax recoverables. Included in the tabular roll forward of unrecognized tax benefits is interest in the amount of $85 million and $72 million as of December 31, 2009, and 2008, respectively.

Included in the balance at December 31, 2009, are $119 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, 2009 and 2008, the Company recognized approximately $18 million and $8 million of interest and penalties, respectively. The Company had approximately $82 million and $66 million of interest and penalties accrued at December 31, 2009 and 2008, 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. On June 10, 2009, the United States Court of Appeals for the First Circuit entered a judgment that dismissed the Government's notice of appeal. As a result, Liberty Mutual received a cash refund of $126 million from the U.S. Treasury in December 2009.

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

The IRS has completed its review of the Company's federal income tax returns through the 1998 tax year and is currently reviewing income tax returns for the 1999 through 2007 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 fifth largest property and casualty insurer in the U.S. based on 2008 direct written premium. The Company also ranks 86th on the Fortune 500 list of largest corporations in the United States based on 2008 revenue. As of December 31, 2009, LMG had $109.475 billion in consolidated assets, $94.961 billion in consolidated liabilities, and $31.094 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.