
Hello. My name is Andrea King and I'm a Liberty Mutual policy-holder. I am writing you because I really want to say how grateful I am for having an adjuster like Charles Blackburn.
Liberty Mutual Group Annual Report 08

Financial Highlights

(Dollars in millions)	December 31,	**2008**	2007	2006
Liberty Mutual Group	Revenues	$ 28,855	$ 25,952	$ 23,508
	Pre-tax operating income	1,625	1,762	1,915
	Net income	1,140	1,518	1,626
	Cash flow from operations	2,745	4,042	3,895
	Total assets	104,316	95,015	85,498
	GAAP combined ratio	99.9%	100.1%	99.3%
Personal Markets	Revenues	$ 6,684	$ 6,524	$ 6,650
	Pre-tax operating income	350	773	737
	Cash flow from operations, pre-tax	718	1,027	1,506
	Total assets	17,402	16,806	16,256
	GAAP combined ratio	99.4%	92.0%	92.1%
Commercial Markets	Revenues	$ 6,804	$ 6,489	$ 6,075
	Pre-tax operating income	202	472	335
	Cash flow from operations, pre-tax	1,295	1,661	1,455
	Total assets	28,877	28,353	27,487
	GAAP combined ratio	109.6%	103.5%	104.8%
Agency Markets	Revenues	$ 8,245	$ 5,569	$ 4,841
	Pre-tax operating income	909	834	497
	Cash flow from operations, pre-tax	750	1,182	1,157
	Total assets	31,821	18,683	11,152
	GAAP combined ratio	95.3%	91.6%	96.5%
International	Revenues	$ 7,049	$ 6,138	$ 4,878
	Pre-tax operating income	683	478	457
	Cash flow from operations, pre-tax	1,119	1,269	838
	Total assets	18,046	18,798	17,687
	GAAP combined ratio	98.4%	99.7%	97.2%
Other*	Revenues	$ 73	$ 1,232	$ 1,064
	Pre-tax operating income	(519)	(795)	(111)
	Cash flow from operations	(1,137)	(1,097)	(1,061)

Liberty Mutual Group results include all significant business units of Liberty Mutual. Each business unit is reported in accordance with U.S. Generally Accepted Accounting Principles.

*Other includes discontinued operations (including asbestos and environmental), interest expense, internal reinsurance programs, net investment income after allocations to business units, certain expenses not allocated to the business units, net realized gains and losses from domestic operations, other revenues from corporate subsidiaries, and federal and foreign tax payments.

When you call your insurer to file a claim — whether it's a "fender bender", a fire or a workplace injury — chances are you have heightened emotions. You may be irritated with yourself, angry at that person in the other car or apprehensive in anticipation of having to deal with your insurance company.

At Liberty Mutual Group, we're well aware such feelings may lurk behind every claim. That's why, as individuals and insurance professionals, we handle your claim quickly, efficiently, and with dignity, respect and empathy. After all, we're in the business of helping people recover from damage and injury.

Andrea King's experience with Liberty Mutual, and the other stories featured in this Annual Report, represent what we seek to attain with each customer interaction. Andrea, whose home was destroyed by fire, said it best:

"If you're ever in a situation where you've lost everything, the last thing you need is an uncaring insurance company employee. Liberty employees clearly care about their jobs and how well they care for people. That makes it so much easier when you have an experience like mine."

Contents:

edmund f. kelly

Chairman, President and

Chief Executive Officer

policyholder message

What a difference a year makes.

Had I predicted, in my 2007 Annual Report message, that Bear Stearns, Washington Mutual and Lehman Brothers would cease to exist by year's end, you would have questioned my judgment. If, on top of that, I had anticipated the nationalization, in effect, of a major competitor and major banks here and abroad, and the collapse of Iceland's financial system, you would have questioned my sanity.

Even as we had a financial catastrophe, Mother Nature was not idle. In the first six months of the year we had more than 35 weather events severe enough to be classified as catastrophes, the highest number in more than 70 years. They combined to cost the industry more than $25 billion.

Then there was Ike, one of the more unusual hurricanes in history. It started by inflicting significant, but not devastating, damage in the Gulf Coast, and then maintained its strength up into the Midwest, destroying property and disrupting lives in Kentucky and Ohio. The total damage made Ike the third-costliest hurricane on record.

Despite the natural and man-made turmoil, Liberty Mutual's fundamental financial strength remained unscathed, and we reported remarkably good results for 2008. Specifically, we grew revenue by 11 percent and produced $1.1 billion in net income. And we reported these numbers despite absorbing almost $1.6 billion in pre-tax natural catastrophe losses and approximately $330 million in net pre-tax investment losses.

While there's always a bit of luck involved in positive outcomes, Liberty did enter the maelstrom well positioned to weather it. We have a well-diversified portfolio of business – by line, distribution channel and geography, and our investment operation emphasizes fundamental value and risk, and an unwillingness to invest in things lacking transparency. Most important, overlaying our operations we have a rigorous, coordinated enterprise risk management process, which identified areas of concern and precipitated ameliorative actions.

The understanding of our various risks permitted us to take numerous steps to prepare our businesses for long-term profitable growth, despite the emerging problems we saw in the environment.

The most significant step was the acquisition of Safeco. This acquisition completes our Agency Markets and greatly improves our overall profitability and risk diversification. To have completed the transaction in an ordinary year would have been a significant accomplishment, but doing so in these tumultuous capital markets, and while simultaneously integrating Ohio Casualty, made it all the more satisfying. We are pleased to add the Safeco brand, and we welcome Safeco employees to the Liberty family.

Another important development, planned in 2008 and announced in early 2009, was the launch of Liberty Mutual Middle Market, a new business unit in Commercial Markets that replaces the Business Market and retires the Wausau brand. Unlike Business Market's direct sales model, the Middle Market will distribute Liberty Mutual products and services exclusively through independent agents and brokers — the preferred channel for most mid-sized businesses.

This is a significant change, and one we didn't make lightly. Liberty Mutual has been a direct writer since its founding in 1912, and the Wausau brand, established in 1911, has had a long and successful history. Despite these proud histories, for several years we have not been able to achieve acceptable growth and profitability in the middle market. We look forward to the new structure producing better results.

In the personal lines market, customer preferences and behavior are vastly different, and our direct sales operation goes from strength to strength. Our Personal Markets business unit continued adding to its field sales and service force, and growing its highly successful affinity marketing program, which added 16 million eligible participants in 2008. Our commitment to customer service also has paid dividends, with J.D. Power and Associates recertifying our direct response centers, which surpassed $1 billion in in-force premium, and our customer call centers for customer service excellence. To maintain its competitive edge, and in recognition of changing market dynamics, Personal Markets reorganized from a regional, divisional structure to a national, functional one.

Finally, our international business continued to execute its diversification and acquisition strategy, establishing a branch in Beijing (the first U.S. insurance carrier operating in China to receive approval to do so), receiving approval as an admitted reinsurer in Brazil, becoming the only nationwide, all-lines foreign company in Vietnam, and expanding its Liberty International Underwriters business with the opening of five offices in the U.S., England, Australia, Brazil and Vietnam.

So, as I said, we achieved much in 2008, but now we're operating in a much more challenging economic environment. We have a very conservative, some might say bearish, outlook.

For many years, the average household has been living beyond its means through credit card and home equity loans; the government has been living beyond its means running fiscal deficits; and the U.S. has run a significant balance-of-trade deficit.

Now the chickens have come home to roost. The bills have to be paid, and personal, corporate and bank balance sheets put back in order. Only when, collectively, balance sheets are sound, do we believe the economy will be on a solid base to grow.

While we all hope that the current mixture of government spending and Federal Reserve market actions will stimulate the economy, we at Liberty Mutual are very concerned about the prospects three or four years hence. The lessons from history are clear: democracies dig out of deficits through inflation. So our working assumption is that we will have double-digit inflation in not too many years. High inflation is very bad for the insurance industry. The annual cycle of rate adjustments and regulatory approvals makes it extremely difficult to cover the inflation in claims costs on a timely basis.

So today, as I write this message, no one at Liberty Mutual is under the illusion that 2009 will be easy, or that the years beyond will provide much relief. It will be, and already is, a tough operating environment for both Liberty Mutual and our policyholders. As a country, we will experience a long road back to economic health.

Yet, despite my bearishness about the economy in the near term, I am very optimistic about Liberty Mutual's ability to emerge strong on the other side of the economic downturn. Our objectives are clear: a strong risk management process, underwriting and pricing discipline, and an unrelenting emphasis on service improvements and on profitability over growth. Our culture helps ensure alignment of these objectives across the globe, and our corporate compliance policies and procedures assure discipline, measurement and accountability.

Before I close, I'd like to bid farewell to Steve Sullivan and Tom Ramey. Steve, who retired early in the year, headed our corporate marketing and communications function, and he was the brain behind our highly successful "Responsibility" positioning, which we reflect in our advertising and The Responsibility Project website.

Tom Ramey, who will retire in June, has led our Liberty International business unit since 1998, taking a business from its infancy and making Liberty Mutual Group the second-largest U.S.-based international property and casualty insurer. Both Tom and Steve have contributed greatly, and will be missed greatly.

In closing, I want to thank our policyholders for giving us an opportunity to serve them, and our agents, brokers and other business partners for placing their trust, and reputations, with Liberty Mutual. I also thank our Advisory Boards for their collective experience and advice, and our Board of Directors for its support, advice and governance.

Finally, I thank Liberty Mutual's 45,000 employees for their individual and collective efforts in 2008. They're the ones who deserve the credit for our accomplishments. It's their integrity, their dedication and their commitment to treating policyholders, partners and one another with dignity and respect that makes me so proud to be their chief executive officer.

Edmund F Kelly

Edmund F. Kelly
Chairman, President and Chief Executive Officer

andrea king

Homeowner

Moreno Valley, California

Her salvaged belongings on the front lawn. Partially melted window blinds. The smell of wet soot. It was all too much for Andrea King, who sat on the curb crying after seeing her heavily fire-damaged home.

right on time

It was supposed to be a getaway weekend for Andrea King and her young son and daughter. But shortly after arriving at Sea World in San Diego on Friday, April 4, a neighbor called to tell King her home was on fire. Without explaining why, she yelled to her kids —"We gotta go! We gotta go!"— and packed everyone back in the car for the return to their home in Moreno Valley, 100 miles away.

After dropping off the kids at her brother's house, King approached her home with the faint hope the damage was minimal. Such was not the case. Upon seeing a gaping hole, a heavily damaged roof and a front lawn covered with her belongings, reality set in.

"Although I've seen tragedies on the news and felt empathy for the victims, I never knew how devastating and debilitating such a loss can be," she said. Prohibited from entering her home by the fire department, she could only look in to see what used to be her living room, including the partially melted window blinds. "The smell was terrible," she said.

Returning on Saturday morning after telling her children, King found her Liberty Mutual homeowners policy in a water-soaked cabinet on the lawn, and called the company's toll-free number.

Soon after, she got a call from Charles Blackburn. A senior property loss specialist based in Fall City, just outside Seattle, Washington, Blackburn specializes in major homeowner fire claims, with a territory that includes the western states.

Accompanied by a Liberty Mutual personal property adjuster to take an inventory of King's damaged or destroyed belongings, Blackburn arrived "right on time" the next day and talked her through what to expect. "I'll be honest. It wasn't an easy time to talk, but Charles was very sympathetic and really did make me feel comfortable," she said.

Early Monday morning, King returned to the site and found Blackburn with his face covered in soot. "I was like 'wow, he's here, and he's already working.'" After giving King a check to cover expenses, Blackburn arranged a brief stay for her family at a hotel, followed by longer-term housing in an apartment. "He arranged everything, even carpet cleaning, and he made sure the apartment came equipped with everything you take for granted," she said.

Meanwhile, King's house had to be entirely rebuilt. The frame was all that remained, so Liberty Mutual gave her a choice of local contractors to do the work. Over the next six months, King called Blackburn frequently with questions as the construction progressed. "I felt bad because I called him so often," she said. "But he'd always say 'Don't be sorry. I'm here to help you. What do you need?'"

It was following one of these conversations that King drafted the email excerpted on the cover of this annual report. "I just wanted them (Liberty Mutual) to know what a great guy he is," she said.

A few days prior to Thanksgiving, the King family returned home.

Charles Blackburn, the Liberty Mutual senior property loss specialist who handled Andrea King's claim, said he was just doing his job. Andrea saw it otherwise. "I just had to write that letter," she said.


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By 2005, workplace accidents were out of control at Empire Pacific Windows. That's when its plant manager, with the solid support of the company's president, invigorated the company's moribund safety program.

turning point

When Empire Pacific Windows asked Laurence Rosen to help them improve their workplace safety record, he knew he couldn't do it alone. As a veteran consulting industrial hygienist with Liberty Northwest, a Liberty Mutual Agency Markets regional company, Rosen was well aware that, without the backing of Empire Pacific's senior management, his effort would be doomed to failure.

Fortunately, Rosen received that support…in abundance.

"Shortly after our new chief executive officer, Jim Lymer, arrived in 2007, he made workplace safety his top priority," said John Maxwell, plant manager of the company's 100,000-square-foot manufacturing facility in Tualatin, Oregon, just outside Portland. "In fact, I remember one of his first statements: 'I want everybody to go home in the same condition that they came to work today.'"

Even with the CEO's backing, however, Maxwell and Rosen faced a monumental task. First, there was the inherent danger of working with 152 different pieces of equipment that move and cut glass, and assemble and prepare windows and doors for shipment. And then there was Empire Pacific's safety record. When Rosen arrived on the scene, injury claims were out of control.

"It was tough going," Maxwell acknowledged. "You work with these individuals eight to 12 hours a day, and you really get to know them. My gut wrenched whenever I heard someone had been injured, sometimes severely. We needed a new approach to keep our employees safe, and we needed it now."

john maxwell
Plant Manager
Empire Pacific Windows
Tualatin, Oregon

Once given the mandate, Rosen systematically addressed the root causes of Empire's workplace accidents, which included lacerations, slips and falls, and ergonomic issues. "From the start, you could see Laurence was passionate about his job. He's excited, and he's engaged. It's infectious," said Logistics Manager Derick Cain.

"Laurence demonstrated that, rather than slow down our production processes, you actually increase productivity when you take steps to improve workplace safety," Maxwell added. "That's why safety is always on the agenda at our daily production meeting."

For Maxwell and Rosen, the turning point came when Empire Pacific's supervisors assumed responsibility for their employees' on-the-job safety. On Rosen's recommendation, Maxwell and his safety team — Production Supervisor Michael Dove, HR Manager Pattie Martinez and Cain — implemented a Supervisor Safety Accountability System. Together they selected critical yet easily measurable safety criteria linked to each supervisor's performance review, including mandatory weekly safety huddles and inspections for all departments, accident analysis and monthly job safety analysis (JSA) events. Rosen also helped train supervisors in effective incident investigation, JSAs and ergonomics.

Best of all, Maxwell said, the plant's entire workforce is engaged in the process. "They know that when they bring a safety issue to our Safety Committee meeting, we will address it. After all, these requests aren't unreasonable. They just want a safer environment."

And, today, that's just what exists at Empire Pacific Windows, which saw its accident frequency rate drop significantly from 85 claims in 2006 to just 26 in 2008.

"Even though we keep improving, we can't press on the brakes," Maxwell said. "As Laurence always says, you must keep going, and keep drilling down to reveal all potential safety hazards, no matter how unlikely."

Liberty Northwest's Laurence Rosen attributes much of Empire Pacific's improved safety record to the company's greater emphasis on communications. "Laurence has been a wonderful asset, especially in helping me make our safety program work," said Plant Manager John Maxwell.

vince morris

Risk Manager

Wheaton College

Wheaton, Illinois

Wheaton College Risk Manager Vince Morris knew the school's lower campus was susceptible to flooding after heavy rains. What he didn't expect was severe flooding in Wheaton's new student center, situated high on a hill.

a river ran through it

"It was like a river ran through it," said Wheaton College (Illinois) Risk Manager Vince Morris. No, he wasn't referring to Norman Maclean's novel or the 1992 film starring Robert Redford. He was describing what happened to the school's student center, dedicated just two years earlier on Wheaton's upper campus.

That October morning, thunderstorms dumped five inches of rain on the Wheaton campus in just three hours, causing water damage to more than 30 buildings. Particularly hard hit was the lower level of the Todd M. Beamer Student Center, where an 18-inch-deep "river" rushed from one end to the other. Named for a Wheaton College graduate, and one of the heroes who died on United Airlines Flight No. 93 on September 11, the Center serves as the dining hall and public gathering spot for Wheaton's 2,500 students.

Morris knew the Center ultimately would be back in business. "The question was, how quickly? Would we be feeding the students Subway sandwiches for weeks? Would we need to temporarily close the school?" he said.

Having had a disappointing claim experience with his previous insurer, Morris wasn't totally confident when he called Liberty Mutual.

But when Liberty Mutual Property Claims Manager Rick DeMott received the claim that morning, he headed straight to the campus to see the damage for himself. "We could hardly believe what we saw," DeMott said.

Meeting him on the Wheaton College campus to discuss the game plan were Morris, Facilities Manager Jim Johnson and Liberty Mutual General Adjuster Dale Vesta.

"The first thing Vince said was: 'We're having Homecoming this weekend. Can we be ready to go by then?' After picking myself up off the floor, I indicated we would do everything we could," DeMott said.

"Everything" meant calling in two more Liberty Mutual adjusters — Executive General Adjuster Mel Jeffers and Adjuster Adam Eggleston — and arranging for building, restoration, equipment and drying experts to be on the campus immediately. "Because they wanted to use the Center in two days, we held off tearing out walls and floor coverings," said Vesta, who was the primary adjuster and oversaw the daily activity. But the drying process couldn't wait, so the restoration expert immediately installed five massive, trailer-mounted dehumidifier units and more than 125 air blowers.

By Friday evening, the dryers and dehumidifiers had done their jobs, and the Center was in good-enough shape to open for Homecoming Weekend. But Sunday night, they closed the Center again, and the Liberty Mutual claims adjusters and hired restoration experts were back at it, pulling out walls and tiles. "We had to make sure the building was completely dry and free of fungus and mold, both of which are health hazards," Vesta said.

By early January, just 90 days after the flooding, the Beamer Center was operational. "Pretty incredible considering the extent of the damage," Vesta added.

Risk Manager Vince Morris agreed, noting that Liberty Mutual also quickly provided cash to cover the rapidly rising costs, which was a big relief to Wheaton's treasurer. "Rick, Dale and the rest of the Liberty Mutual team obviously knew what they were doing. It was a positive experience all around."

General Adjuster Dale Vesta and three of his peers from Liberty Mutual were on the Wheaton College campus for three days, coordinating the recovery and maintaining constant communication with the school's risk and facility manager.


EXIT
EXIT

Conduspar Condutores Elétricos, a Curitiba, Brazil-based manufacturer of copper and aluminum cables, regularly trucks cable and raw material between Brazil and its facility in Chile. With a constant threat of highway hijackings, however, they were finding it difficult to provide security from one country to the next.

without borders

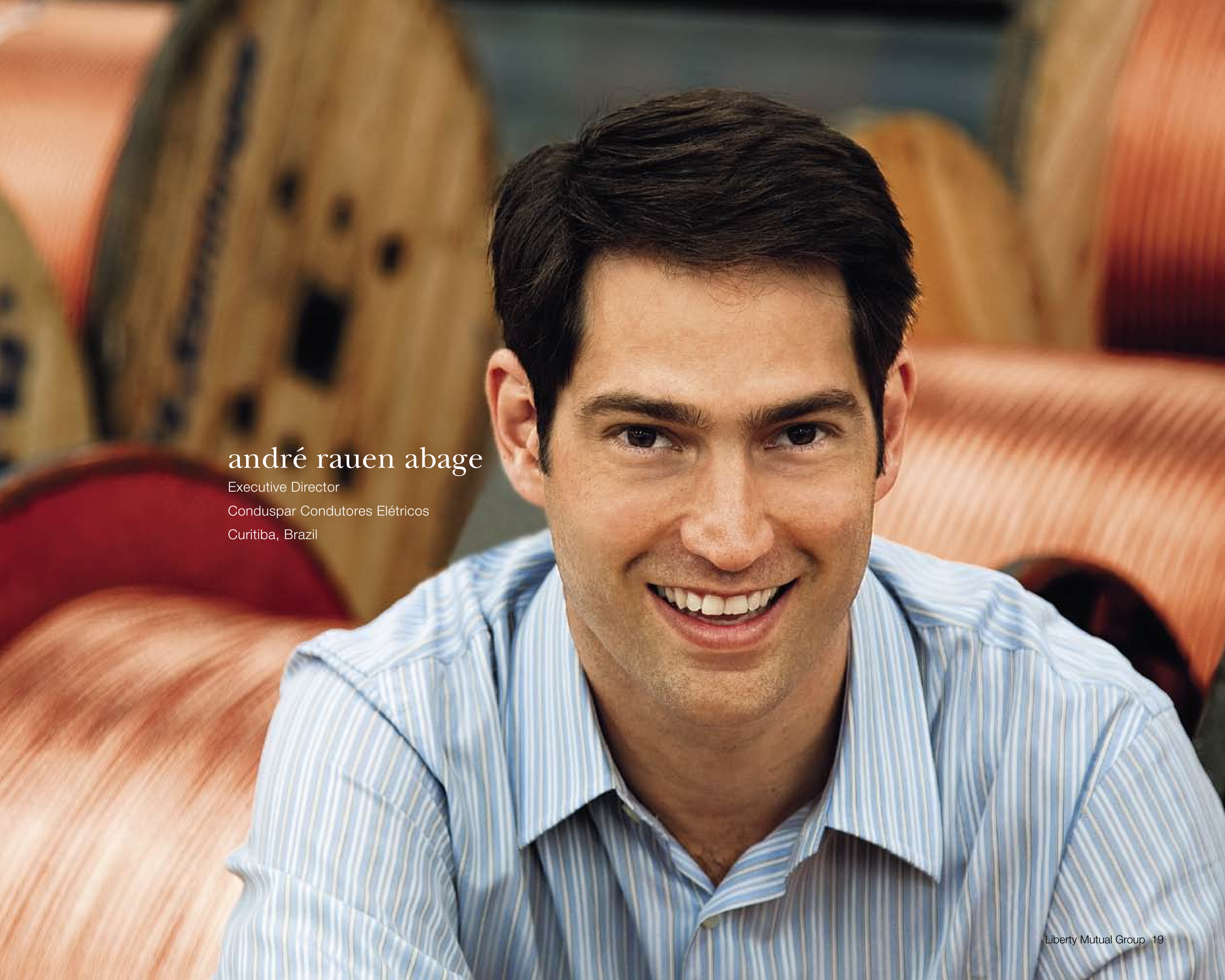
It reads like an Old West dime novel. Masked hijackers stop heavily laden trucks on roadways that fringe major cities in Brazil and Argentina, and disappear with valuable cargo.

Fortunately, insurance industry-imposed security measures, such as set routes and satellite monitoring of a truck's location, have substantially reduced the frequency of hijackings *within* these countries' borders.

But hijackings of *cross-border* transports is another matter, and that's a problem considering annual exports shipped via inland transport (truck) total $15 billion in Brazil and $10 billion in Argentina.

Just ask André Rauen Abage, executive director of Conduspar Condutores Elétricos, a Curitiba, Brazil-based manufacturer of copper and aluminum cables. His business regularly ships cable and raw material between Brazil and its facility in Chile.

"When one of our trucks, which carries as much as $200,000 in finished cable, crosses the border, security becomes very complicated, if not impossible," Abage said. "That's because, traditionally, a security company's responsibilities stop at the border. As a result, insurers are reluctant to cover this cross-border cargo, and a shipment may go uninsured or we place the burden on the buyer. Neither is a satisfactory solution."



andré rauen abage

Executive Director

Conduspar Condutores Elétricos

Curitiba, Brazil


FCIU 360015
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VEÍCULO LONGO
COMPRIMENTO 22,40 METROS

Abage did find a solution, however, with a new product — Sem Fronteiras ("Without Borders") — developed by Liberty Seguros marine underwriting managers Luis Carlos dos Santos (Brazil), Jorge Osses (Chile) and Jose Leiro (Argentina), and Liberty International Regional Underwriting Manager Tom Walker in Miami. Offered by Liberty Seguros companies in Brazil, Argentina and Chile, Sem Fronteiras ("Sin Frontera" in Spanish) simplifies security and claim handling for any company that ships among the three countries.

"Before Sem Fronteiras, exporters had to make and pay for their own security arrangements in each country," said dos Santos. "But because we have companies in all three countries, we can offer a product that includes security and builds its cost into the premium."

Luis Carlos dos Santos, marine underwriter with Liberty Seguros in Brazil, is one of the brains behind Sem Fronteiras ("Without Borders"), a unique insurance product that simplifies security and claim handling for any company that ships among Brazil, Argentina and Chile.

Sem Fronteiras also makes theft and accident claims handling easier, he explained, since Liberty Seguros can manage the claim whether it occurs in Brazil, Argentina or Chile, and make payment in whichever country the customer chooses. While the customer is dealing, in actuality, with two or three distinct Liberty Seguros companies, they come across as one. Otherwise, the insurance company had to work with a central bank's bureaucracy to make a claims payment in another country – a process that could take months, or even years.

"With Sem Fronteiras," Conduspar's Abage said, "I know our cargo's insured from the moment our product leaves our facility to when it reaches its destination, whether in Brazil, Argentina or Chile."

company overview

Boston-based Liberty Mutual Group is a diversified global insurer and the sixth-largest property and casualty insurer in the U.S. based on 2007 direct written premium. The company also ranks 94th on the Fortune 500 list of largest corporations in the U.S. based on 2007 revenues. As of December 31, 2008, Liberty Mutual Group had $104.3 billion in consolidated assets, $94.2 billion in consolidated liabilities and $28.9 billion in annual consolidated revenues.

Liberty Mutual Group offers a wide range of insurance products and services, including personal automobile, homeowners, individual and group life, workers compensation, commercial multiple peril, commercial automobile, general liability, global specialty, group disability, reinsurance, fire and surety.

Liberty Mutual Group employs approximately 45,000 people in more than 900 offices throughout the world.

Liberty Mutual Group's pre-tax operating income for 2008 was $1.6 billion, a decrease of 7.8 percent from 2007. Net investment income was approximately $2.9 billion and cash flow from operations was $2.7 billion. The Group's property and casualty combined ratio decreased to 99.9 percent in 2008 from 100.1 percent in 2007, and policyholders' equity decreased by $2.2 billion to $10.2 billion.

timothy m. sweeney
President
Personal Markets

gary r. gregg
President
Agency Markets

j. paul condrin, lll
President
Commercial Markets

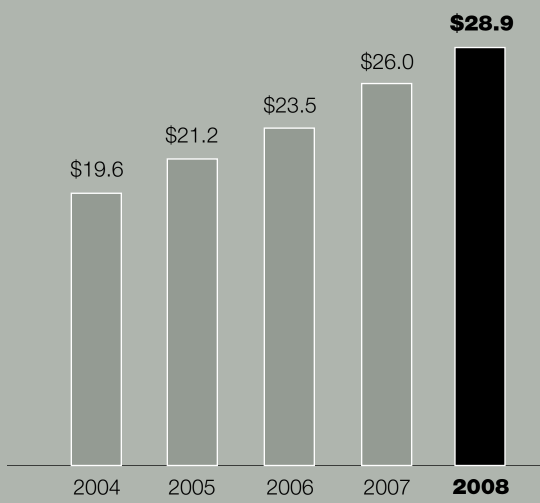
thomas c. ramey
Chairman
Liberty International

a. alexander fontanes
Executive Vice President &
Chief Investment Officer

david h. long
President
Liberty International

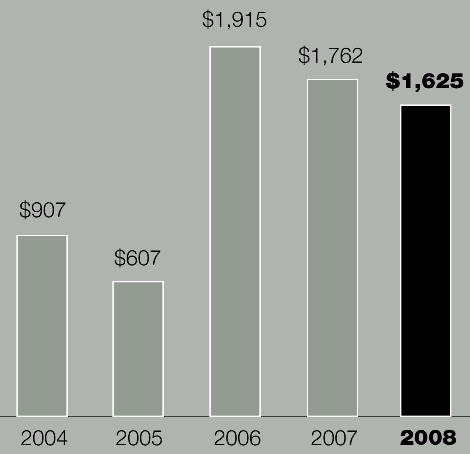
Revenues

(In billions)



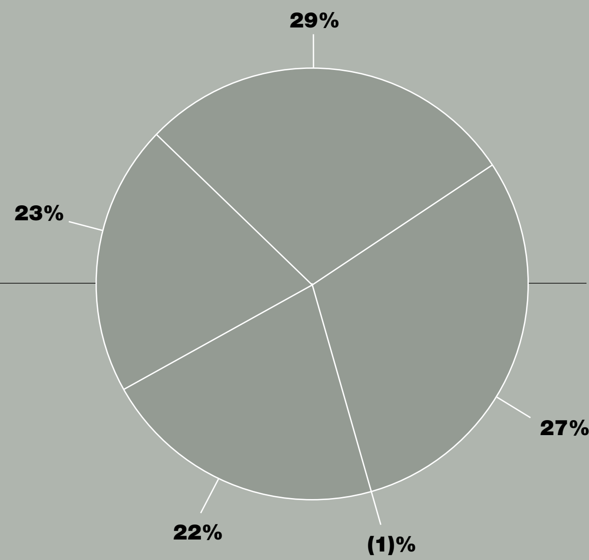
Pre-Tax Operating Income

(In millions)



Strategic Business Units

($25.5 billion in 2008 net written premium)



Agency Markets **29%**

International **27%**

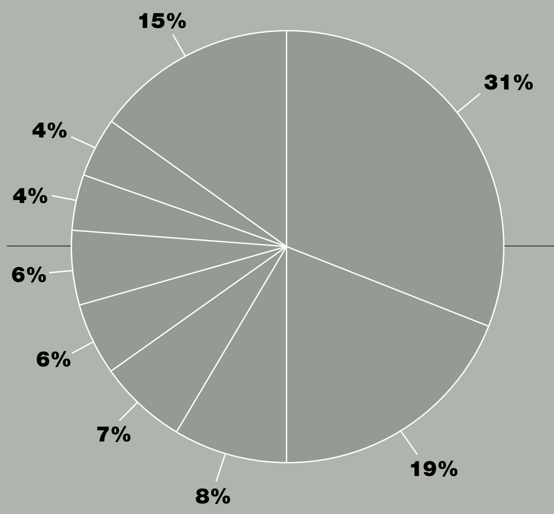
Personal Markets **23%**

Commercial Markets **22%**

Other **(1)%**

Significant Lines of Business

($25.5 billion in 2008 net written premium)



Private Passenger Automobile **31%**

Workers Compensation **19%**

Commercial Multi-Peril/Fire **8%**

Homeowners **7%**

International Local Business **6%**

Commercial Automobile **6%**

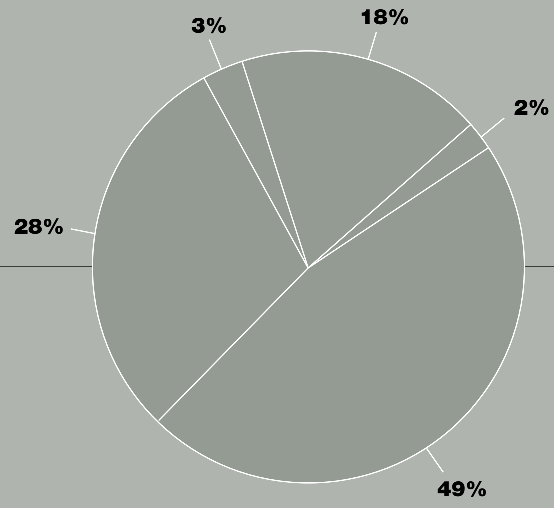
LIU Reinsurance **4%**

General Liability **4%**

Other **15%**

Distribution Channels

(Based on 2008 direct written premium)



Independent Agents **49%**

Direct Sales Force **28%**

Brokers **18%**

Exclusive Agents **3%**

Other **2%**

personal markets

Liberty Mutual's Personal Markets provides full lines of coverage for private passenger automobile, homeowners, valuable possessions and personal liability through its own sales force in more than 350 offices throughout the U.S., two direct response centers, appointed third-party producers and the internet. It also offers a wide range of traditional and variable life insurance and annuity products. Personal Markets' largest source of new business is its more than 11,850 sponsored affinity group relationships including employers, professional and alumni associations, credit unions and other partnerships. Liberty Mutual's affinity program is the industry's most-sponsored voluntary auto and home insurance benefit. Liberty Mutual has been recognized for call center customer service excellence under the J.D. Power and Associates Certified Call Center Program[SM].

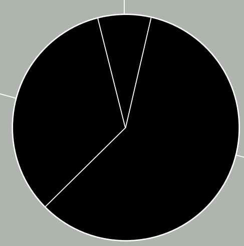
distribution

- direct sales force
- direct response centers
- internet
- third-party producers

by the numbers

- ninth-largest writer of personal lines insurance in the U.S.
- #1 in sponsored affinity programs
- 4.8 million auto and home policies
- 11,850 affinity relationships
- 10,800 employees
- 1,800 field sales reps
- 500 telesales counselors
- 1,100 third-party producers

product mix % 2008 net written premium



financial results

	2008	2007	2006
Revenues	$6.7 B	$6.5 B	$6.7 B
Pre-tax operating income	$350 M	$773 M	$737 M
Cash flow from operations	$718 M	$1.0 B	$1.5 B
GAAP combined ratio	99.4%	92.0%	92.1%
P&C policies in force	5,193,492	4,961,751	4,812,921

agency markets

Agency Markets delivers personal and commercial insurance products and services to independent agents and brokers and the customers they serve. It operates under a unique national/regional model that leverages the service-oriented focus of regional operations with the power of a national infrastructure.

Operating Units:

Commercial Lines – Regional Companies

- America First Insurance™ (Central Region)
- Colorado Casualty™ (Mountain Region)
- Golden Eagle Insurance™ (California Region)
- Indiana Insurance™ (Midwest Region)
- Liberty Northwest® (Pacific Northwest Region)
- Montgomery Insurance™ (Southeast Region)
- Ohio Casualty™ (Mid-Atlantic Region)
- Peerless Insurance™ (Northeast Region)

Personal Lines - Safeco® Insurance

Surety – Liberty Mutual Surety™

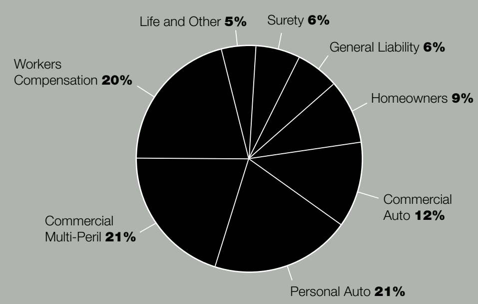
Specialty Companies

- Summit™
- Liberty Agency Underwriters™

by the numbers

- 13,000 employees
- 1,282,000 Regional Companies commercial lines policies in force with average premium of $3,900
- 4,964,000 Safeco personal lines policies in force with average premium of $800
- 27,000 Summit policies in force with average premium of $20,400

product mix % 2008 net written premium



financial results

	2008	2007	2006
Revenues	$8.2 B	$5.6 B	$4.8 B
Pre-tax operating income	$909 M	$834 M	$497 M
Cash flow from operations	$750 M	$1.2 B	$1.2 B
GAAP combined ratio	95.3%	91.6%	96.5%

commercial markets

Liberty Mutual's Commercial Markets provides mid-sized and large companies with high-quality insurance products and services through six business units:

- *National Market* serves the complex needs of large companies;
- *Middle Market* serves mid-sized companies;
- *Liberty Mutual Property* provides property insurance programs to mid-sized and large companies;
- *Specialty Lines* provides specialty coverage for companies of all sizes through its four businesses: Commercial Affinity, Energy, Global and Umbrella;
- *Liberty Mutual Reinsurance* provides reinsurance programs for insurance companies in the U.S. and other countries; and,
- *Group Market* provides group disability and life products and services to companies with more than 250 employees.

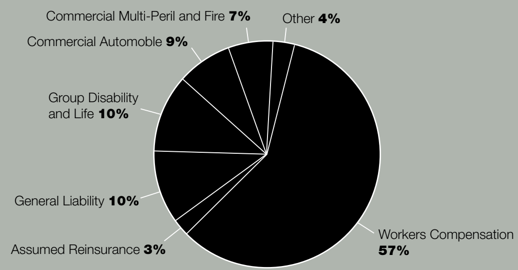
distribution

- national and regional brokers
- agents
- employee benefits brokers and consultants

by the numbers

- fourth-largest writer of commercial lines insurance in the U.S.
- second-largest writer of workers compensation insurance in the U.S.
- 21,881 customers
- 9,242 employees
- 161 offices

product mix % 2008 net written premium



financial results

	2008	2007	2006
Revenues	$6.8 B	$6.5 B	$6.1 B
Pre-tax operating income	$202 M	$472 M	$335 M
Cash flow from operations	$1.3 B	$1.7 B	$1.5 B
GAAP combined ratio	109.6%	103.5%	104.8%

liberty international

Liberty International provides personal and small commercial lines insurance through operations in 14 countries: Argentina, Brazil, Chile, China, Colombia, Hong Kong, Poland, Portugal, Singapore, Spain, Thailand, Turkey, Venezuela and Vietnam. Additionally, Liberty International Underwriters, a global specialty commercial lines insurance and reinsurance business, writes a variety of products including casualty, specialty casualty, marine, energy, construction and aviation through 39 offices in 18 countries throughout Asia, Australia, Europe, the Middle East, North America and South America. Liberty Syndicate 4472 at Lloyd's of London writes on a worldwide basis.

Country Operations (62 percent of international net written premium)

Asia
Liberty Insurance Company Ltd. (China)
Liberty International Insurance Ltd. (Hong Kong)
Liberty Insurance Pte. Ltd. (Singapore)
LMG Insurance Co., Ltd. (Thailand)
Liberty Insurance Limited (Vietnam)

Europe
Liberty Direct (Poland)
Liberty Seguros S.A. (Portugal)
Liberty Seguros and Genesis (Spain)
Liberty Sigorta, A.S. (Turkey)

Latin America
Liberty ART (Argentina)
Liberty Seguros Argentina
Liberty Seguros (Brazil)
Liberty Seguros (Chile)
Liberty Seguros (Colombia)
Seguros Caracas de Liberty Mutual C.A. (Venezuela)

Liberty International Underwriters (LIU)
(38 percent of international net written premium)

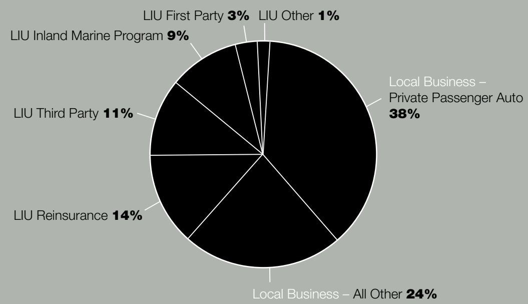
Liberty Syndicate Management
Liberty Mutual Insurance Europe
LIU Australia
LIU Canada
LIU Dubai
LIU Hong Kong
LIU Singapore
LIU U.S.

by the numbers

- second-largest U.S.-based international property and casualty insurance company
- 8,500 employees worldwide
- offices in 26 countries
- net written premium grew 18 percent in 2008 with a compound annual growth rate of 19 percent since 1998

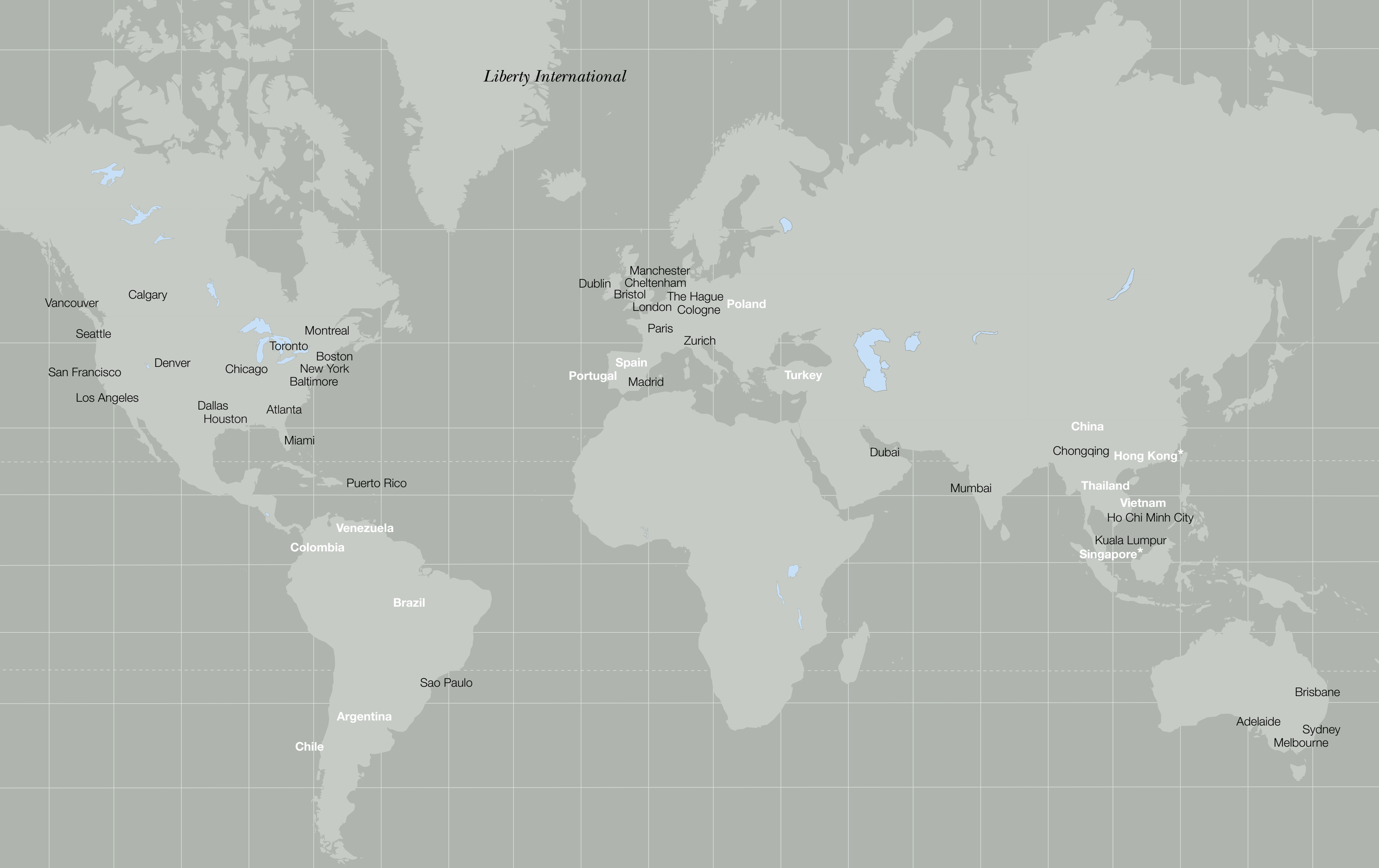
product mix

% 2008 total net written premium



financial results

	2008	2007	2006
Revenues	$7.0 B	$6.1 B	$4.9 B
Pre-tax operating income	$683 M	$478 M	$457 M
Cash flow from operations	$1.1 B	$1.3 B	$838 M
GAAP combined ratio	98.4%	99.7%	97.2%



legend

Liberty International Underwriters offices

Local Companies

**Both Liberty International Underwriters offices and Local Companies*

financial statements

Consolidated Statements of Income Liberty Mutual Holding Company Inc.

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

See accompanying notes to the audited consolidated financial statements.

Consolidated Balance Sheets Liberty Mutual Holding Company Inc.

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

See accompanying notes to the audited consolidated financial statements.

Consolidated Statements of Cash Flows Liberty Mutual Holding Company Inc.

Dollars in millions		2008	Years Ended December 31, 2007	2006
Cash flows from operating activities:	Net income	$ 1,140	$ 1,518	$ 1,626
	Adjustments to reconcile net income to net cash provided by operating activities, net of effects from purchases of companies:			
	Depreciation and amortization	313	260	238
	Realized investment losses (gains)	330	(436)	(343)
	Undistributed private equity investment losses (gains)	5	(324)	(275)
	Premium, other receivables, and reinsurance recoverables	582	755	660
	Deferred policy acquisition costs	(16)	(126)	(154)
	Liabilities for insurance reserves	1,730	2,272	1,865
	Taxes payable, net of deferred	(205)	256	169
	Other, net	(1,134)	(133)	109
	Total adjustments	1,605	2,524	2,269
	Net cash provided by operating activities	2,745	4,042	3,895
Cash flows from investing activities:	Purchases of investments	(13,668)	(19,719)	(20,952)
	Sales and maturities of investments	18,257	18,405	16,508
	Property and equipment purchased, net	(143)	(259)	(762)
	Payment for purchase of companies, net of cash acquired	(5,414)	(2,700)	(48)
	Other investing activities	(185)	(430)	270
	Net cash used in investing activities	(1,153)	(4,703)	(4,984)
Cash flows from financing activities:	Net activity in policyholder accounts	62	34	69
	Debt financing, net	1,121	889	646
	Net security lending activity and other financing activities	(65)	(602)	684
	Net cash provided by financing activities	1,118	321	1,399
	Effect of exchange rate changes on cash	(61)	27	47
	Net increase (decrease) in cash and cash equivalents	2,649	(313)	357
	Cash and cash equivalents, beginning of year	3,199	3,512	3,155
	Cash and cash equivalents, end of year	$ 5,848	$ 3,199	$ 3,512
	Supplemental disclosure of cash flow information:			
	Income taxes paid	$ 310	$ 563	$ 496

See accompanying notes to the audited consolidated financial statements.

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

See accompanying notes to the audited consolidated financial statements.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2007 and 2006 consolidated financial statements to conform with the 2008 presentation. All material intercompany transactions and balances have been eliminated.

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

Nature of Operations

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

The Company's Personal Markets business unit, with $6,684 of revenues in 2008, writes property and casualty insurance covering personal risks, primarily automobile, homeowners, and other types of property and casualty insurance coverage, as well as a wide range of life and annuity products, to individuals in the United States.

The Commercial Markets business unit, with $6,804 of revenues in 2008, is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base, product grouping, or distribution channel to provide tailored products and services that specifically address customers' needs. The Commercial Markets business unit includes National Market, Middle Market, Liberty Mutual Property, Group Market, and Other Markets. Other Markets include Liberty Mutual Reinsurance and state-mandated involuntary market workers compensation and automobile assigned risk plans.

The Commercial Markets coverages include workers compensation, commercial automobile, general liability, including product liability, multiple peril, group disability and life insurance, property, and a variety of other coverages. Commercial Markets is also a servicing carrier for workers compensation and commercial automobile involuntary market pools. In January 2009, the Company established Liberty Mutual Middle Market, a new market segment that combines Business Market and Wausau Insurance market segments. Note 2 contains more detail on this transaction.

In the fourth quarter of 2007, the Company realigned Wausau Insurance into the Commercial Markets business unit to organize its operations with those of other Liberty Mutual businesses that serve middle market and national customers.

The Agency Markets business unit, with $8,245 of revenues in 2008, is composed of eight regionally branded insurance companies that offer personal and commercial insurance coverage to individuals and businesses. It also includes Liberty Mutual Surety (nationwide contract and commercial surety) and Summit, (mono-line workers compensation in the Southeast, primarily Florida). Agency Markets expanded its personal, commercial, and surety market presence with the acquisition of Safeco Corporation on September 22, 2008, and Ohio Casualty on August 24, 2007. Agency Markets companies distribute their products and services primarily through independent agents and brokers.

The Company's International business unit, with $7,049 of revenues in 2008, provides insurance products and services through local businesses outside the United States, which sell personal and small commercial lines products, and Liberty International Underwriters ("LIU") which sells specialty commercial lines worldwide. The local businesses consist of local insurance operations selling traditional property, casualty, health and life insurance products to individuals and businesses. Automobile insurance is the predominant line of business. In South America, International operates in Venezuela, Argentina, Colombia, Brazil and Chile. In Asia, International writes business in Singapore, Thailand, Vietnam and China (including Hong Kong). In Europe, International operates in Spain, Portugal, Turkey and Poland. LIU is composed of global specialty commercial insurance and reinsurance operations principally based in the United States, Canada, Australia and the United Kingdom. The United Kingdom operations consist of Liberty Mutual Insurance Europe Ltd., headquartered in London with branches in Spain, United Kingdom, Hong Kong, France, Singapore, Switzerland, Germany, the Netherlands, United Arab Emirates and Ireland, and Lloyd's of London Syndicate 4472 with branches in France, Germany and Spain. LIU provides a variety of global specialty products including casualty, marine, construction, energy, inland marine, directors and officers, errors and omissions, aviation, property and professional liability insurance, together with multi-line insurance and reinsurance, including property catastrophe reinsurance, written through Lloyd's Syndicate 4472.

Adoption of New Accounting Standards

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

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

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

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

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

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

Effective December 31, 2007, the Company adopted Statement of Financial Accounting Standards No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132(R)"* ("SFAS 158"). This statement requires the Company to (a) recognize the funded status of its pension, supplemental pension and postretirement benefit plans on the consolidated balance sheet as an asset or liability, measured as the difference between plan assets at fair value and the benefit obligation as of the employer's fiscal year end, with a corresponding adjustment to accumulated other comprehensive income ("AOCI"), net of tax; and to (b) recognize as a component of AOCI, net of tax, actuarial gains or losses or prior service cost or credit that arise during the period but are not recognized as a component of net periodic benefit cost. Consistent with the provisions of SFAS 158, these amounts will be subsequently recognized in the income statement pursuant to the Company's historical accounting policy for amortizing such amounts with a corresponding offset to AOCI. The provisions of Statement of Financial Accounting Standards No. 87, *"Employers' Accounting for Pensions"* and Statement of Financial Accounting Standards No. 106, *"Employers' Accounting for Postretirement Benefits Other than Pensions"* continue to apply in measuring plan assets and benefit obligations, as of the date of fiscal year-end statement of financial position, and in determining net periodic benefit cost. The adoption of SFAS 158 as of December 31, 2007, decreased other assets by $245, increased other liabilities by $198, increased deferred tax assets by $155, and decreased AOCI, a component of policyholders' equity by $288, net of tax. Adoption of SFAS 158 did not affect the Company's results of operations or liquidity as SFAS 158 did not affect the determination of net periodic benefit costs.

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

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

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109"* ("FIN 48"). FIN 48 requires companies to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The amount recognized is the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability is recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty (if applicable) on the excess. FIN 48 requires a tabular reconciliation of the change in the aggregate unrecognized tax benefits claimed, or expected to be claimed, in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Discussion also is required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next 12 months. As a result of the adoption, the Company recognized a decrease of approximately $11 in the liability for unrecognized tax benefits, which was accounted for as an increase to unassigned equity.

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

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

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

Future Adoption of New Accounting Standards

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

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *"Noncontrolling Interests in Consolidated Financial Statements"* ("SFAS 160"). SFAS 160 will result in the consolidation of all noncontrolling interests within the income statement and balance sheet of the Company for all consolidated subsidiaries. The Company is required to adopt

SFAS 160 effective January 1, 2009. Prospective adoption is required, except for the required reclassifications which are to be applied retrospectively. Early adoption is not permitted. The adoption of SFAS 160 will not have a material impact on the Company.

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

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

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

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

Investments

Fixed maturity securities classified as available for sale are debt securities that have principal payment schedules, held for indefinite periods of time, and are used as a part of the Company's asset/liability strategy or sold in response to risk/reward characteristics, liquidity needs or similar economic factors. These securities are reported at fair value with changes in market values, net of deferred income taxes, reported in accumulated other comprehensive (loss) income.

Equity securities classified as available for sale include common equities and non-redeemable preferred stocks and are reported at quoted market values. Changes in the market values of these securities, net of deferred income taxes, are reflected as unrealized investment gains or losses in accumulated other comprehensive (loss) income.

Trading securities are securities purchased principally for the purpose of sale in the near term and are reported at market value. Changes in market values are reported in income as realized gains or losses in the current period.

Realized gains and losses on sales of investments are recognized in income using the specific identification method. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company reviews fixed income and public equity securities for impairment on a quarterly basis and private equity and co-investment securities on a semi-annual basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to, (1) the extent of the decline in fair value below book value, (2) the duration of the decline, (3) significant adverse changes in the financial condition or near term prospects for the investment or issuer, (4) significant changes in the business climate or credit ratings of the issuer, (5) general market conditions and volatility, (6) industry factors, and (7) the past impairment history of the security holding or the issuer. All mortgage-backed securities and asset-backed securities are reviewed for other-than-temporary impairment treatment in accordance with the guidance of EITF Issue No. 99-20, *"Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets"* and FASB Staff Position EITF 99-20-1, *"Amendments to the Impairment Guidance of EITF Issue 99-20".* In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

For mortgage-backed fixed maturity securities, the Company recognizes income using a constant effective yield based on anticipated prepayments over the economic life of the security. The mortgage-backed portfolio is accounted for under the retrospective method and prepayment assumptions are based on market expectations. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments and any resulting adjustment is included in net investment income.

Cash equivalents are short-term, highly liquid investments that are both readily convertible into known amounts of cash and so near to maturity that they present insignificant risk of changes in value due to changing interest rates. The Company's cash equivalents include debt securities purchased with maturities of three months or less at acquisition and are carried at amortized cost, which approximates fair value.

Short-term investments are debt securities with maturities at acquisition between three months and one year, are considered available for sale and are carried at amortized cost, which approximates fair value.

All Variable Interest Entities ("VIEs") for which the Company is the primary beneficiary are consolidated into the Company's financial statements.

Limited partnerships and other alternative investments are reported at their carrying value with the change in carrying value accounted for under the equity method and, accordingly, the Company's share of earnings are included in net investment income. Recognition of limited partnerships and other alternative investment income is delayed due to the availability of the related financial statements, as private equity and other funds are generally on a three-month delay. Equity investments in privately held businesses are accounted for under the cost method where market value data is unavailable for the underlying investment.

Mortgage loans are stated at amortized cost less a valuation allowance for potentially uncollectible amounts.

Derivatives

All derivatives are recognized on the balance sheet at fair value. On the date a contract is entered into, the Company designates the derivative as either (1) a hedge of a fair value of a recognized asset ("fair value hedge"), (2) an economic hedge ("non-designated derivative"), or (3) a cash flow hedge. Changes in the fair value of a derivative that is highly effective and is designated as a fair value hedge, along with the loss or gain on the hedged asset attributable to the hedged risk, are recorded in current period operations as a component of net investment income. Changes in the fair value of non-designated derivatives are reported in current period operations and the derivative is included in other assets or liabilities. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge is reported as a component of other comprehensive (loss) income and reclassified into earnings in the same period in which the hedged items affect earnings. The ineffective portion of the cash flow hedge is recorded directly to earnings.

The Company owns fixed maturity securities which have an option to convert to equity. The derivative features embedded are ancillary to the overall investment. This type of activity is unrelated to hedging. The Company also uses various derivative instruments to hedge exposure against interest rates and equity market returns guaranteed by certain life products. In addition, there may be call, put or conversion options embedded in certain bonds it has purchased. These derivatives are not material to the Company's financial statements.

Securities Lending

The Company participates in a securities lending program to generate additional income, whereby certain domestic fixed income securities are loaned for a short period of time from the Company's portfolio to qualifying third parties via a lending agent. Terms of the agreement are for borrowers of these securities to provide collateral of at least 102% of the market value of the loaned securities. Acceptable collateral may be in the form of cash or permitted securities as outlined in the securities lending agreement. The market value of the loaned securities is monitored and additional collateral is obtained if the market value of the collateral falls below 102% of the market value of the loaned securities. Under the terms of the securities lending program, the lending agent indemnifies the Company against borrower defaults. The loaned securities remain a recorded asset of the Company; however, the Company records a liability for the amount of cash collateral held, representing its obligation to return the collateral related to the loaned securities.

Goodwill and Intangible Assets

Goodwill and intangible assets are 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. Other changes in the carrying amount of goodwill are primarily caused as a result of foreign currency translation adjustments and adjustments to valuation allowances for acquired tax losses. Intangible assets subject to amortization are amortized on a straight-line basis over their estimated useful lives.

Deferred Policy Acquisition Costs & Acquired Policy In-Force Intangibles

Costs that vary with and are primarily related to the acquisition of new insurance and investment contracts are deferred and amortized over the respective policy terms. For short-duration contracts, acquisition costs include commissions, underwriting expenses and premium taxes. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales and underwriting expenses. Deferred policy acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment.

For short-duration contracts, acquisition costs are amortized in proportion to earned premiums. For traditional long-duration contracts, acquisition costs are amortized over the premium paying period of the related policies using assumptions consistent with those used in computing policy benefit reserves. For universal life insurance, annuity, and investment products, acquisition costs are amortized in relation to expected gross profits.

For long-duration contracts, to the extent unrealized gains or losses on fixed income securities carried at fair value would result in an adjustment of estimated gross profits had those gains or losses actually been realized, the related unamortized deferred policy acquisition costs are recorded net of tax as a reduction of the unrealized capital gains or losses and included in accumulated other comprehensive income.

As a result of the Company's acquisitions of the Ohio Casualty Corporation and Safeco Corporation, the Company recognized intangible assets equal to the fair value of the acquired in-force policies. Amortization of these assets will occur over the remaining policy term.

Real Estate and Other Fixed Assets

The costs of buildings, furniture, and equipment are depreciated, principally on a straight-line basis, over their estimated useful lives (a maximum of 39.5 years for buildings, 10 years for furniture, and 3-5 years for equipment). Expenditures for maintenance and repairs are charged to income as incurred while expenditures for improvements are capitalized and depreciated.

Separate Account Assets and Liabilities

Separate and variable accounts represent funds for which investment income and investment gains and losses accrue directly to the policyholders who bear the investment risk. Each account has specific investment objectives, and the assets are carried at fair value. The assets of each account are legally segregated and are not subject to claims that arise out of any other business of the Company. The liabilities of these accounts are equal to the account assets. Investment income, realized investment gains (losses), and policyholder account deposits and withdrawals related to separate accounts are excluded from the consolidated statements of income. The fees earned for administrative and contract holder maintenance services performed for these separate accounts are included in fee and other revenues.

Insurance Liabilities and Reserves

For short-duration contracts, the Company establishes reserves for unpaid insurance claims and claim adjustment expenses covering events that occurred in 2008 and prior years. These reserves reflect estimates of the total cost of claims reported but not yet paid and the cost of claims not yet reported, as well as the estimated expenses necessary to settle the claims. Reserve estimates are based on past loss experience modified for current claim trends, as well as prevailing social, economic and legal conditions. Final claim payments, however, may ultimately differ from the established reserves, since these payments might not occur for several years. Reserve estimates are continually reviewed and updated, and any resulting adjustments are reflected in current operating results. The Company does not discount reserves other than tabular discounting on the long-term indemnity portion of workers compensation claims, the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states, the long-term portion of certain workers compensation claims of foreign subsidiaries, and specific asbestos structured settlements. Reserves are reduced for estimated amounts of salvage and subrogation and deductibles recoverable from policyholders.

For long-duration contracts, measurement of liabilities is based on generally accepted actuarial techniques but requires assumptions about mortality, lapse rates, and assumptions about future returns on related investments. Annuity and structured settlement contracts without significant mortality or morbidity risk are accounted for as investment contracts, whereby the premium received plus interest credited less policyholder withdrawals represents the investment contract liability. Implied credited interest rates for domestic structured settlement contracts in force averaged 5.8% for 2008 and 2007 and 5.9% for 2006. Implied credited interest rates for foreign structured settlement contracts in force were between 2.5% and 6.0% in 2008, 2007, and 2006. Credited rates for domestic universal life contracts in force were between 3.5% and 6.3% in 2008 and 2007 and 4.0% and 6.3% in 2006. Credited rates for foreign universal life contracts in force were between 1.3% and 6.0% in 2008 and 2007 and 2.0% and 6.0% in 2006. Liabilities for future policy benefits for traditional life policies have been computed using the net level premium method based upon estimated future investment yields (between 2.5% and 10.3% in 2008, 2007, and 2006), mortality assumptions (based on the Company's experience relative to standard industry mortality tables) and withdrawal assumptions (based on the Company's experience).

Policyholder Dividends

Policyholder dividends are accrued using an estimate of the ultimate amount to be paid in relation to premiums earned based on the underlying contractual obligations.

For domestic property-casualty insurance, certain insurance contracts, primarily workers compensation policies, are issued with dividend plans to be paid subject to approval by the insurer's board of directors. The premium related to such policies approximated 3%, 4%, and 5% of domestic property-casualty insurance premiums written for the years ended December 31, 2008, 2007 and 2006, respectively. Additionally, certain jurisdictions impose excess profits taxes which limit the profitability of particular lines of business, and any excess is returned to the policyholder in the form of a dividend.

For life insurance, dividends to participating policyholders are calculated as the sum of the difference between the assumed mortality, interest and loading, and the actual experience of the Company relating to participating policyholders. As a result of statutory regulations, the major portion of earnings from participating policies inures to the benefit of the participating policyholders and is excluded from the consolidated net income and policyholders' equity. Participating policies approximate 37%, 39% and 40% of ordinary life insurance in force for the years ended December 31, 2008, 2007, and 2006, respectively. Participating policies approximate 30%, 33%, and 37% of premium for the years ended December 31, 2008, 2007, and 2006, respectively.

Long-Term Incentive and Performance Based Incentive Plans

The Company maintains short- and long-term incentive compensation plans. Long-term plans that vest over the requisite service period and are based upon notional units are accounted for under SFAS 123(R). Additionally, the Company provides various performance based incentive compensation to the majority of employees meeting the participation requirements of the respective plans. Compensation cost related to these plans is determined in accordance with plan formulas and recorded over the years the employee service is provided.

Revenue Recognition

For short-duration insurance contracts, premiums are reported as earned income generally on a pro-rata basis over the terms of the related policies. For retrospectively rated policies and contracts, premium estimates are continually reviewed and updated and any resulting adjustments are reflected in current operating results. For traditional long-duration insurance contracts (including term and whole life contracts and annuities), premiums are earned when due. For annuities and structured settlements without significant mortality or morbidity risk (investment contracts) and universal life contracts (long-duration contracts with terms that are not fixed or guaranteed), revenues represent investment income earned on the related assets. Universal life and annuity contract revenues also include mortality, surrender, and administrative fees charged to policyholders.

Reinsurance

All assets and liabilities related to ceded reinsurance contracts are reported on a gross basis in the consolidated balance sheets. Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with the terms of the reinsurance contracts. The consolidated statements of income reflect premiums, benefits, and settlement expenses net of reinsurance ceded.

Transactions that do not transfer risk are included in other assets or other liabilities. Ceded transactions that transfer risk but are retroactive are included in reinsurance recoverables. The excess of estimated liabilities for claims and claim costs over the consideration paid net of experience adjustments is established as a deferred credit at inception. The deferred amounts are subsequently amortized using the effective interest method over the expected settlement period. The periodic amortization is reflected in the accompanying consolidated statements of income through operating costs and expenses.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liabilities associated with the reinsured business. The Company evaluates reinsurance collectability and a provision for uncollectible reinsurance is recorded.

Translation of Foreign Currencies

The Company translates the financial statements of its foreign operations into U.S. dollars from the functional currency designated for each foreign unit, generally the currency of the primary economic environment in which it does its business. Assets and liabilities are translated into U.S. dollars at period-end exchange rates, while income and expenses are translated using average rates for the period. Translation adjustments are recorded as a separate component of accumulated other comprehensive (loss) income, net of tax to the extent applicable. Foreign currency amounts are remeasured to the functional currency, and the resulting foreign exchange gains or losses are reflected in earnings.

For subsidiaries operating in highly inflationary economies, monetary assets and liabilities are translated at the rate of exchange as of the balance sheet date and non-monetary items are translated at historical rates. Gains and losses from balance sheet translation adjustments and foreign currency transactions are included in net income.

The aggregate exchange gains and (losses) included in income from continuing operations for the years ended December 31, 2008, 2007, and 2006 were $16, $(6), and $(5), respectively. These amounts have been included in insurance operating costs and expenses in the accompanying consolidated statements of income.

Income Taxes

The income tax provision is calculated under the liability method. Deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax basis of assets and liabilities at the enacted tax rates. The principal assets and liabilities giving rise to such differences are unrealized capital gains and losses on investments, insurance reserves, unearned premiums, retroactive deferred gains, tax credits, deferred policy acquisition costs, certain employee benefits expenses, and net operating losses. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized. Deferred tax positions are not established for adjustments arising from foreign operations whose earnings are considered to be permanently reinvested (See Note 9).

Service Revenues and Expenses

Service revenues consist primarily of fees generated from processing business for involuntary assigned risk pools, self insured customers, and risk retention groups and are earned on a pro-rata basis over the term of the related policies and are included in fee and other revenues in the consolidated statements of income.

Accumulated Other Comprehensive (Loss) Income

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

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

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

Catastrophe Exposure

The Company writes insurance and reinsurance contracts that cover catastrophic events. The Company's policies cover unpredictable natural and other disasters, such as hurricanes, windstorms, earthquakes, floods, fires, terrorist attacks, and explosions. Although the Company purchases reinsurance to mitigate its exposure to certain catastrophic events, claims from catastrophic events could cause substantial volatility in its financial results for any fiscal year and have a material adverse effect on its financial condition.

The Terrorism Risk Insurance Act, as amended by the Terrorism Insurance Program Reauthorization Act of 2007, requires all commercial property and casualty insurers writing business in the U.S. to make terrorism coverage available to commercial policyholders and provides a Federal backstop for certified terrorist acts, which result in losses above individual insurance company deductible amounts. The Terrorism Act directly applies to the Company's U.S. property and casualty insurance business. In 2009, on eligible lines of business, participating insurers will receive reimbursement from the Federal government for 85% of paid losses in excess of the insurer's deductible, provided the aggregate industry losses exceed $100 to a maximum industry loss of $100,000. The Company estimates its deductible for commercial policies subject to the Terrorism Act (the amount the Company will have to pay before the Federal backstop becomes available) to be $1,840 in 2009. This amounts to 20% of the Company's direct earned premium from commercial lines of business subject to the Terrorism Act and approximately 11.8% on a net of tax basis of policyholders' equity of the Company at December 31, 2008, prior to consideration of terrorism reinsurance that the Company has purchased for 2008. As of the effective date of the Reauthorization Act, December 26, 2007, the U.S. government may "certify," and the Terrorism Act will cover, losses caused by any individual, foreign or domestic. Damage outside the U.S. is not covered except in limited circumstances, such as damage to a U.S. air carrier. The Terrorism Act will remain in effect until December 31, 2014. There can be no assurance that it will be extended beyond that date.

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation

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

The total purchase price was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was primarily determined using the income approach, which discounts expected cash flows to present value using estimates and assumptions determined by management. The Company is in the process of finalizing the fair value of the acquired business and related restructuring efforts; therefore, the allocation of the purchase price is subject to refinement.

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

The purchase price allocation based on the opening balance sheet of September 22, 2008, as of December 31, 2008, is as follows:

Assets:	
Total investments	$ 8,600
Cash and cash equivalents	971
Premium and other receivables	1,074
Reinsurance recoverables	481
Goodwill	2,632
Other assets	1,656
Total assets	$15,414
Liabilities:	
Unpaid claims and claim adjustment expenses	$ 5,270
Unearned premiums	2,294
Long-term debt	505
Other liabilities	1,101
Total liabilities	$ 9,170

Intangible Assets

	Carrying Value December 31, 2008[1]	Period (Years)	Method
Agency relationship	$ 605	15	Straight-line
Trademarks	229	Not subject to amortization	Not subject to amortization
State licenses	63	Not subject to amortization	Not subject to amortization
Other	4	10	Straight-line
Total intangible assets[2]	$ 901		

(1) The only difference between these carrying values and the carrying values at the date of acquisition relates to normal amortization.

(2) The above table excludes the acquired in-force policy intangible, which is included in deferred acquisition costs and acquired in-force policy intangibles on the consolidated balance sheet. See Note 4.

For the year ended December 31, 2008, the Company recognized $9 of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. Estimated amortization for the years ended December 31, 2009 through 2013, is $37, $41, $41, $42, and $43, respectively.

Integration Activities

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

Indiana Seguros, S.A.

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

Ohio Casualty Corporation

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

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

The opening balance sheet is as follows:

Assets:	
Total investments	$ 4,176
Cash and cash equivalents	105
Premium and other receivables	396
Reinsurance recoverables	611
Goodwill	1,054
Other assets	581
Total assets	$ 6,923
Liabilities:	
Unpaid claims and claim adjustment expenses	$ 2,698
Unearned premiums	698
Funds held under reinsurance treaties	113
Long-term debt	207
Other liabilities	427
Total liabilities	$ 4,143

Intangible Assets

	Carrying Value December 31, 2007[(1)]	Carrying Value December 31, 2008	Period (Years)	Method
Agency relationship	$ 233	$ 140	20	Straight-line
Non-compete agreements	3	1	2	Straight-line
Trademarks	33	33	Not subject to amortization	Not subject to amortization
State licenses	22	22	Not subject to amortization	Not subject to amortization
Total intangible assets[(2)(3)(4)]	$ 291	$ 196		

(1) The only difference between these carrying values and the carrying values at the date of acquisition relates to normal amortization.

(2) The above table excludes the acquired in-force policy intangible, which is included in deferred acquisition costs and acquired in-force policy intangibles on the consolidated balance sheet. See Note 4.

(3) In addition to amortization, as of December 31, 2008, the above table reflects a purchase accounting adjustment to agency relationships of $87.

(4) Net of accumulated amortization of $13 and $5 as of December 31, 2008, and 2007, respectively.

For the year ended December 31, 2008, the Company recognized $8 of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. For each of the years ended December 31, 2009 through 2013, estimated amortization is $8.

Integration Activities

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

Şeker Sigorta A.Ş.

On September 5, 2006, and during the course of the fourth quarter of 2006, the Company, through its Spanish subsidiary, Liberty Seguros Compania de Seguros y Reaseguros S.A. (“Liberty Seguros”), acquired 90.425% of Şeker Sigorta A.Ş., a mid-sized insurer located in Istanbul, Turkey. Goodwill recognized from the transaction was $102. Net income for Şeker Sigorta A.Ş., subsequent to acquisition was $1. The results of operations for the acquired business, which are not material, are included in the financial statements subsequent to September 5, 2006.

Dispositions

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

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

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

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

(3) INVESTMENTS

Components of Net Investment Income

	Years Ended December 31, 2008	2007	2006
Taxable interest income	$ 2,349	$ 2,211	$ 2,089
Tax-exempt interest income	472	342	200
Dividends	98	83	52
Limited partnerships and limited liability companies	4	345	304
Commercial mortgage loans	58	27	–
Other investment income	27	7	20
Gross investment income	3,008	3,015	2,665
Investment expenses	(128)	(130)	(117)
Net investment income	$ 2,880	$ 2,885	$ 2,548

Components of Net Realized Investment (Losses) Gains

	Years Ended December 31, 2008	2007	2006
Fixed maturities			
Gross realized gains	$ 109	$ 124	$ 105
Gross realized losses	(436)	(156)	(110)
Equities			
Gross realized gains	341	199	112
Gross realized losses	(801)	(48)	(19)
Other			
Gross realized gains	469	338	273
Gross realized losses	(12)	(21)	(18)
Net realized investment (losses) gains	$ (330)	$ 436	$ 343

During the years ended December 31, 2008, 2007, and 2006, other-than-temporary impairments recognized were $800, $47, and $50, respectively.

During the years ended December 31, 2008, 2007, and 2006, proceeds from sales of fixed maturities available for sale were $7,013, $8,006, and $5,432, respectively. The gross realized gains (losses) on such sales totaled $85 and $(122) in 2008, $60 and $(81) in 2007, and $60 and $(47) in 2006. The net realized gains (losses) related to trading securities held as of the end of the year amounted to $0, $0, and $8 for the years ended December 31, 2008, 2007, and 2006, respectively.

Components of Change in Net Unrealized Investment Losses

	2008	2007	2006
Fixed maturities	$(2,257)	$ (35)	$ (308)
Equities	(962)	(88)	220
Other	(5)	3	(1)
Adjustments to deferred policy acquisition costs	145	33	71
Net change in unrealized investment losses	(3,079)	(87)	(18)
Deferred income taxes	1,048	17	6
Net change in unrealized investment losses, net of tax	$(2,031)	$ (70)	$ (12)

Available for Sale Investments

The gross unrealized gains and losses and fair values of available for sale investments at December 31, 2008, and 2007, are as follows:

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 of government and corporate agencies	12,265	300	(565)	12,000
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
Total equity securities	1,279	215	(310)	1,184
Total securities available for sale	$51,181	$ 1,289	$(3,555)	$48,915

December 31, 2007	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	$ 3,156	$ 173	$ (11)	$ 3,318
Mortgage and asset-backed securities of government and corporate agencies	13,459	172	(140)	13,491
U.S. state and municipal	9,902	153	(54)	10,001
Corporate and other	17,636	275	(473)	17,438
Foreign government securities	2,695	43	(52)	2,686
Total fixed maturities	46,848	816	(730)	46,934
Total equity securities	2,418	1,071	(204)	3,285
Total securities available for sale	$49,266	$ 1,887	$ (934)	$50,219

At December 31, 2008, and 2007, securities carried at $3,701 and $3,020, respectively, were on deposit with regulatory authorities as required by law.

At December 31, 2008, and 2007, the fair values of fixed maturities loaned were approximately $771 and $819, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately $682 and $467 as of December 31, 2008, and 2007, respectively. Other investments received as collateral in connection with the loaned securities was approximately $119 and $377 as of December 31, 2008, and 2007, respectively.

The amortized cost and fair value of fixed maturities at December 31, 2008, by contractual maturity are as follows:

	Amortized Cost	Fair Value
Due to mature:		
One year or less	$ 1,694	$ 1,669
Over one year through five years	10,032	9,764
Over five years through ten years	10,359	9,689
Over ten years	15,552	14,609
Mortgage and asset-backed securities of government and corporate agencies	12,265	12,000
Total fixed maturities	$49,902	$47,731

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

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

	Less Than 12 Months		Greater Than 12 Months	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. government and agency securities	$ (1)	$ 25	$ (1)	$ 9
Mortgage and asset-backed securities of government and corporate agencies	(422)	2,372	(143)	729
U.S. state and municipal	(491)	7,287	(211)	1,311
Corporate and other	(831)	7,168	(1,035)	4,322
Foreign government securities	(35)	116	(75)	300
Common stock	(60)	238	(21)	28
Preferred stock	(29)	159	(200)	233
Total	$(1,869)	$17,365	$(1,686)	$ 6,932

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration that individual securities have been in a continuous unrealized loss position at December 31, 2007, that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		Greater Than 12 Months	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. government and agency securities	$ (1)	$ 158	$ (10)	$ 90
Mortgage and asset-backed securities of government and corporate agencies	(30)	1,807	(110)	3,641
U.S. state and municipal	(39)	2,396	(15)	437
Corporate and other	(200)	5,257	(273)	4,602
Foreign government securities	(42)	876	(10)	539
Common stock	(60)	387	(6)	24
Preferred stock	(138)	546	–	–
Total	$ (510)	$11,427	$ (424)	$ 9,333

The above table for 2008 includes $737 of unrealized losses related to securities issued and guaranteed by the United States government, its agencies, government sponsored enterprises and state and municipal governments. Included in the $1,686 of unrealized losses was $411 of unrealized losses on securities that had been in an unrealized position of 10% or greater for more than twelve months. Unrealized losses as of December 31, 2008, increased by $2,621 from December 31, 2007, primarily due to an increase in credit spreads and a general decline in market values related to both fixed income and equity markets. The Company monitors the difference between the amortized cost and estimated fair value of investments to ascertain whether declines in value are temporary in nature. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy.

More than 73% of the Company's securitized portfolio is explicitly backed by the U.S. government (GNMA and SBA) or by government-sponsored entities (FHLMC and FNMA). Over 97% of these holdings remain rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with 98.8% rated AA or above.

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

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

Variable Interest Entities

The Company's exposure to investment structures subject to analysis under FIN 46(R) relates primarily to investments in energy, private equity and real estate limited partnerships that are accounted for under the equity method. Two VIEs in the energy investment sector have been consolidated in the Company's 2008, 2007, and 2006 financial statements as the Company has been deemed to be the primary beneficiary. In addition, the Company had investments in 62 and 40 VIEs at December 31, 2008, and 2007, respectively, for which it was not the primary beneficiary. The Company's investments in VIEs were $623 and $386 at December 31, 2008, and 2007, respectively. The Company's maximum exposure to losses from VIEs is $1,267 and $786 as of December 31, 2008, and 2007, respectively, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Investments in Mortgage Loans

At December 31, 2008, and 2007, the carrying values of commercial mortgage loans were $1,090 and $657, respectively. The carrying values reflect allowances, which are immaterial to the total. Additionally, the Company's participation in any one commercial mortgage loan acquired does not exceed 49% of the loan value. As of December 31, 2008, the average total loan size was $1 and the average loan participation size was $1. The number of loans in the portfolio increased from 1,406 at December 31, 2007, to 2,257 at December 31, 2008. Approximately 90% of the loans are full or partial recourse to borrowers.

Derivatives

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

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

(4) DEFERRED POLICY ACQUISITION COSTS AND ACQUIRED IN-FORCE POLICY INTANGIBLE

The following reflects the policy acquisition costs and acquired in-force policy intangible deferred for amortization against future income and related amortization charged to income:

	Years Ended December 31, 2008	2007	2006
Balance at beginning of year	$ 2,045	$ 1,710	$1,512
Acquisition costs deferred	3,991	3,455	2,998
Acquired in-force policy intangible [1]	494	161	8
Amortization charged to continuing income	(3,989)	(3,281)	(2,808)
Balance at end of year	$ 2,541	$ 2,045	$1,710

[1] For 2008, the acquired in-force policy intangible was recognized in conjunction with the Company's purchase of Safeco Corporation on September 22, 2008, and the acquisition of Indiana Seguros on January 9, 2008. For 2007 and 2006, the acquired in-force policy intangible was recognized in conjunction with the Company's purchase of Ohio Casualty on August 24, 2007, and the acquisition of Şeker Sigorta A.Ş. on September 5, 2006, respectively.

(5) ASBESTOS AND ENVIRONMENTAL RESERVES

The Company has exposure to asbestos and environmental claims that emanate principally from general liability policies written prior to the mid-1980's. In establishing the Company's asbestos and environmental reserves, the Company estimates case reserves for anticipated losses and bulk reserves for claim adjustment expenses and incurred but not reported claims reserves ("IBNR"). The Company maintained casualty excess of loss reinsurance during the relevant periods. The reserves are reported net of cessions to reinsurers and include any reserves reported by ceding reinsurers on assumed reinsurance contracts.

Upon their de-affiliation from the Nationwide Group and affiliation with the Company, Employers Insurance Company of Wausau ("EICOW"), Wausau Business Insurance Company ("WBIC"), Wausau General Insurance Company ("WGIC"), and Wausau Underwriters Insurance Company ("WUIC") entered into ceded reinsurance contracts whereby Nationwide Indemnity Company assumed full responsibility for obligations on certain policies with effective dates prior to January 1, 1986, including all asbestos and environmental exposures.

The process of establishing reserves for asbestos and environmental claims is subject to greater uncertainty than the establishment of reserves for liabilities relating to other types of insurance claims. A number of factors contribute to this greater uncertainty surrounding the establishment of asbestos and environmental reserves, including, without limitation: (i) the lack of available and reliable historical claims data as an indicator of future loss development, (ii) the long waiting periods between exposure and manifestation of any bodily injury or property damage, (iii) the difficulty in identifying the source of asbestos or environmental contamination, (iv) the difficulty in properly allocating liability for asbestos or environmental damage, (v) the uncertainty as to the number and identity of insureds with potential exposure, (vi) the cost to resolve claims, and (vii) the collectability of reinsurance.

The uncertainties associated with establishing reserves for asbestos and environmental losses and loss adjustment expenses are compounded by the differing, and at times inconsistent, court rulings on environmental and asbestos coverage issues involving: (i) the differing interpretations of various insurance policy provisions and whether asbestos and environmental losses are or were ever intended to be covered, (ii) when the loss occurred and what policies provide coverage, (iii) whether there is an insured obligation to defend, (iv) whether a compensable loss or injury has occurred, (v) how policy limits are determined, (vi) how policy exclusions are applied and interpreted, (vii) the impact of entities seeking bankruptcy protection as a result of asbestos-related liabilities, (viii) whether clean-up costs are covered as insured property damage, and (ix) applicable coverage defenses or determinations, if any, including the determination as to whether or not an asbestos claim is a products/completed operation claim subject to an aggregate limit and the available coverage, if any, for that claim. The uncertainties cannot be reasonably estimated, but could have a material impact on the Company's future operating results and financial condition.

In the last few years the Company, as well as the industry generally, has seen decreases in the number of asbestos claims being filed. This turn to a more favorable trend is due to a number of factors. Screening activity used by some lawyers to find new plaintiffs has been as a result of questionable practices discovered in the Federal Silica Multi District Litigation. Court decisions in several key states (e.g., Mississippi) have been favorable to defendants. Most importantly, several states have enacted legislation in the past few years that contain medical criteria provisions aimed at reducing the number of lawsuits filed by unimpaired plaintiffs and providing prompt and fair compensation to those who meet the criteria.

Biennially, the Company completes comprehensive ground-up asbestos reserve studies. The studies are completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and includes all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal reviews, potential exposures of large policyholders are 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 are the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. Small policyholders are evaluated using aggregate methods that utilize information developed from the large policyholders. The last 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. Net increases to asbestos reserves were $18, $90 and $25 for the years ended December 31, 2008, 2007, and 2006, respectively.

The Company completed an annual study on the environmental claims liability. Net (decreases) increases to environmental reserves were $(5), $64 and $22 for the years ended December 31, 2008, 2007, and 2006, respectively.

As a result of the significant uncertainty inherent in determining a company's asbestos and environmental liabilities and establishing related reserves, the amount of reserves required to adequately fund the Company's asbestos and environmental claims cannot be accurately estimated using conventional reserving methodologies based on historical data and trends. As a result, the use of conventional reserving methodologies frequently has to be supplemented by subjective considerations including managerial judgment. In that regard, 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 an aggregate liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

The following tables summarize the activity for the Company's asbestos and environmental claims and claim adjustment expenses, a component of the Company's unpaid claims and claim adjustment expenses, for the years ended December 31, 2008, 2007, and 2006. Acquisition activity in 2008 and 2007 relates to the purchase of Safeco and Ohio Casualty, respectively:

	2008	2007	2006
Gross Asbestos:			
January 1 reserves	$ 2,526	$ 2,541	$ 2,720
Acquisitions	224	53	–
Incurred activity	146	413	152
Paid activity	357	481	331
Ending reserves	$ 2,539	$ 2,526	$ 2,541
Net Asbestos:			
January 1 reserves	$ 761	$ 872	$ 1,066
Acquisitions	182	39	–
Incurred activity	18	90	25
Paid activity	149	240	219
Ending reserves	812	761	872
Allowance for reinsurance on unpaid losses	89	87	100
Total unpaid losses including allowance for unpaid reinsurance	$ 901	$ 848	$ 972

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

Included in gross asbestos incurred for 2008, 2007, and 2006 are significant amounts attributable to claims against 1985 and prior policies issued by EICOW and its affiliates, which are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of Prudential Property and Casualty Insurance Company, Prudential General Insurance Company, and Prudential Commercial Insurance Company (collectively referred to as "PruPac") included $175 and $118 of gross and net asbestos reserves, respectively. Any increase in asbestos reserves related to PruPac is reinsured by Vantage Casualty Insurance Company ("Vantage") and guaranteed by Prudential Financial, Inc. The Company had gross paid losses associated with these reserves of $47, $56, and $60 in 2008, 2007, and 2006, respectively. All 2008 gross paid losses are recoverable from Vantage.

	2008	2007	2006
Gross Environmental:			
January 1 reserves	$ 621	$ 585	$ 775
Acquisitions	95	56	–
Incurred activity	13	57	52
Paid activity	109	77	242
Ending reserves	$ 620	$ 621	$ 585
Net Environmental:			
January 1 reserves	$ 486	$ 414	$ 452
Acquisitions	84	56	–
Incurred activity	(5)	64	22
Paid activity	70	48	60
Ending reserves	$ 495	$ 486	$ 414

The Company's 2003 acquisition of PruPac included $15 and $12 of gross and net environmental reserves, respectively. Any increase in environmental reserves related to PruPac is reinsured by Vantage and guaranteed by Prudential Financial, Inc. The Company had gross paid losses associated with these reserves of $1 in each of 2008, 2007, and 2006. All 2008 gross paid losses are recoverable from Vantage.

(6) UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

The Company establishes reserves for payment of claims and claim adjustment expenses that arise from the policies issued. As required by applicable accounting rules, no reserves are established until a loss, including a loss from a catastrophe, occurs. The Company's reserves are segmented into three major categories: reserves for reported claims (estimates made by claims adjusters); incurred but not reported ("IBNR") representing reserves for unreported claims and supplemental reserves for reported claims; and reserves for the costs to settle claims. The Company establishes its reserves net of salvage and subrogation by line of business or coverage and year in which losses occur.

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.

Catastrophes are an inherent risk of the property-casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and financial position. The level of catastrophe losses experienced in any period cannot be predicted and can be material to the results of operations and financial position of the Company. Catastrophe losses incurred during the years ended December 31, 2008, 2007, and 2006, were $1,580, $379, and $558, respectively.

Note 5 includes a discussion of incurred attributable to prior years for asbestos and environmental reserves.

Activity in property and casualty unpaid claims and claim adjustment expenses of the Company are summarized as follows:

	2008	2007	2006
Balance as of January 1	$42,992	$38,606	$38,067
Less: unpaid reinsurance recoverables[1]	12,474	12,462	13,516
Net balance as of January 1	30,518	26,144	24,551
Balance attributable to dispositions, acquisitions, and affiliations	4,966	2,133	25
Incurred attributable to:			
Current year	18,623	15,106	12,854
Prior years:			
Asbestos and environmental	6	147	35
All other	(1,081)	(256)	376
Discount accretion	125	84	109
Total incurred	17,673	15,081	13,374
Paid attributable to:			
Current year	9,064	7,176	6,050
Prior years	7,567	5,969	6,027
Total paid	16,631	13,145	12,077
Amortization of deferred retroactive reinsurance gain	82	83	97
Net adjustment due to foreign exchange	(298)	222	174
Add: unpaid reinsurance recoverables[1]	12,417	12,474	12,462
Balance as of December 31	$48,727	$42,992	$38,606

[1] In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements discussed in Note 7, the Company has recorded retroactive reinsurance recoverable balances of $2,216, $2,277, and $2,292 at December 31, 2008, 2007, and 2006, respectively.

Incurred attributable to prior years, excluding asbestos and environmental, includes $82, $83, and $97 of amortization of deferred retroactive gain in the years ended December 31, 2008, 2007, and 2006, respectively. In 2008, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain is primarily attributable to favorable loss trends in the LIU reinsurance and workers compensation lines of business. In 2007, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is due to favorable trends in personal auto and commercial multiple peril, partially offset by reserve increase for workers compensation. The prior year development in workers compensation is composed of unfavorable development in Commercial Markets, caused by higher than expected severity, partially offset by favorable development in Agency Markets, caused by better than expected severity and impact of Florida reform. In 2006, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily related to the workers compensation and assumed non-proportional liability lines of business, partially offset by personal auto and commercial auto lines of business.

Included in the unpaid claims and claim adjustment expenses are reserves from involuntary insurance pools. Changes to the involuntary pool reserves are received from the pools' administrators on a periodic basis and recorded by the Company. (Decreases) increases in discount accretion related to these involuntary pool reserves was $29, $(11), and $12 for the years ended December 31, 2008, 2007, and 2006, respectively.

The Company has not discounted unpaid property and casualty insurance claims and claim adjustment expenses other than tabular discounting on the long-term indemnity portion of workers compensation claims, the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states, the long-term portion of certain workers compensation claims of foreign subsidiaries, and specific asbestos structured settlements.

The tabular discounting on these workers compensation claims is based on Unit Statistical Plan tables as approved by the respective states and ranges from 3.5% to 4.0% for the years ended December 31, 2008, and 2007. The held discounted reserves on these unpaid workers compensation claims, net of all reinsurance, at December 31, 2008, and 2007, were $2,351 and $2,304, respectively. The held discounted reserves on unpaid asbestos structured settlement claims at December 31, 2008, and 2007, were $145 and $174, respectively.

For certain commercial lines of insurance, the Company offers experience-rated insurance contracts whereby the ultimate premium is dependent upon the claims incurred. At December 31, 2008, and 2007, the Company held $4,612 and $4,103, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of $566 and $617 at December 31, 2008, and 2007, respectively. For the years ended December 31, 2008, 2007, and 2006, the Company recognized a decrease in premium income of $(77), $(105), and $(28), respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of $625 and $570 as of December 31, 2008, and 2007, respectively.

At December 31, 2008, and 2007, the reserve for unpaid claim reserves was reduced by $4,690 and $4,812, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were $231 and $243 at December 31, 2008, and 2007, respectively.

Relating to future policy benefits, the discounting of the disability claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 4.5% to 7.0% in 2008 and 2007. Unpaid disability claims and claim adjustment expenses at December 31, 2008, and 2007, include liabilities of $1,221 and $1,098 carried at discounted values of $933 and $829, respectively.

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

(7) REINSURANCE

In the ordinary course of business, the Company assumes reinsurance and also cedes reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Company is also a member of various involuntary pools and associations and serves as a servicing carrier for residual market organizations.

A summary of reinsurance financial data reflected within the consolidated statements of income is presented below:

	2008		2007		2006	
	Written	Earned	Written	Earned	Written	Earned
Direct	$28,635	$ 28,309	$ 24,844	$ 24,250	$23,158	$ 22,453
Assumed	1,640	1,642	1,320	1,375	1,341	1,328
Ceded[(1)]	4,808	4,427	3,626	3,738	3,944	3,987
Net premiums	$25,467	$ 25,524	$ 22,538	$ 21,887	$20,555	$ 19,794

[(1)] The Company, through its domestic insurance subsidiaries, entered into a homeowners quota share reinsurance contract on a written premium basis effective December 31, 2008, ceding 31.725% of U.S. homeowners premium.

The following table summarizes the Company's reinsurance recoverables by reinsurers' Standard & Poor's ("S&P") rating (or the rating of any guarantor) as of December 31, 2008.

S&P Rating	Reinsurance Recoverables	Collateral Held	Net Recoverables
AAA	$ 1,157	$ 645	$ 512
AA+, AA, AA-	4,879	1,380	3,646
A+, A, A-	3,511	344	3,263
BBB+, BBB, BBB-	12	3	9
BB+ or below	4	–	4
Involuntary pools	3,207	7	3,200
Voluntary pools	376	74	302
Other [(1)]	2,507	2,453	665
Gross recoverables	15,653	4,906	11,601
Less: allowance	344	–	–
Net recoverables	$ 15,309	$ 4,906	$ 11,601

[(1)] Includes $968 and $1,539 of recoverables from non-rated reinsurers and captive and program business, respectively.

The Company remains contingently liable in the event reinsurers are unable to meet their obligations for paid and unpaid reinsurance recoverables and unearned premiums ceded under reinsurance agreements. As of December 31, 2008, the Company holds $4,906 of collateral as security under related reinsurance agreements in the form of funds, securities and/or letters of credit.

The Company has an aggregate reinsurance recoverable from Nationwide Indemnity Company in the amount of $1,995 and $2,119 as of December 31, 2008, and 2007, respectively. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company. Additionally, the Company has significant reinsurance recoverable concentrations with Swiss Reinsurance Group, Berkshire Hathaway Group, Everest Re Group and Munich Re totaling $1,613, $506, $502, and $497, respectively, as of December 31, 2008, net of offsetting collateral under the contracts.

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. Reinsurer credit risk with respect to any such involuntary pool or association is a function of the creditworthiness of all of the pool participants.

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

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002, renewal, any premium and loss activity subsequent to

December 31, 2001, is accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods. Activity related to each of these retroactive and prospective contracts was immaterial in 2008 and 2007. Approximately $45 and $32 of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2006, with additional premium of $29 and $23, respectively. The income statement impact of ceding the additional losses and premium on the fourth quarter 2000 through fourth quarter 2001 covered accident year periods was deferred and is amortized into income using the effective interest method over the estimated settlement period.

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

(8) DEBT OUTSTANDING

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

Short-term debt:

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

Long-term debt:

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

[1] Reflects debt originally issued by Safeco. On December 29, 2008, $281 of the outstanding $300 4.875% notes due 2010 and $187 of the outstanding $204 7.25% notes due 2012 were exchanged for a like principal amount of newly issued Liberty Mutual Group Inc. ("LMGI") notes.

[2] Reflects debt originally issued by Ohio Casualty. On December 29, 2008, $180 of the outstanding $200 7.30% senior notes were exchanged for a like principal amount of newly issued LMGI notes.

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

[4] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

[5] The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

[6] Includes net purchase accounting adjustment of $8 related to Ohio Casualty $200 senior notes, due 2014, Safeco $300 senior notes, due 2010, and Safeco $204 senior notes, due 2012.

Short-term Debt

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

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

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

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

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

Long-term Debt

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

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

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

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

Capital lease obligations as of December 31, 2008, and 2007, were $149 and $87, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. Amortization of the assets subject to capital leases is included in insurance operating costs and expenses on the consolidated statements of income. As of December 31, 2008, the Company's amortization of the lease obligation through maturity is approximately $47 for 2009, $15 for 2010, $16 for 2011, $17 for 2012, $17 for 2013, and $33 thereafter.

Interest

The Company paid $406, $299, and $188 of interest in 2008, 2007, and 2006, respectively.

(9) INCOME TAXES

The Company files a consolidated U.S. Federal income tax return for substantially all of its domestic operations. Pursuant to intercompany Federal income tax allocation agreements among each of these companies and their respective subsidiaries, the consolidated tax liabilities are allocated to each company based on its separate return tax liability. Tax benefits are allocated to each company for its portion of net operating losses and tax credit carry forwards in the year they are used by the consolidated group. Intercompany tax balances are settled quarterly. A provision is made, where applicable, for taxes on foreign operations.

The components of Federal, state and foreign income tax expense (benefit) related to continuing operations are:

Years ended December 31,	**2008**	**2007**	**2006**
Current tax expense (benefit):			
United States Federal	$ 220	$ 411	$ 530
United States Federal benefit of net operating losses	–	–	(18)
State	1	–	–
Foreign	117	100	125
Total current tax expense	338	511	637
Deferred tax expense (benefit):			
United States Federal	(226)	139	(7)
Foreign	43	30	2
Total deferred tax (benefit) expense (benefit)	(183)	169	(5)
Total Federal, state and foreign income tax expense	$ 155	$ 680	$ 632

A reconciliation of the income tax expense attributable to continuing operations computed at U.S. Federal statutory tax rates to the income tax expense as included in the consolidated statements of income follows:

Years ended December 31,	**2008**	**2007**	**2006**
Expected Federal income tax expense	$ 454	$ 769	$ 790
Tax effect of:			
Nontaxable investment income	(155)	(110)	(67)
Change in valuation allowance	15	–	(11)
Goodwill	(13)	(15)	(15)
IRS settlement	–	–	(10)
Tax litigation	(76)	(19)	–
Revision to estimates	(24)	3	14
Tax inflation adjustment	(41)	(20)	(15)
State	1	–	–
Foreign	(43)	(2)	(28)
Other	37	74	(26)
Actual income tax expense	$ 155	$ 680	$ 632

The significant components of the deferred income tax assets and liabilities at December 31, are summarized as follows:

	2008	**2007**
Deferred tax assets:		
Unpaid claims discount	$ 713	$ 588
Unearned premium reserves	707	573
Net operating losses	266	344
Employee benefits	1,011	520
Retroactive reinsurance deferred gain	262	284
Credits	46	61
Net unrealized losses and other – than – temporary decline in investments	880	–
Other	496	248
	4,381	2,618
Less: valuation allowance	(131)	(112)
Total deferred tax assets	4,250	2,506
Deferred tax liabilities:		
Deferred acquisition costs	644	518
Net unrealized gains	–	358
Intangibles	392	102
Other	48	59
Total deferred tax liabilities	1,084	1,037
Net deferred tax assets	$ 3,166	$1,469

The increase in the valuation allowance is primarily due to net operating losses generated in certain foreign subsidiaries where there is uncertainty in the timing and amount of the realization of these losses. Based on the assumption that future levels of income will be achieved, management believes it is more likely than not the net deferred tax assets will be realized.

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

The Company's subsidiaries had net operating loss carry forwards of $824, alternative minimum tax credit carry forwards of $1, and foreign tax credit carry forwards of $45 as of December 31, 2008. The net operating losses available in the U.S. and various non-U.S. tax jurisdictions will begin to expire, if not utilized, as follows:

2009	$ 2
2010	3
2011	16
2012	28
2013	33
Thereafter	742
Total	$ 824

The foreign tax credits will begin to expire, if not utilized, in 2013 and the alternative minimum tax credits do not expire.

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the United States where such earnings are permanently reinvested. At December 31, 2008, unremitted earnings of foreign subsidiaries were $1,109. If these earnings were distributed in the form of dividends or otherwise, the Company would be subject to U.S. income taxes less an adjustment for applicable foreign tax credits.

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 2005 tax years. Any adjustments that may result from the IRS examinations of these income tax returns are not expected to have a material impact on the financial position, liquidity, or results of operations of the Company.

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

Balance at January 1, 2007	$ 107
Additions based on tax positions related to the current year	–
Additions for tax positions of prior years	60
Reductions for tax positions of prior years	–
Settlements	8
Balance at January 1, 2008	175
Additions based on tax positions related to the current year	1
Additions for tax positions of prior years	34
Reductions for tax positions of prior years	(89)
Settlements	(11)
Increases in unrecognized tax benefits acquired or assumed in a business combination	15
Balance at December 31, 2008	$ 125

Included in the tabular rollforward of unrecognized tax benefits is interest in the amount of $17 and $56 as of December 31, 2008, and 2007, respectively.

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

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. During the years ended December 31, 2008, 2007, and 2006, the Company recognized approximately $(40), $10, and $11 in interest and penalties. The Company had approximately $12 and $53 of interest and penalties accrued at December 31, 2008, and 2007, respectively.

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

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

(10) BENEFIT PLANS

The Company acquired Safeco and Ohio Casualty effective September 22, 2008, and August 24, 2007, respectively. The Safeco and Ohio Casualty benefit plans are combined with the Company benefit plans results in the Benefit Plans footnote after purchase price allocation adjustment.

The Company sponsors non-contributory defined benefit pension plans ("the Plans") covering substantially all U.S. and Canadian employees. The benefits and eligibility are based on age, years of service, and the employee's compensation, as more fully described in the Plans. Some foreign subsidiaries sponsor pension plans (principally non-contributory) which provide benefits based on final pay.

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

The Company also provides certain healthcare and life insurance benefits ("Postretirement") covering substantially all U.S. and Canadian employees. Life insurance benefits are based on a participant's final compensation subject to the plan maximum.

Assets of the defined benefit pension and postretirement plans consist primarily of investments in a subsidiary life insurance company's separate accounts that invest primarily in fixed income and Standard and Poor's 500 Index of equity securities. As of December 31, 2008, and 2007, assets of the plans totaling $2,893 and $3,203, respectively, were held in separate accounts of the Company.

The Company sponsors defined contribution savings plans for substantially all U.S. (a 401(k) plan) and Canadian (a Deferred Profit Sharing Plan) employees who meet certain eligibility requirements. During 2008, 2007, and 2006, employees could contribute a percentage of their annual compensation on a before and after-tax basis, subject to Federal limitations. The benefits are based on the employee's contribution amount and Company profitability. In 2008, 2007, and 2006, the Company made matching contributions of $149, $128, and $88, respectively, including the supplemental defined contribution plans. The increase in 2008 was primarily due to the Safeco acquisition. The increase in 2007 was primarily due to the Ohio Casualty acquisition.

Compensation expense related to the Company's long-term and short-term incentive compensation plans was $387, $557, and $488, for the years ended December 31, 2008, 2007, and 2006, respectively.

The following table sets forth the assets, obligations, and assumptions associated with the various U.S., Canadian, and certain foreign subsidiary pension and postretirement benefits. The amounts are recognized in the accompanying consolidated balance sheets as of December 31, 2008, and 2007, and consolidated statements of income for the years ended December 31, 2008, 2007, and 2006.

	Pension		**Supplemental Pension**		**Postretirement**	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**
Change in benefit obligations:						
Benefit obligation at beginning of year	$3,839	$3,355	$ 238	$ 224	$ 554	$ 512
Service costs	142	148	10	8	22	19
Interest costs	251	213	15	13	40	31
Amendments	–	53	–	2	–	–
Actuarial (gains) losses	425	(192)	69	4	56	(53)
Currency exchange rate change	(32)	15	(1)	1	(1)	1
Acquisitions	164	336	11	2	80	65
Benefits paid	(156)	(131)	(18)	(16)	(33)	(21)
Employee contributions	1	–	–	–	–	–
Other	–	42	–	–	63	–
Benefit obligations at end of year	**$4,634**	**$3,839**	**$ 324**	**$ 238**	**$ 781**	**$ 554**
Accumulated benefit obligations	**$4,029**	**$3,348**	**$ 278**	**$ 184**	**$ 781**	**$ 554**
Change in plan assets:						
Fair value of plan assets at beginning of year	$3,696	$2,987	$ –	$ –	$ 17	$ 18
Actual return on plan assets	(542)	259	–	–	(2)	1
Currency exchange rate change	(22)	10	–	–	–	–
Acquisitions	158	363	–	–	–	1
Employer contribution	5	205	–	–	21	18
Benefits paid	(155)	(129)	–	–	(33)	(21)
Other	1	1	–	–	–	–
Fair value of plan assets at end of year	**$3,141**	**$3,696**	**$ –**	**$ –**	**$ 3**	**$ 17**
Funded status of Plan	**$(1,493)**	**$ (143)**	**$ (324)**	**$(238)**	**$ (778)**	**$(537)**

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

	Pension		Supplemental Pension		Postretirement	
	2008	2007	2008	2007	2008	2007
Amounts recognized in the Statement of Financial Position:						
Noncurrent assets	$ 3	$ 36	$ –	$ –	$ –	$ –
Current liabilities	(1)	–	(21)	(8)	(31)	(10)
Noncurrent liabilities	(1,495)	(179)	(303)	(230)	(747)	(527)
Net liability at end of year	**$ (1,493)**	**$ (143)**	**$ (324)**	**$ (238)**	**$ (778)**	**$ (537)**
Amounts recognized in Accumulated Other Comprehensive Loss (Income):						
Net loss (gain)	$1,581	$ 359	$ 136	$ 73	$ (13)	$ (74)
Prior service costs	40	46	8	10	(29)	(32)
Net transition (asset) liability	(12)	(17)	–	–	68	77
Total	**$1,609**	**$ 388**	**$ 144**	**$ 83**	**$ 26**	**$ (29)**
Other changes in Plan assets and projected benefit obligation recognized in Other Comprehensive Loss (Income):						
Net actuarial loss	$1,234	–	$ 69	–	$ 59	–
Currency exchange rate change	(1)	–	–	–	–	–
Amortization of net actuarial (gain) loss	(11)	–	(5)	–	2	–
Prior service costs	–	–	–	–	–	–
Amortization of prior service cost	(6)	–	(3)	–	3	–
Transition obligation	–	–	–	–	–	–
Amortization of transition obligation	5	–	–	–	(9)	–
Total	**$1,221**	**$ –**	**$ 61**	**$ –**	**$ 55**	**$ –**

The estimated net actuarial loss, prior service cost, and transition obligation for the pension, supplemental pension and postretirement welfare plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2009 fiscal year are $63, $9, and $(6), respectively for pension and supplemental plans and $1, $(3), and $9, respectively, for retiree welfare plans.

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

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

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

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

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

Weighted-average actuarial assumptions for benefit obligations are set forth in the following table:

December 31,	2008	2007
Pension		
Discount rate	6.00%	6.50%
Rate of compensation increase	4.70%	4.70%
Supplemental Pension		
Discount rate	6.00%	6.50%
Rate of compensation increase	4.90%	4.90%
Postretirement		
Discount rate	6.00%	6.50%

Weighted-average actuarial assumptions for net periodic benefit costs are set forth in the following table:

December 31,	2008	2007	2006
Pension			
Discount rate	6.50%	6.00%	5.50%
Expected return on plan assets	7.50%	7.50%	7.50%
Rate of compensation increase	4.70%	4.70%	4.70%
Supplemental Pension			
Discount rate	6.50%	6.00%	5.50%
Rate of compensation increase	4.90%	4.90%	4.90%
Postretirement			
Discount rate	6.50%	6.00%	5.50%
Expected return on plan assets	7.15%	7.15%	7.15%

The discount rate assumption used to determine the benefit obligations is based on a yield curve approach where the cash flow related to the retirement plan liability stream is discounted at an interest rate specifically applicable to the timing of the cash flow. The yield curve is developed from the December 31, 2008 Citigroup Pension Discount Curve. The process calculates the present value of these cash flows and determines the equivalent single discount rate that produces the same present value of the future cash flows. The equivalent single discount rate is then rounded to the nearest 25 basis points.

In choosing the expected long-term rate of return, the Company's Retirement Board considered the historical returns of equity and fixed income markets in conjunction with today's economic and financial market conditions.

The weighted-average healthcare cost trend rates are expected to be 8.7% in 2009 graded down to 5.2% in 2016. Healthcare cost trend rate assumptions have a material impact on the postretirement benefit obligation. A one-percentage point change in assumed healthcare cost trend rates would have the following effects:

	1% point increase	1% point decrease
Effect on Postretirement Benefit Obligation	$ 81	$ 74
Effect on total service and interest costs	$ 8	$ 7

Plan Assets

The Plans' weighted-average asset allocation by asset category is as follows:

Asset Category	2008	2007
Equity Investments	23%	51%
Debt Investments	50%	26%
Other	27%	23%
Total	100%	100%

The fundamental investment policies of the Plans have been formulated so they balance the primary objectives of (1) achieving long-term growth sufficient to fund, as fully practicable, future obligations and (2) supporting the short-term requirement of meeting current benefit payments, all after giving due consideration to the underlying characteristics of the Company's employment base. Overall, the Plans' policies have traditionally emphasized the maximization of long-term returns in a manner that is consistent with an asset base that: consists of high quality investments as a means of enhancing capital preservation; is broadly diversified; generates a relatively high level of investment income in accordance with the level of risk incurred; and is generally, highly marketable. The change in asset allocation percentages in 2008 was the result of recent economic turmoil.

Asset allocation and selection guidelines for the Plans have been developed around the aforementioned fundamental policies. Debt investments are considered the most appropriate asset class for the plans given their record of generating a relatively high level of investment income with a relatively low level of risk. Emphasis is placed on high quality investment grade bonds and the diversification of risk. The Plans' current target allocation for debt investments is 62%, with a range of 50% to 80%.

The other major component of the Plans' assets consists of equity investments. The primary investment objective for this class of assets is to balance the pursuit of a relatively high level of investment income with the pursuit of superior, long term, real rate of return. The guideline for equity investing is focused on high quality stocks and the diversification of risk. The Plans' current target allocation for equity investments is 20%, with a range of 15% to 25%.

The remaining assets of the Plans are maintained in cash or invested in limited partnerships or real estate, which are principally engaged in venture capital investing and other so-called "non-traditional" forms of investment. The Plans' current target allocation for other investments is 18%, with a range of 8% to 35%.

The Postretirement Plan weighted-average asset allocations by asset category are as follows:

Asset Category	2008	2007
Equity Investments	4%	35%
Debt Investments	9%	17%
Other	87%	48%
Total	100%	100%

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The Postretirement Plan maintains assets in an insurance contract used to pay current life insurance premiums for certain retirees. These amounts are classified as other assets. The investment strategy for this portion of the assets places a greater emphasis on funding current benefits and a lesser emphasis on long-term growth. The change in asset allocation percentages in 2008 was the result of recent economic turmoil.

Cash Flows

Contributions

The Company contributed $5 to the qualified plans, and directly funded $18 to retirees in the supplemental pension plans in 2008. In addition, the Company directly funded $21 to the postretirement benefit plans in 2008.

The Company expects to contribute approximately $304 to the qualified plans, and directly fund $21 to retirees in the supplemental pension plans in 2009. In addition, the Company expects to directly fund $39 to the postretirement benefit plans gross of the Medicare Subsidy in 2009.

Expected Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate are expected to be paid:

	Pension	Supplemental Pension	Postretirement Welfare Plans	Postretirement Medicare Subsidy
2009	$ 181	$ 21	$ 39	$ (5)
2010	319	24	41	(6)
2011	174	32	44	(6)
2012	184	31	45	(7)
2013	196	46	47	(8)
2014-2018	1,231	100	268	(52)

(11) FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[1] See above table for 2008 carrying value and fair value balances.

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

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

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

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

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

Notes to Consolidated Financial Statements (Dollars in millions, except per share amounts)

(12) COMMITMENTS AND CONTINGENT LIABILITIES

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

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

The Company leases certain office facilities and equipment under operating leases expiring in various years through 2016. Rental expense amounted to $224, $215, and $185, for the years ended December 31, 2008, 2007, and 2006, respectively. In addition, the Company is party to two land leases expiring in 2025 and 2101. The Company also owns certain office facilities and receives rental income from tenants under operating leases expiring in various years through 2022. Rental income amounted to $30, $35, and $36 for the years ended December 31, 2008, 2007, and 2006, respectively.

Future minimum rental payments and receipts under non-cancelable leases with terms in excess of one year are estimated as follows:

	Operating Leases	Land Leases	Rental Income	Net Lease Obligations
2009	$ 200	$ 1	$ 29	$ 172
2010	185	1	29	157
2011	126	1	20	107
2012	92	1	15	78
2013	67	1	14	54
2014 – 2033	158	20	44	134
2034 – 2053	–	20	–	20
2054 – 2101	–	95	–	95
Total	$ 828	$ 140	$ 151	$ 817

The Company sold and leasedback certain furniture and equipment through 2019. The transactions are accounted for as operating leases. Rental expense and future minimum rental payments under these leases are immaterial to financial position and results of operations for all periods presented.

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

At December 31, 2008, the Company had $664 of undrawn letters of credit outstanding secured by assets of $868.

Liabilities for guaranty fund and other insurance-related assessments are accrued when an assessment is probable, when it can be reasonably estimated, and when the event obligating the entity to pay an imposed or probable assessment has occurred (based on past premiums for life lines and future premiums for property and casualty lines). Liabilities for guaranty funds and other insurance-related assessments are not discounted and are included as part of other liabilities in the consolidated balance sheets. As of December 31, 2008, and 2007, the liability balance was $313 and $271, respectively.

As of December 31, 2008, and 2007, included in other assets were $10 and $18, respectively, of related assets for premium tax offsets or policy surcharges. The related asset is limited to the amount that is determined based on future premium collections or policy surcharges from policies in force. Current assessments are expected to be paid out over the next five years, while premium tax offsets are expected to be realized within one year.

The Company has reinsurance funds held balances of approximately $1,626, which are subject to ratings triggers whereby if any of the Company's insurance financial strength ratings (with the three major rating agencies) fall below the A- or A3 categories or certain surplus targets are breached, the funds may be required to be placed in trust and invested in assets acceptable to the Company. The Company has no additional material ratings triggers related to reinsurance arrangements.

(13) POLICYHOLDERS' EQUITY

Statutory Surplus

The Statutory surplus of the Company's domestic insurance companies was $12,330 and $14,155 at December 31, 2008, and 2007, respectively. The Company's domestic insurance subsidiaries prepare the statutory basis financial statements in accordance with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual ("NAIC APP"), subject to any deviations prescribed or permitted by the insurance commissioners of the various insurance companies' states of domicile. The Company does not have any material permitted practices that deviate from the NAIC APP.

Dividends

The insurance subsidiaries' ability to pay dividends is restricted under applicable insurance law and regulations. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Under the insurance laws of Wisconsin, the domiciliary state of Liberty Mutual Fire Insurance Company ("LMFIC") and 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 the notes held at LMGI, as could a redomestication, merger, or consolidation of LMIC, LMFIC, or EICOW to a different domiciliary state. The maximum dividend payout in 2009 that may be made prior to regulatory approval is $1,693.

Report of Independent Registered Public Accounting Firm

The Board of Directors
Liberty Mutual Holding Company Inc.

We have audited the accompanying consolidated balance sheets of Liberty Mutual Holding Company Inc. (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in policyholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liberty Mutual Holding Company Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2008, the Company changed its method of accounting and reporting for the fair value measurement of financial instruments and for deferred compensation and postretirement benefit aspects of endorsement split dollar life insurance arrangements, and, in 2007, changed its method of accounting and reporting for defined benefit pension and other postretirement plans and for income tax contingencies.

We also have audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), Liberty Mutual Holding Company Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2009 expressed an unqualified opinion thereon.

Ernst & Young LLP

Boston, Massachusetts
March 13, 2009

Management's Report on the Effectiveness of Internal Control Over Financial Reporting

The Board of Directors
Liberty Mutual Holding Company Inc.

Our management is responsible for establishing and maintaining adequate internal control over Liberty Mutual Holding Company Inc.'s (the Company) financial reporting. Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements. We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework.

The Company completed its acquisition of Safeco Corporation (Safeco) on September 22, 2008. As permitted under prevailing guidance, Management's assessment as of December 31, 2008 does not include the internal control of Safeco, whose balance sheet is included in the Company's consolidated financial statements as of December 31, 2008. Such operations of Safeco constituted approximately $14.3 billion and $6.2 billion of the Company's total assets and net assets, respectively, as of December 31, 2008, and $1.5 billion and $74 million of revenues and net income (including $92 million of net realized investment losses and $15 million of integration expenses, net of tax), respectively, for the year then ended.

Based on our assessment, which excludes an assessment of internal control of the acquired operations of Safeco, we conclude that the Company's internal control over financial reporting is effective as of December 31, 2008 in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. Ernst & Young LLP, our independent registered public accounting firm, have issued an audit report on the effectiveness of the Company's internal control over financial reporting.

Edmund F. Kelly *Chairman, President and Chief Executive Officer*

Edmund F. Kelly

Dennis J. Langwell *Senior Vice President and Chief Financial Officer*

Dennis J. Langwell

The Board of Directors
Liberty Mutual Holding Company Inc.

We have audited Liberty Mutual Holding Company Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Liberty Mutual Holding Company Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report On The Effectiveness of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report On the Effectiveness of Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Safeco Corporation, which is included in the 2008 consolidated financial statements of Liberty Mutual Holding Company Inc., and constituted $14.3 billion and $6.2 billion of total and net assets, respectively, as of December 31, 2008 and $1.5 billion and $74 million of revenues and net income (including $92 million of net realized investment losses and $15 million of integration expenses, net of tax), respectively, for the year then ended. Our audit of internal control over financial reporting of Liberty Mutual Holding Company Inc. also did not include an evaluation of the internal control over financial reporting of Safeco Corporation.

In our opinion, Liberty Mutual Holding Company Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Liberty Mutual Holding Company Inc. as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in policyholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated March 13, 2009 expressed an unqualified opinion thereon.

Ernst & Young LLP

Boston, Massachusetts
March 13, 2009

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New Jersey

New York

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Brooklyn, New York

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Vice President
Halmar Contracting Inc.
Newburgh, New York

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President
T.F. Nugent
New York, New York

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Park City, Utah

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American Pecco
Corporation
Millwood, New York

New York State

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DeCarolis Truck Rental, Inc.
Rochester, New York

Michael Dranichak
Chairman
LB Furniture Industries, LLC
Hudson, New York

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President and
Chief Operating Officer
Cathedral Corporation
Rome, New York

Kirk B. Hinman
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Rome Strip Steel Co., Inc.
Rome, New York

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Kinney Drugs, Inc.
Gouverneur, New York

North Carolina

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Southern Furniture
Company of Conover, Inc.
Conover, North Carolina

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Chairman of the Board
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McAdenville, North Carolina

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Crowder Construction
Company
Charlotte, North Carolina

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Manufacturing Co.
Hickory, North Carolina

Northern New England

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Goodwill Industries of
Northern New England
Portland, Maine

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Frisbee Memorial Hospital
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Precision Metal Forming
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Industries, Inc.
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Wisconsin

Annual Meeting

Liberty Mutual Holding Company Inc. holds its annual meeting on the second Wednesday of April at 10 a.m. at the headquarters in Boston.

Policyholders of Liberty Mutual Insurance Company (a stock insurance company), Liberty Mutual Fire Insurance Company (a stock insurance company) and Employers Insurance Company of Wausau (a stock insurance company) are members of Liberty Mutual Holding Company Inc. If you are a policyholder of any of these entities at the time of such meetings, you are entitled to vote, either in person or by proxy. You may obtain a proxy form by writing to the Secretary of Liberty Mutual Holding Company Inc. at 175 Berkeley Street, Boston, MA 02117.

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