



**Global Company. Common Culture.**

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**On the cover:** 2011 marks the 125th anniversary  
of the Statue of Liberty

It's easy to be a company with global presence. Just open offices around the world and put your name on the door. But a true global company is more than a dispersed collection of nameplates. Strong global companies share talent, expertise and best practices across borders, and they operate under a consistent customer service philosophy, whether in Hong Kong or Houston.

**Liberty Mutual Group** is, in all respects, a global company. Visit our offices in Madrid, Santiago, Ho Chi Minh City and Istanbul, and you'll experience the same enthusiastic, hard-working employees, the same commitment to exceptional customer service, and the same focus on shaping products and services that benefit you over the long term. In a nutshell, you'll experience a common culture, and we're a stronger company because of it.

**In this Annual Report, we visit these four operations to illustrate the various ways they share a common culture and approach to doing business.**

## Policyholder Message

**F**rom the appointment of a new company president to the groundbreaking for an expanded world headquarters to further proof of the strength of Liberty Mutual's operating model, 2010 was a year that showed our optimism as we work to continue to build this great company.

**P**erhaps giving me the most optimism and confidence was the appointment of David Long as President of Liberty Mutual Group. David has excelled as a member of our management team, and I look forward to working with him as we share the joys and burdens of running the Group.

**T**he groundbreaking for our new building at 157 Berkeley Street in Boston says a lot about our importance to the local economy but, more important, it's visible evidence that we're a Boston-based global and growing Fortune 100 company with a promising future.

**E**ven the economy gave us a degree of confidence as we finally saw signs in 2010 that the recovery, already well rooted in developing nations, has begun to take hold in North America. While the U.S. economy is far from out of the woods, we are increasingly optimistic about the near-term prospects for business.

## To our Policyholders

**T**urning to the Group's performance in 2010, we had, in aggregate, a very satisfactory year. We grew revenues by 6.8 percent to \$33.2 billion, and we produced \$1.7 billion in net income. Pre-tax operating income was \$1.9 billion, a 61.6 percent increase over the same period in 2009. Policyholders' equity increased \$2.5 billion to \$17.0 billion, while consolidated assets totaled \$112.4 billion, a \$2.9 billion increase over 2009.

**W**e also, once again, under the leadership of Chief Investment Officer Alex Fontanes, had a very strong year in our investment operation. On top of several gains in our energy portfolio and our traditional private equity portfolio, we successfully restructured our bond portfolio to reduce its duration in anticipation of significantly higher interest rates in the not-too-distant future. In the process, we realized significant capital gains and successfully reinvested the proceeds with little loss of current income.



*Left to right:*

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

**David H. Long,** *President*

## Policyholder Message

“Even the economy gave us a degree of confidence as we finally saw signs in 2010 that the economic recovery, already well rooted in developing nations, has begun to take hold in North America.”

**O**verall, these results reflect the strength of Liberty Mutual’s operating model, including our leading domestic personal lines business and unparalleled international operations, which more than compensate for both the soft commercial environment and a tough year for severe weather events and natural catastrophes.

**I**n particular, and grabbing worldwide headlines in February 2010, was the 8.8-magnitude earthquake just off the coast of Chile, home of Santiago-based Liberty Seguros. Looking back at the 12 months since that terrible event, I’m extremely proud of this company’s global response to this catastrophe – as described later in this report. While obviously unfortunate for those affected, it’s during these stressful times that we deliver what our policyholders expect of us and help get them back on their feet. It is the business we are in.

**T**urning to results and accomplishments at the business unit level, Personal Markets continues its profitable growth at a rate three-times faster than the industry average. We remain the leader in affinity marketing, with a continued emphasis on innovative products through integrated multi-channel distribution. Furthermore, in 2010, we enhanced this strategy with key improvements to the customer experience, including a next generation website, “model” field offices, claims servicing via mobile phone, and several auto-product innovations. Taking into account our international operations, today we insure roughly 14 million personal autos worldwide.

**T**he postponement of the initial public offering of stock in Liberty Mutual Agency Corporation (LMAC) in September reflected the market’s dim view of insurance stocks, not the strength of LMAC’s business. Indeed, the unit had another successful year as it deepened agency relationships and continued to improve the customer experience. New product introductions from Safeco and Liberty Mutual Surety are a direct response to customer feedback, and several system enhancements across the organization will provide our customers, agents and employees with a better experience through streamlined processes, paperless workflows and improved tools.

**L**iberty International also continued to perform well. Our Brazilian and Venezuelan operations, along with Liberty Syndicate, each generated more than \$1 billion in premium, and we entered a joint venture with Videocon, a well-respected company in India with great knowledge of that nation’s consumer market. Despite a backdrop of excess capacity in the industry, both within reinsurance and specialty lines, Liberty International Underwriters continues to grow while maintaining its underwriting discipline across all classes of business.

“Overall, these results reflect the strength of Liberty Mutual’s operating model, including our leading domestic personal lines business and unparalleled international operations.”


Finally, while our Commercial Markets business continues to experience a tough, under-priced environment, we’ve made great progress since we exited the direct distribution business to focus exclusively on agents and brokers, and reorganized the business under a cohesive, functional structure. Today, while there’s a way to go, we’re confident we’re on the right track to get this business back to profitable growth.

On a personal note, Gary Gregg, formerly president, Liberty Mutual Agency Corporation, retired from Liberty Mutual on February 1, 2011. During his 21-year career, Gary made many significant and important contributions to the Company in a variety of key management positions. He has helped Liberty greatly along its path towards being one of the elite global property and casualty insurance companies. We wish Gary and his wife, Karen, a wonderful retirement.

Fortunately, we have a very deep management team, and we welcome our SBU leader, Chris Peirce, as president of Commercial Markets, replacing Paul Condren, who moved over to head up Liberty Mutual Agency Corporation.

So, as we close the books on another productive and successful year, I thank our broker and agent friends for their ongoing support, and our customers and policyholders for their business.

As always, I also thank the Board of Directors for its support and counsel, and our employees, whose continued enthusiasm, hard work and dedication make it all possible.

A handwritten signature in black ink that reads "Edmund F. Kelly". The signature is written in a cursive, flowing style.

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





*Left to right:*

*Independent insurance agents*

**Luis Angel Pérez**, with Cumbre  
Correduria de Seguros in Pamplona,  
Spain, and **Richard Logan**, with  
Goss Logan Insurance in Lebanon, N.H.





## Global Approach

**L**uis Angel Pérez and Richard Logan have never met. In fact, 3,500 miles and the Atlantic Ocean separate the two. And that's too bad because they have a lot in common. Each owns an independent insurance agency – Perez with Cumbre Correduria de Seguros in Pamplona, Spain, and Logan with Goss Logan Insurance in Lebanon, N.H., and each has a long-standing relationship placing personal and commercial lines insurance through a Liberty Mutual company: Madrid-based Liberty Seguros and Keene, N.H.-headquartered Peerless Insurance, respectively.

**“**Our agency has had a relationship with Peerless for more than 45 years and, during that time, the clients we serve have had a consistently positive impression of Peerless,” Logan said. As proof, the two independent agents point to recent commercial claims experiences with local restaurants: Lui Lui in Nashua, N.H., and Restaurant Alhambra in Pamplona.



## Global Approach



**I**ñaki Idoate (photo above), owner of Restaurant Albambra, describes an incident at his 26-year-old, highly rated restaurant. “It was during the Festival of San Fermin. We were very busy, and a woman slipped and injured her leg,” he said. “I immediately called my agent, Luis Angel Pérez, whom I have known personally for 40 years, because, if a customer gets injured in our restaurant, it’s very important that we deal with the matter quickly.”

“I called the injured woman, asked how she was feeling, reassured her that Albambra had excellent insurance, and explained that we’d take care of everything,” Pérez said. “In other words, we help both our client, Restaurant Albambra, and our client’s client.”

**F**or Eric Roberts (photo, facing page), owner of Lui Lui and a Peerless policyholder for more than ten years, it started with a phone call. “It was Christmas morning, and my family and I were leaving town for the holiday. On the way, I stopped by the restaurant to find water spraying everywhere from a broken pipe in the ceiling,” he said. “We had more than \$30,000 worth of food in our walk-in refrigerators and freezers and, when the fire department arrived,



*they turned off the power and heat, so we lost all of our refrigerated and frozen items. Combined with the physical damage, I didn't think we'd recover, and that was my frame of mind when I called my independent agent."*

***M**uch to Roberts' relief and surprise, the first words out of his agent's mouth were "don't worry, you're covered." "I'm very pleased with the way the claim went," said Independent Agent Logan. "Within an hour, we had a certified contractor on location to stabilize the situation and, within days, a construction crew had begun restoring the restaurant to its pre-loss condition."*

***"I**n this case, our coverage allowed me to keep paying my employees, all of whom returned when we reopened," Roberts said. "It even covered TV advertising to let the community know we'd be back in business soon. I'm a restaurant owner, not an insurance expert, so I rely on my independent agent to recommend appropriate coverage. Thank goodness I do."*



*Left to right:*

**Juan Manuel Garcia Uribe**, *claims and services manager, Liberty Seguros, Bogotá, Colombia*, **Manuel Burgos**, *claims manager, Liberty Seguros, Santiago, Chile*, and **Nelson Vazquez**, *property claims manager, Liberty Mutual, Boston, Mass.*

## Global Resources

**“Our** policyholders are fortunate to be associated with a strong, global company.” That sentiment recurred multiple times for Liberty Seguros (Chile) Claims Manager Manuel Burgos and coworkers who responded to the devastating earthquake that struck Chile on February 27, 2010. The magnitude 8.8 earthquake, just off the country’s southern coast, caused \$30 billion in damage, and ultimately killed 524 people and left 220,000 homeless.

**A**t the time of the quake, Burgos was with his family in southern Chile, more than 500 miles from his company’s headquarters in Santiago. “The shaking immediately brought memories of my first earthquake experience as a claims professional in 1985,” he said. “Little did I know that the 3,000 claims I faced 25 years ago would seem miniscule compared to what I would soon face.”

**I**mmediately after the earthquake struck, Liberty Seguros put its business contingency plan into action, with the first step to confirm all employees were safe, which fortunately was the case. At the same time Burgos, working out of a branch office, began coordinating his company’s response.









## Global Resources



**W**hen he finally reached Santiago ten days after the quake, traveling 26 hours by car through a landscape that looked like a war zone, Burgos continued the daunting task of effectively managing more than 28,000 homeowner claims, the second-highest number of claims received by a Chilean insurer, and in excess of 12 years of Liberty Seguros' normal claims volume combined. Put another way, the company was receiving 600 claims a **day** versus the normal rate of 300 claims a **month**.

**W**ithin two weeks of the earthquake, Burgos had hired and trained 30 people to review independent adjusters' claims reports, and he created a special unit in Santiago to respond to policyholder questions and complaints. It soon became apparent, however, that he needed more resources, and that help came from his Liberty Mutual Group counterparts in Colombia and the United States.

**F**rom Colombia, Claims and Services Manager Juan Manuel Garcia Uribe departed for Chile to help Burgos efficiently handle the massive number of claims cases. He assembled a team, including employees from Liberty Seguros, Colombia, which, over the next three



*months, and amidst numerous strong and unsettling aftershocks, were on the ground visiting policyholders affected by the quake.*

**I**n the U.S., Boston-based Property Claims Director Nelson Vazquez coordinated a multi-business unit response, including helping to manage a Call Center claims team in Lake Mary, Fla., dedicated to processing phoned-in or emailed claims with moderate to light damage. He also recruited a bilingual claims team of colleagues in the U.S. whose members could travel to Chile and comfortably step into a catastrophic situation, write estimates and provide customer service. Carolina Castro del Villar (photo above), whose Santiago apartment was damaged by the quake, was one of many Liberty Seguros policyholders surprised to find an American claims adjuster at her door.

**L**ooking back one year later, with almost all claims settled, Liberty Seguros Chile's Burgos points to another way his company helped rebuild communities: financing the construction of one of many damaged or destroyed schools. "The people we helped were our own employees, customers and neighbors," he said.







## Global Talent

*It's difficult enough to start up an insurance business in a country with an established and competitive insurance industry. But launching an insurance business from scratch in a developing country with 89 million people and a seven percent annual growth rate, along with regulatory limitations, unsophisticated sales channels and low public awareness, is an entirely different matter.*

*That was the challenge facing Liberty International when it saw a promising business opportunity in Vietnam. Having gone through a similar experience in China, management knew it would be a long road, starting with government approval to open a Representative Office in Hanoi in 2003, followed by a license to conduct business in late 2006.*

*With Vietnam lacking experienced insurance professionals, Carlos Vanegas arrived in 2007 from Liberty Seguros Colombia, one of Liberty Mutual's most successful and well-established operations, as the fledgling company's chief operating officer. With 15 years' insurance experience in underwriting, claims and project management, he was the right person for the job. "At that time, we could only offer our insurance products to non-Vietnamese individuals, so*

*Left to right:*

**Carlos Vanegas**, president,  
Liberty Insurance, Ho Chi Minh City,  
Vietnam, and **Cesar Rodriguez**,  
claims director



## Global Talent



*we took the opportunity to get the fundamentals in place, and we took steps to be ready once the government granted the Vietnamese people full access to the country's non-life insurance market, one year later," Vanegas said.*

**D**uring the last four years, Vanegas has worked hand in hand with his local team on the basics of a successful P&C insurance company starting with the recruitment of more than 200 talented Vietnamese individuals. With the right people in place, the focus then was on effective claims-handling, sales and service, and the systems that pull it all together.

**W**ith claims handling so critical, and a key point of differentiation for both the company and its agents and policyholders, Vanegas, now the company's CEO, recruited a former coworker, Cesar Rodriguez, in March 2009 from Colombia, where he had been with Liberty Seguros' Claims Department since 2002. "We had been very successful in automating the claims process in Colombia, and we needed to apply that same thinking here," Vanegas said.

**W**hen Rodriguez arrived, he quickly learned that Liberty Insurance, and the entire Vietnamese insurance industry, lacked anything resembling a smooth claims-handling system.



**T**o Rodriguez, that spelled opportunity and he quickly recruited and trained a team of Vietnamese individuals. “In nine months, Cesar orchestrated the creation of a fully automated system to standardize claim costs, a garage network with internet portals for easy claim handling and a paperless environment,” Vanegas said. Unique features and services included a 24-hour call center to handle claims, sales and service calls, and an online process to arrange pre-inspections for individuals applying for insurance.

“Today most everything’s in place, we have offices in Ho Chi Minh City, Hanoi, Da Nang and Dong Nai, and we continue to make it easier for the country’s agents, dealers, brokers and service providers to do business with us,” Vanegas said.

In fact, he noted, out of the 29 non-life insurance companies in Vietnam, Liberty Insurance ranks 10th, and this in an auto insurance market that’s growing 30 percent annually.

“The conditions are right for the Vietnamese people to have more purchasing power and increasingly switch from motorbikes — which are prevalent on city streets — to cars,” he said. “I have no doubt that Vietnam will ultimately be a global economic power, and we’ll be there.”



**Hanzade Aytaçlı**, marketing director,  
Liberty Sigorta, Istanbul, Turkey, with children  
attending the earthquake safety play

## Global Culture

**T**ake one look at a seismic hazard map of Turkey, with its crisscrossing fault lines, and you see why the possibility of a major earthquake is a constant threat. The Marmara earthquake, which struck 12 years ago, killed more than 17,000 people, and left approximately 500,000 people homeless.

**T**hat's why Istanbul-based Liberty Sigorta, building on Liberty Mutual's mission of "helping people live safer, more secure lives," launched a program to educate children on precautions they should take to lessen the impact of an earthquake, and actions they should take should an earthquake strike.

**A**t the core of the program is a play, "Birimiz Hepimiz, Hepimiz AKUT" (We Are All One, We Are All AKUT), which uses song and dance to explain the stages of an earthquake, repeating lessons in different ways. "The actors tell children the basic movements to protect them during an earthquake, such as bending down and covering one's head, and what to do after the shaking ceases," said Liberty Sigorta Marketing Director Hanzade Aytaçlı, in photo with face-decorated kids at a performance in Istanbul.









## Global Culture



***“We** learned about the play through one of our employees, who volunteers with AKUT, a Turkish search-and-rescue organization,” she said. AKUT has 1,000 volunteers throughout Turkey who have rescued approximately 1,200 people, 200 of whom they rescued from collapsed structures after the Marmara quake.*

***S**ince its launch in January 2010, more than 14,000 children in nine cities have watched 42 productions of the play in various venues. “It’s a packed house of attentive kids – every time,” said Aytaçlı, who noted that each child leaves the performance with a comic book recapping what they saw.*

***A**nd there’s a business benefit too as Liberty Sigorta, which began operation in 2007, invites many of its more than 650 agents, and their customers and children, to the shows, which feature talented actors from Tiyatrokare, a local theater company. “After attending a show, and seeing how engrossed their children are in the story, our agents and clients tell us we’re more than an insurer; that we’re a company that really cares,” Aytaçlı said.*





**L**iberty Sigorta and AKUT also hold training sessions for employees and agents to reinforce the “helping people live safer, more secure lives” message.

**W**hile unique in Turkey, Liberty Sigorta’s program is similar in spirit to other Liberty Mutual programs found around the globe, such as its “Where’s the Fire?” exhibit at Epcot® at the Walt Disney World® Resort in Florida, which has attracted more than 1.4 million visitors since its launch in 2004. In Venezuela, Seguros Caracas de Liberty Mutual leads a national education campaign on risks of using cell phones while driving. In Spain, Liberty Seguros sponsors a show, in conjunction with a national association for the study of spinal cord injury, which speaks to young drivers about avoiding car accidents.

**A**ytaçlı speaks with pride of being part of Liberty Mutual’s global culture of responsibility. “It’s been very fulfilling for myself and all employees of Liberty Sigorta to bring Liberty Mutual Group’s mission to life here in Turkey.”

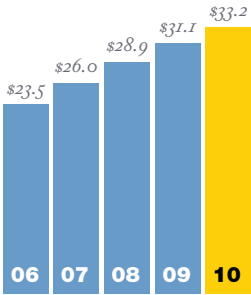
Boston-based Liberty Mutual Group is a diversified global insurer and fifth-largest property and casualty insurer in the U.S. based on 2009 direct written premium. The company also ranks 71st on the Fortune 500 list of largest corporations in the U.S. based on 2009 revenue.

As of December 31, 2010, Liberty Mutual Group had \$112.4 billion in consolidated assets, \$95.4 billion in consolidated liabilities and \$33.2 billion in annual consolidated revenue.

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

## Company Overview

**Revenues**  
(in billions)



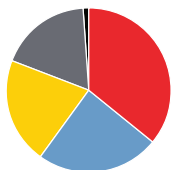
**L**iberty Mutual Group's pre-tax operating income for 2010 was \$1.9 billion, an increase of 61.6 percent from 2009. Net investment income was approximately \$3.3 billion on cash flows from operations of \$2.8 billion.

**N**et income increased to \$1.7 billion, an increase of \$655 million or 64 percent over 2009, and policyholders' equity increased by \$2.5 billion to \$17.0 billion.

Each business unit operates independently of the others and has dedicated sales, underwriting, claims, actuarial, financial and certain information technology resources.

### Strategic Business Units

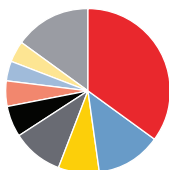
\$29.2 billion in 2010 net written premium



LMAC **36%**  
 International **25%**  
 Personal Markets **23%**  
 Commercial Markets **18%**  
 Other **(2%)**

### Significant Lines of Business

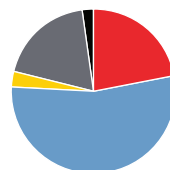
\$29.2 billion in 2010 net written premium



Private Passenger Auto **35%**  
 Workers Compensation **13%**  
 Homeowners **10%**  
 Commercial Multi-Peril/Fire **8%**  
 International Local Business **6%**  
 Commercial Auto **5%**  
 General Liability **4%**  
 LIU Reinsurance **4%**  
 Other **15%**

### Distribution Channels

Based on 2010 gross written premium



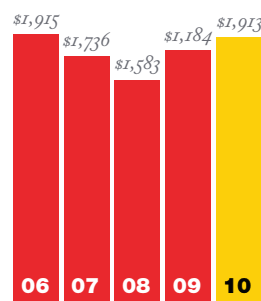
Direct Sales Force **23%**  
 Independent Agents **53%**  
 Exclusive Agents **3%**  
 Brokers **19%**  
 Other **2%**

Liberty Mutual Group offers a wide range of insurance products and services, including personal automobile, workers compensation, homeowners, commercial multiple peril, commercial automobile, general liability, global specialty, group disability, assumed reinsurance, fire and surety through four strategic business units:

- Liberty Mutual Agency Corporation
- International
- Personal Markets
- Commercial Markets

### Pre-tax Operating Income

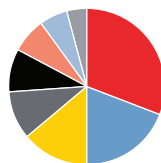
(in billions)



# Liberty Mutual Agency Corporation

**Product Mix**

(based on 2010 net written premium)



Personal Automobile **31%**  
Commercial Multi-Peril **19%**  
Homeowners **14%**  
Commercial Automobile **10%**  
Workers Compensation **9%**  
Surety **7%**  
General Liability **6%**  
Other **4%**

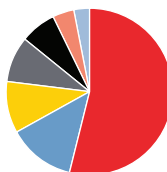
**L**iberty Mutual Agency Corporation offers personal and commercial insurance, as well as surety bonds, through independent agents throughout the United States. Commercial lines products are offered through eight regional companies and Liberty Agency Underwriters, which provides specialty commercial products, including excess casualty and program business nationally. Personal lines products are offered nationally under the Safeco Insurance brand. Liberty Mutual Surety and Liberty SuretyFirst provide nationwide contract and commercial surety and fidelity bonds. Liberty Mutual Agency Corporation's unique regional/national approach leverages the responsiveness of regional operations with the power of national resources.

**I**ts companies are committed to providing innovative insurance products and services, a positive customer experience and meaningful partnerships with its independent agencies.

# Commercial Markets

**Product Mix**

(based on 2010 net written premium)



Workers Compensation **54%**  
Group Disability and Life **13%**  
General Liability **10%**  
Commercial Automobile **9%**  
Commercial Multi-Peril and Fire **7%**  
Reinsurance **4%**  
Other **3%**

**C**ommercial Markets offers a wide array of property and casualty and group benefits insurance coverage through independent agents, brokers and benefit consultants throughout the United States.

**C**ommercial Markets P&C provides commercial lines products and services to mid-sized and large businesses. Group Benefits provides mid-sized and large businesses with short- and long-term disability insurance products and administrative services and group life insurance through Liberty Life Assurance Company of Boston, a subsidiary of the Company. Summit provides workers compensation in the Southeast primarily to small businesses. Liberty Mutual Reinsurance provides reinsurance programs to domestic and foreign insurance and reinsurance companies. Commercial Markets is also a servicing carrier for state-based workers compensation involuntary market pools.

# Liberty International

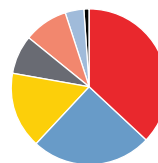
**L**iberty International provides insurance products and services through two distinct approaches: local businesses, which sell personal and small commercial lines products, and Liberty International Underwriters (LIU), which sells specialty commercial insurance and reinsurance worldwide.

**I**nternational's local business operations consist of local insurance operations selling property, casualty, health and life insurance products to individuals and businesses in three geographic regions: Latin America, including Venezuela, Brazil, Colombia, Argentina, and Chile; Europe, including Spain, Portugal, Turkey and Poland; and Asia-Pacific, including Thailand, Singapore, China (including Hong Kong) and Vietnam. Private passenger automobile insurance is the single largest line of business.

**LIU** writes casualty, specialty casualty, marine, energy, construction, aviation, property, crisis management and trade credit coverages and other specialty programs through offices in Asia, Australia, Europe, the Middle East, North America and Latin America. LIU, through its Lloyd's Syndicate 4472, also provides multi-line insurance and reinsurance worldwide.

## Product Mix

(based on 2010 net written premium)



### Local Business

- Private Passenger Automobile **37%**
- All Other **25%**

LIU Reinsurance **16%**

LIU Third Party **9%**

LIU Inland Marine Program **8%**

LIU First Party **4%**

LIU Other **1%**

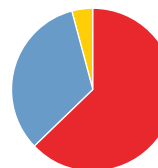
# Personal Markets

**P**ersonal Markets provides full lines of coverage for private passenger automobile, homeowners, valuable possessions and personal liability through its own sales force in nearly 400 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.

**P**ersonal Markets' largest source of new business is its more than 13,000 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.

## Product Mix

(based on 2010 net written premium)



Private Passenger Automobile **63%**

Homeowners and Other **33%**

Individual Life **4%**

**Liberty Mutual Group's**



**Argentina**



**Canada**



**Australia**



**Chile**



**Brazil**



**China**

# Global Presence

**Liberty Mutual Group** operates in the Americas, Europe, Asia-Pacific and the Middle East. The operations include local company operations and specialty lines offices.



**Colombia**



**Poland**



**Turkey**



**France**



**Portugal**



**United Arab Emirates**



**Germany**



**Puerto Rico**



**United Kingdom**



**Hong Kong**



**Singapore**



**United States**



**Ireland**



**Spain**



**Venezuela**



**Malaysia**



**Switzerland**



**Vietnam**



**Netherlands**



**Thailand**



## Financial Highlights

	December 31,		
(Dollars in millions)	2010	2009	2008
<b>Liberty Mutual Group</b>			
Revenues	<b>\$33,193</b>	\$31,094	\$28,855
Pre-tax operating income	<b>1,913</b>	1,184	1,583
Net income	<b>1,678</b>	1,023	1,113
Cash flow from operations	<b>2,761</b>	2,487	2,745
Total assets	<b>112,350</b>	109,475	104,039
GAAP combined ratio	<b>100.1%</b>	99.9%	100.1%
<b>Personal Markets</b>			
Revenues	<b>\$ 7,502</b>	\$ 7,001	\$ 6,684
Pre-tax operating income	<b>673</b>	654	350
Cash flows from operations	<b>1,134</b>	1,012	718
Total assets	<b>19,936</b>	18,461	17,416
GAAP combined ratio	<b>95.7%</b>	94.8%	99.4%
<b>Commercial Markets</b>			
Revenues	<b>\$ 6,331</b>	\$ 6,607	\$ 7,491
Pre-tax operating income	<b>278</b>	425	347
Cash flows from operations	<b>469</b>	671	1,458
Total assets	<b>28,793</b>	29,510	30,698
GAAP combined ratio	<b>110.9%</b>	106.1%	107.3%
<b>LMAC</b>			
Revenues	<b>\$11,687</b>	\$ 10,937	\$ 7,275
Pre-tax operating income	<b>1,007</b>	1,455	934
Cash flows from operations	<b>1,113</b>	951	660
Total assets	<b>29,258</b>	32,386	30,870
GAAP combined ratio	<b>97.6%</b>	93.6%	95.6%
<b>International</b>			
Revenues	<b>\$ 7,928</b>	\$ 7,589	\$ 7,049
Pre-tax operating income	<b>740</b>	480	683
Cash flows from operations	<b>1,240</b>	1,328	1,119
Total assets	<b>20,645</b>	20,206	18,038
GAAP combined ratio	<b>95.2%</b>	100.6%	98.4%
<b>Other*</b>			
Revenues	<b>\$ (255)</b>	\$ (1,040)	\$ 356
Pre-tax operating income	<b>(785)</b>	(1,830)	(731)
Cash flows from operations	<b>(1,195)</b>	(1,475)	(1,210)

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, income (loss) related to limited partnership and limited liability company investments, other revenues from corporate subsidiaries, and federal and foreign tax payments.

# Financial Statements

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## Consolidated Statements of Income

Liberty Mutual Holding Company Inc.

Years Ended December 31,

(Dollars in millions)

### Revenues

Premiums earned	<b>\$28,699</b>	\$27,791	\$25,524
Net investment income	<b>3,328</b>	2,482	2,880
Net realized investment gains (losses)	<b>402</b>	26	(330)
Fee and other revenues	<b>764</b>	795	781

Total revenues

**33,193** 31,094 28,855

### Claims, Benefits and Expenses

Benefits, claims and claim adjustment expenses	<b>20,984</b>	20,169	18,894
Insurance operating costs and expenses	<b>4,496</b>	4,336	4,105
Amortization of deferred policy acquisition costs	<b>4,757</b>	4,692	3,989
Interest expense	<b>456</b>	483	411
Interest credited to policyholders	<b>185</b>	204	203

Total claims, benefits and expenses

**30,878** 29,884 27,602

Income before income tax expense

**2,315** 1,210 1,253

Income tax expense

**637** 187 140

Net income

**\$ 1,678** \$ 1,023 \$ 1,113

### Net Realized Investment Gains (Losses)

Other-than-temporary impairment losses:

Total other-than-temporary impairment losses

**\$ (55)** \$ (244) \$ (800)

Change in portion of loss recognized in other comprehensive income

**(1)** 13 —

Other-than-temporary impairment losses

**(56)** (231) (800)

Other net realized investment gains

**458** 257 470

Net realized investment gains (losses)

**\$ 402** \$ 26 \$ (330)

See accompanying notes to the audited consolidated financial statements.

## Consolidated Balance Sheets

Liberty Mutual Holding Company Inc.

	December 31,	
	2010	2009
(Dollars in millions)		
<b>Assets:</b>		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of \$56,375 and \$54,789)	\$ 58,553	\$ 56,439
Equity securities, available for sale, at fair value (cost of \$1,552 and \$1,077)	1,733	1,188
Short-term investments	313	575
Mortgage loans	1,206	1,121
Other investments	3,067	2,619
Total investments	64,872	61,942
Cash and cash equivalents	4,930	4,847
Premium and other receivables (net of allowance of \$143 and \$121)	8,072	7,629
Reinsurance recoverables (net of allowance of \$393 and \$434)	14,310	14,749
Deferred income taxes (net of valuation allowance of \$153 and \$160)	796	1,691
Deferred acquisition costs	2,771	2,636
Goodwill	4,750	4,748
Prepaid reinsurance premiums	1,404	1,317
Separate account assets	3,893	3,557
Other assets	6,552	6,359
Total assets	\$112,350	\$ 109,475
<b>Liabilities:</b>		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	\$ 48,059	\$ 48,355
Life	6,781	6,586
Other policyholder funds and benefits payable	3,629	3,300
Unearned premiums	13,977	13,224
Funds held under reinsurance treaties	1,784	1,819
Short-term and current maturities of long-term debt	1	305
Long-term debt	5,635	5,635
Separate account liabilities	3,893	3,557
Other liabilities	11,613	12,180
Total liabilities	95,372	94,961
<b>Policyholders' equity:</b>		
Unassigned equity	15,692	14,014
Accumulated other comprehensive income	1,286	500
Total policyholders' equity	16,978	14,514
Total liabilities and policyholders' equity	\$112,350	\$ 109,475

See accompanying notes to the audited consolidated financial statements.

# Consolidated Statements of Changes in Policyholders' Equity

Liberty Mutual Holding Company Inc.

(Dollars in millions)	Unassigned Equity	Accumulated Other Comprehensive Income (Loss)	Policyholders' Equity
<b>Balance, January 1, 2008</b>	<b>\$ 11,891</b>	<b>\$ 745</b>	<b>\$ 12,636</b>
Cumulative effect of adoption of ASC 715 at January 1, 2008 (Note 1)	(41)		(41)
Comprehensive loss			
Net income	1,113	—	1,113
Other comprehensive income, net of taxes:			
Unrealized losses on securities	—	(2,246)	(2,246)
Less: reclassification adjustment for gains and losses included in net income	—	215	215
Change in pension and post retirement plans funded status	—	(869)	(869)
Foreign currency translation and other adjustments	—	(405)	(405)
Other comprehensive loss, net of taxes	—	(3,305)	(3,305)
Total comprehensive loss			(2,192)
<b>Balance, December 31, 2008</b>	<b>\$ 12,963</b>	<b>\$ (2,560)</b>	<b>\$ 10,403</b>
Cumulative effect of adoption of ASC 320 at January 1, 2009 (Note 1)	28	(28)	—
Comprehensive income			
Net income	1,023	—	1,023
Other comprehensive income, net of taxes:			
Unrealized gains on securities	—	2,589	2,589
Less: reclassification adjustment for gains and losses included in net income	—	(17)	(17)
Change in pension and post retirement plans funded status	—	298	298
Foreign currency translation and other adjustments	—	218	218
Other comprehensive income, net of taxes	—	3,088	3,088
Total comprehensive income			4,111
<b>Balance, December 31, 2009</b>	<b>\$ 14,014</b>	<b>\$ 500</b>	<b>\$ 14,514</b>
Comprehensive income			
Net income	<b>1,678</b>	<b>—</b>	<b>1,678</b>
Other comprehensive income, net of taxes:			
Unrealized gains on securities	—	<b>443</b>	<b>443</b>
Less: reclassification adjustment for gains and losses included in net income	—	<b>(261)</b>	<b>(261)</b>
Change in pension and post retirement plans funded status	—	<b>560</b>	<b>560</b>
Foreign currency translation and other adjustments	—	<b>44</b>	<b>44</b>
Other comprehensive income, net of taxes	—	<b>786</b>	<b>786</b>
Total comprehensive income			<b>2,464</b>
<b>Balance, December 31, 2010</b>	<b>\$15,692</b>	<b>\$1,286</b>	<b>\$16,978</b>

See accompanying notes to the audited consolidated financial statements.

## Consolidated Statements of Cash Flows

Liberty Mutual Holding Company Inc.

Years Ended December 31,

(Dollars in millions)

### Cash flows from operating activities:

	2010	2009	2008
Net income	\$ 1,678	\$ 1,023	\$ 1,113
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	409	350	313
Realized investment (gains) losses	(402)	(26)	330
Undistributed private equity investment (gains) losses	(364)	423	5
Premium, other receivables, and reinsurance recoverables	(132)	526	572
Deferred policy acquisition costs	(167)	(131)	(16)
Liabilities for insurance reserves	1,081	197	1,775
Taxes payable, net of deferred	649	(173)	(220)
Other, net	9	298	(1,127)
Total adjustments	1,083	1,464	1,632
Net cash provided by operating activities	2,761	2,487	2,745

### Cash flows from investing activities:

Purchases of investments	(19,578)	(18,874)	(13,668)
Sales and maturities of investments	17,721	14,928	18,257
Property and equipment purchased, net	(507)	(355)	(143)
Payment for purchase of companies, net of cash acquired	—	—	(5,414)
Other investing activities	(40)	173	(185)
Net cash used in investing activities	(2,404)	(4,128)	(1,153)

### Cash flows from financing activities:

Net activity in policyholder accounts	194	122	62
Debt financing, net	(301)	(84)	1,121
Net security lending activity and other financing activities	50	621	(65)
Net cash (used in) provided by financing activities	(57)	659	1,118

Effect of exchange rate changes on cash	(217)	(19)	(61)
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Net increase (decrease) in cash and cash equivalents	83	(1,001)	2,649
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Cash and cash equivalents, beginning of year	4,847	5,848	3,199
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Cash and cash equivalents, end of year	\$ 4,930	\$ 4,847	\$ 5,848
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### Supplemental disclosure of cash flow information:

Income tax (refund) paid	\$ (2)	\$ 366	\$ 310
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See accompanying notes to the audited consolidated financial statements.



## Notes to 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 2009 and 2008 consolidated financial statements to conform with the 2010 presentation. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company’s principal estimates include (1) unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years; (2) reinsurance recoverables and associated uncollectible reserves; (3) fair value determination and other-than-temporary impairments of the investment portfolio; (4) deferred acquisition costs; (5) valuation of goodwill and intangible assets; and (6) deferred income tax valuation allowance. 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: Liberty Mutual Agency Corporation (“LMAC”), International, Personal Markets, and Commercial Markets.

The Company’s LMAC business unit, with \$11,687 of revenues in 2010, distributes products through independent agents and brokers. It consists of: eight regionally branded insurance companies that offer commercial insurance coverage to small businesses; personal lines products sold under the Safeco brand; and Liberty Mutual Surety (contract and commercial surety bonds).

The Company’s International business unit, with \$7,928 of revenues in 2010, provides insurance products and services through local businesses outside the United States and Liberty International Underwriters (“LIU”) which sells specialty commercial lines worldwide. The local businesses consist of local insurance operations selling property, casualty, health and life insurance products to individuals and businesses in countries

with a large and growing middle class. Automobile insurance is the predominant line of business. International operates local businesses in Latin America (Venezuela, Argentina, Colombia, Brazil and Chile); Asia (Singapore, Thailand, Vietnam and China); and Europe (Spain, Portugal, Turkey and Poland). LIU, a global specialty commercial lines insurance and reinsurance business with operations principally based in 18 countries: United States, Canada, Brazil, United Kingdom, Germany, France, the United Arab Emirates, the Netherlands, Spain, Switzerland, Ireland, Australia, Hong Kong, China, Singapore, Malaysia, India and Vietnam. LIU operations provide a variety of specialty products including casualty, marine, construction, energy, inland marine, directors and officers, professional liability, aviation, property, surety and crisis management insurance, together with multi-line insurance and reinsurance written through Lloyd’s of London, Syndicate 4472.

The Company’s Personal Markets business unit, with \$7,502 of revenues in 2010, writes U.S. property and casualty insurance covering personal risks, primarily automobile and homeowners, as well as a wide range of life and annuity products, to individuals in the United States. Products are distributed through licensed captive sales representatives, licensed telesales counselors, third-party producers, and the Internet.

The Commercial Markets business unit, with \$6,331 of revenues in 2010, is organized into separate operating units. Each of these operating units consists of separate marketing and underwriting groups focusing on a particular customer base, product grouping or distribution channel to provide tailored products and services to address customers’ needs. Operating units within the Commercial Markets business unit include Commercial Markets P&C, Liberty Mutual Reinsurance, Summit, and Group Benefits. Commercial Markets coverages include workers compensation, commercial automobile, general liability, group disability, group life, assumed reinsurance, property, commercial multiple peril, and a variety of other coverages. Commercial Markets is also a servicing carrier for workers compensation involuntary market pools. In addition, Commercial Markets provides third-party administration services through Helmsman Management Services. Effective January 1, 2010, Summit, a mono-line workers compensation company for Florida and the Southeast, previously included in LMAC, became part of the Commercial Markets strategic business unit. On July 14, 2010, Commercial Markets

established a new distribution and service organization, Commercial Markets P&C, combining Middle Market, National Market, Specialty Lines and Liberty Mutual Property. This operating model provides agents and brokers a single point of entry for accessing Commercial Markets' property, casualty and specialty lines insurance as well as claims and loss control services for national accounts and mid-sized business clients.

#### ***Adoption of New Accounting Standards***

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

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

#### ***Future Adoption of New Accounting Standards***

In October 2010, the FASB issued Accounting Standards Update 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* ("ASU 2010-26"). This guidance, as codified in ASC 944, *Financial Services – Insurance*, specifies that acquisition costs should include only those costs that are directly related to the acquisition or renewal of insurance contracts. All other acquisition related costs – including market research, training, administration, unsuccessful acquisition or renewal efforts, and product development – should be charged to expense as incurred. The Company is required to adopt ASU 2010-26 effective January 1, 2012. The Company is in the process of evaluating the impact of adoption.

#### ***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 fair values, net of deferred income taxes, reported in accumulated other comprehensive income (loss).

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

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, public equity securities, private equity securities and private equity co-investment securities for impairment on a quarterly basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to, (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 of the security holding or the issuer.

For fixed maturity securities that the Company does not intend to sell or for which it is more likely than not that the Company would not be required to sell before an anticipated recovery in value, the Company separates impairments into credit loss and non-credit loss components. The determination of the credit loss component of the impairment charge is based on management's best estimate of the present value of the cash flows expected to be collected from the debt security compared to its amortized cost and is reported as part of net realized gains (losses). The non-credit component, the residual difference between the credit impairment component and the fair value, is recognized in other comprehensive income (loss). The factors considered in making an evaluation of credit versus non-credit other-than-temporary impairment include the following: (1) failure of the issuer of the security to make scheduled interest or principal payments (including the payment structure of the debt security and the likelihood the issuer will be able to make payments that increase in the future), (2) performance indicators of the underlying assets in the security (including default and delinquency rates), (3) vintage, (4) geographic concentration, and (5) industry analyst reports, sector credit ratings, and volatility of the security's fair value.

## Notes to Consolidated Financial Statements *(continued)*

For non-fixed maturity investments and fixed maturity investments the Company intends to sell or for which it is more likely than not that the Company will be required to sell before an anticipated recovery in value, the full amount (fair value less amortized cost) of the impairment is included in net realized investment gains (losses).

Upon recognizing an other-than-temporary impairment, the new cost basis of the investment is the previous amortized cost basis less the other-than-temporary impairment recognized in net realized investment gains (losses). The new cost basis is not adjusted for any subsequent recoveries in fair value; however, for fixed maturity investments the difference between the new cost basis and the expected cash flows is accreted to net investment income over the remaining expected life of the investment.

All mortgage-backed securities and asset-backed securities are reviewed for other-than-temporary impairment treatment in accordance with the guidance of ASC 320, *Investments – Debt and Equity Securities* and ASC 325, *Investments – Other*.

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 fair value, which approximates amortized cost.

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

Other investments are primarily comprised of limited partnerships and other alternative investments, which 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 carried at fair value.

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 income. Changes in the fair value of non-designated derivatives are reported in current period income 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. 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 is tested for impairment at least annually 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 by foreign currency translation adjustments.

Indefinite-lived intangible assets held by the Company are reviewed for impairment on at least an annual basis. The classification of the asset as indefinite-lived is reassessed, and an impairment is recognized if the carrying amount of the asset exceeds its fair value.

Intangible assets that are deemed to have a finite useful life are amortized over their useful lives. The carrying amount of intangible assets with a finite useful life is regularly reviewed for indicators of impairment in value. Impairment is recognized only if the carrying amount of the intangible asset is not recoverable from its undiscounted cash flows and is measured as the difference between the carrying amount and the fair value of the asset.

***Deferred Policy Acquisition Costs***

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 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 change in unrealized capital gains or losses and included in accumulated other comprehensive income (loss).

***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 2010 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 discounting on the long-term indemnity portion of workers compensation settled 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. The Company discounts the long-term indemnity portion of workers compensation claims at risk-free discount rates determined by reference to the U.S. Treasury yield curve. The weighted average discount rates were 5.3%, 5.5%, and 5.7% for 2010, 2009, and 2008, respectively. The held discounted reserves on these unpaid workers compensation claims, net of all reinsurance, as of December 31, 2010 and 2009 were \$1,935 and \$1,974, respectively.

The held discounted reserves on unpaid asbestos structured settlement claims as of December 31, 2010 and 2009 were \$93 and \$118, respectively.

The discounting of disability claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 4.0% to 7.0% and 4.5% to 7.0% in 2010 and 2009, respectively. Unpaid disability claims and claim adjustment expenses as of December 31, 2010 and 2009, include liabilities at discounted values of \$1,155 and \$1,030, respectively.

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 were between 5.7% and 6.0% for 2010, 2009, and 2008. Implied credited interest rates for foreign structured settlement contracts in force were between 2.5% and 6.0% in 2010, 2009, and 2008. Credited rates for domestic universal life contracts in force were between 3.5% and 4.3% in 2010 and 3.5% and 6.3% in 2009 and 2008. Credited rates for foreign universal life contracts in force were between 0.9% and 6.0% in 2010 and 1.3% and 6.0% in 2009 and 2008. 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 2010, 2009, and 2008), 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 related insurance policies.

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 2%, 2%, and 3% of domestic property-casualty insurance premiums written for the years ended December 31, 2010, 2009, and 2008, 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 31%, 34% and 37% of ordinary life insurance in force for the years ended December 31, 2010, 2009, and 2008, respectively. Participating policies approximate 15%, 23%, and 30% of life premium for the years ended December 31, 2010, 2009, and 2008, respectively.

#### **Long-Term Incentive and Performance Based Incentive Plans**

The Company maintains short-term 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 ASC 718, *Compensation – Stock Compensation*, using the intrinsic value method. Additionally, the Company provides 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 loss portfolio transfers, premiums are fully recognized as written and earned on a prospective basis at contract inception. 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 claims and claims adjustment expenses.

Amounts recoverable from reinsurers include unpaid losses 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 that operation 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 income (loss), 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 remeasured at the rate of exchange as of the balance sheet date and non-monetary items are remeasured at historical rates. Gains and losses from balance sheet remeasurement adjustments and foreign currency transactions are included in net income.

The aggregate exchange (losses) gains included in income from continuing operations for the years ended December 31, 2010, 2009, and 2008 were \$(109), \$(1), and \$16, respectively. These amounts have been included in insurance operating costs and expenses in the accompanying consolidated statements of income.



## Notes to Consolidated Financial Statements *(continued)*

### *Income Taxes*

The income tax provision is calculated under the liability method. The Company recognizes deferred income tax assets and liabilities for the expected future tax effects attributable to temporary differences between the financial statement and tax return bases of assets and liabilities based on enacted tax rates and other provisions of the tax law. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. 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.

### *Fee and Other Revenues*

Fee and other revenues primarily consist of revenues from the Company's energy production operations and service fees generated from processing business for involuntary assigned risk pools, self insured customers, and risk retention groups. Service fees are earned on a pro-rata basis over the term of the related policies.

### *Accumulated Other Comprehensive Income (Loss)*

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

The components of accumulated other comprehensive income (loss), net of related deferred acquisition costs and taxes, for the years ended December 31, 2010, 2009, and 2008 are as follows:

	2010	2009	2008
Unrealized gains (losses) on securities	\$ 1,269	\$ 1,115	\$ (1,457)
Foreign currency translation and other adjustments	313	269	51
Pension liability funded status	(296)	(856)	(1,154)
Cumulative effect of adoption of ASC 320 at January 1, 2009	—	(28)	—
Accumulated other comprehensive income (loss)	\$ 1,286	\$ 500	\$ (2,560)

## **(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 operations of Safeco were merged into the LMAC strategic business unit.

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

### *Intangible Assets*

	Carrying Value December 31, 2010	Carrying Value December 31, 2009	Period (Years)	Method
Agency relationship	\$523	\$564	15	Straight-line
Trademarks	229	229	Not subject to amortization	Not subject to amortization
State licenses	63	63	Not subject to amortization	Not subject to amortization
Other	16	17	10	Present Value Mid-year Convention
Total intangible assets <sup>(1)</sup>	\$831	\$873		

<sup>(1)</sup> Net of accumulated amortization of \$89 and \$47 as of December 31, 2010 and 2009, respectively.

For the years ended December 31, 2010 and 2009, the Company recognized \$42 and \$38, respectively, of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statements of income. Estimated amortization for the years ended December 31, 2011 through 2015 is \$42, \$43, \$44, \$44 and \$44, respectively.

### Integration Activities

As part of the Safeco acquisition, management conducted integration efforts that resulted in employment reductions, contract terminations, systems integrations and other transitional activities. Total integration (benefit) costs incurred for the years ended December 31, 2010 and 2009 were \$(2) and \$65, respectively, of which \$(1) and \$42, respectively, were recognized as assumed liabilities as part of purchase accounting for the acquisition. Integration costs not directly associated with the acquisition were included in insurance operating costs and expenses in the consolidated statements of income. \$6 and \$77 of the costs were paid in 2010 and 2009, respectively.

### 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 operations of Ohio Casualty were merged into the LMAC strategic business unit.

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

### Intangible Assets

	Carrying Value December 31, 2010	Carrying Value December 31, 2009	Period (Years)	Method
Agency relationship	<b>\$124</b>	\$132	20	Straight-line
Trademarks	<b>33</b>	33	Not subject to amortization	Not subject to amortization
State licenses <sup>(2)</sup>	<b>20</b>	22	Not subject to amortization	Not subject to amortization
Total intangible assets <sup>(1)</sup>	<b>\$177</b>	\$187		

<sup>(1)</sup> Net of accumulated amortization of \$30 and \$22 as of December 31, 2010 and 2009, respectively.

<sup>(2)</sup> On February 23, 2010, the Company merged two of its insurance subsidiaries, Avomark Insurance Company and West American Insurance Company. As of May 24, 2010, authorization was given by all states to terminate certificates of authority resulting in a decrease in value of \$2.

For the years ended December 31, 2010 and 2009, the Company recognized \$8 and \$9, respectively, of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. For each of the years ended December 31, 2011 through 2015 estimated amortization is \$8.

### 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 were substantially completed in 2009.

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

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 *(continued)*

### (3) Investments

#### *Components of Net Investment Income*

Years Ended December 31,	2010	2009	2008
Taxable interest income	\$ 2,426	\$ 2,301	\$ 2,349
Tax-exempt interest income	539	623	472
Dividends	42	41	98
Limited partnerships and limited liability companies	398	(411)	4
Commercial mortgage loans	73	68	58
Other investment income	6	9	27
Gross investment income	3,484	2,631	3,008
Investment expenses	(156)	(149)	(128)
Net investment income	\$ 3,328	\$ 2,482	\$ 2,880

#### *Components of Net Realized Investment Gains (Losses)*

Years Ended December 31,	2010	2009	2008
Fixed maturities			
Gross realized gains	\$ 421	\$ 173	\$ 109
Gross realized losses	(72)	(259)	(436)
Equities			
Gross realized gains	52	146	341
Gross realized losses	(3)	(64)	(801)
Other			
Gross realized gains	73	84	469
Gross realized losses	(69)	(54)	(12)
Net realized investment gains (losses)	\$ 402	\$ 26	\$ (330)

As of December 31, 2010 and 2009, other-than-temporary impairments recognized through accumulated other comprehensive income were \$31 and \$30, respectively.

During the years ended December 31, 2010, 2009, and 2008, proceeds from sales of fixed maturities available for sale were \$9,177, \$4,859, and \$7,013, respectively. The gross realized gains (losses) on such sales totaled \$357 and \$(22) in 2010, \$145 and \$(67) in 2009, and \$85 and \$(122) in 2008.

#### *Components of Change in Net Unrealized Investment Gains (Losses)*

Years Ended December 31,	2010	2009	2008
Fixed maturities	\$ 357	\$ 3,864	\$ (2,257)
Equities	71	206	(962)
Other	(10)	18	(5)
Adjustments to deferred policy acquisition costs	(8)	(169)	145
Net change in unrealized investment gains (losses)	410	3,919	(3,079)
Deferred income tax (expense) benefit	(228)	(1,347)	1,048
Net change in unrealized investment gains (losses), net of tax	\$ 182	\$ 2,572	\$ (2,031)

#### *Available for Sale Investments*

The gross unrealized gains and losses and fair values of available for sale investments as of December 31, 2010 and 2009, are as follows:

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	\$ 3,008	\$ 197	\$ (13)	\$ 3,192
Residential mortgage and ABS securities	9,628	455	(50)	10,033
Commercial mortgage and ABS securities	2,378	99	(4)	2,473
Other mortgage and ABS securities	1,661	93	(6)	1,748
U.S. state and municipal	12,414	438	(120)	12,732
Corporate and other	22,907	1,274	(206)	23,975
Foreign government securities	4,379	106	(85)	4,400
Total fixed maturities	56,375	2,662	(484)	58,553
Common stock	1,000	253	(23)	1,230
Preferred stock	552	35	(84)	503
Total equity securities	1,552	288	(107)	1,733
Total securities available for sale	\$ 57,927	\$ 2,950	\$ (591)	\$ 60,286

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agency securities	\$ 2,324	\$ 147	\$ (6)	\$ 2,465
Residential mortgage and ABS securities	10,725	376	(112)	10,989
Commercial mortgage and ABS securities	2,163	39	(42)	2,160
Other mortgage and ABS securities	1,849	74	(21)	1,902
U.S. state and municipal	14,910	700	(100)	15,510
Corporate and other	19,134	891	(342)	19,683
Foreign government securities	3,684	128	(82)	3,730
Total fixed maturities	54,789	2,355	(705)	56,439
Common stock	525	195	(32)	688
Preferred stock	552	32	(84)	500
Total equity securities	1,077	227	(116)	1,188
Total securities available for sale	\$ 55,866	\$ 2,582	\$ (821)	\$ 57,627

Of the \$1,230 and \$688 of common stock as of December 31, 2010 and 2009, respectively, \$304 and \$275, respectively, related to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk.

As of December 31, 2010 and 2009, securities carried at \$4,281 and \$4,051, respectively, were on deposit with regulatory authorities as required by law.

As of December 31, 2010 and 2009, the fair values of fixed maturities loaned were approximately \$1,687 and \$1,547, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately \$1,336 and \$1,352 as of December 31, 2010 and 2009, respectively. Other investments received as collateral in connection with the loaned securities was approximately \$396 and \$247 as of December 31, 2010 and 2009, respectively.

The amortized cost and fair value of fixed maturities as of December 31, 2010, by contractual maturity are as follows:

	Amortized Cost	Fair Value
Due to mature:		
One year or less	<b>\$ 2,428</b>	<b>\$ 2,458</b>
Over one year through five years	<b>15,801</b>	<b>16,408</b>
Over five years through ten years	<b>12,768</b>	<b>13,391</b>
Over ten years	<b>11,711</b>	<b>12,042</b>
Mortgage and asset-backed securities of government and corporate agencies	<b>13,667</b>	<b>14,254</b>
Total fixed maturities	<b>\$ 56,375</b>	<b>\$ 58,553</b>

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

The following table shows a schedule of the Company's unrealized losses and fair value by security type and by duration that individual securities have been in a continuous unrealized loss position as of December 31, 2010, that are not deemed to be other-than-temporarily impaired.

	Less Than 12 Months		12 Months or Longer	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. government and agency securities	<b>\$ (13)</b>	<b>\$ 571</b>	<b>\$ —</b>	<b>\$ —</b>
Residential mortgage and ABS securities	<b>(14)</b>	<b>1,182</b>	<b>(36)</b>	<b>403</b>
Commercial mortgage and ABS securities	<b>(2)</b>	<b>103</b>	<b>(2)</b>	<b>62</b>
Other mortgage and ABS securities	<b>(1)</b>	<b>17</b>	<b>(5)</b>	<b>31</b>
U.S. state and municipal	<b>(84)</b>	<b>2,295</b>	<b>(36)</b>	<b>214</b>
Corporate and other	<b>(96)</b>	<b>3,601</b>	<b>(110)</b>	<b>892</b>
Foreign government securities	<b>(43)</b>	<b>1,536</b>	<b>(42)</b>	<b>305</b>
Common stock	<b>(8)</b>	<b>178</b>	<b>(15)</b>	<b>98</b>
Preferred stock	<b>(2)</b>	<b>51</b>	<b>(82)</b>	<b>308</b>
Total	<b>\$ (263)</b>	<b>\$ 9,534</b>	<b>\$ (328)</b>	<b>\$ 2,313</b>

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

	Less Than 12 Months		12 Months or Longer	
	Unrealized Losses	Fair Value of Investments with Unrealized Losses	Unrealized Losses	Fair Value of Investments with Unrealized Losses
U.S. government and agency securities	<b>\$ (6)</b>	<b>\$ 386</b>	<b>\$ —</b>	<b>\$ 25</b>
Residential mortgage and ABS securities	<b>(16)</b>	<b>1,077</b>	<b>(96)</b>	<b>501</b>
Commercial mortgage and ABS securities	<b>(2)</b>	<b>253</b>	<b>(40)</b>	<b>629</b>
Other mortgage and ABS securities	<b>(7)</b>	<b>274</b>	<b>(14)</b>	<b>60</b>
U.S. state and municipal	<b>(35)</b>	<b>1,148</b>	<b>(65)</b>	<b>604</b>
Corporate and other	<b>(30)</b>	<b>1,324</b>	<b>(312)</b>	<b>2,875</b>
Foreign government securities	<b>(49)</b>	<b>884</b>	<b>(33)</b>	<b>150</b>
Common stock	<b>(2)</b>	<b>15</b>	<b>(30)</b>	<b>132</b>
Preferred stock	<b>—</b>	<b>—</b>	<b>(84)</b>	<b>357</b>
Total	<b>\$ (147)</b>	<b>\$ 5,361</b>	<b>\$ (674)</b>	<b>\$ 5,333</b>

The above table for 2010 includes \$227 of unrealized losses related to securities issued and guaranteed by the United States government, its agencies, government sponsored enterprises and state and municipal governments. Unrealized losses decreased from \$821 as of December 31, 2009 to \$591 as of December 31, 2010 primarily due to declining Treasury yields and a decrease in credit spreads. Unrealized losses less than 12 months increased from \$147 at December 31, 2009 to \$263 as of December 31, 2010, an increase of \$116. Unrealized losses 12 months or longer decreased from \$674 as of December 31, 2009 to \$328 as of December 31, 2010 and accounted for \$346 of the overall decrease in unrealized losses. As of December 31, 2010, there were 488 securities that were in an unrealized loss position for 12 months or longer. The Company monitors the difference between the amortized cost and estimated fair value of debt securities to ascertain whether declines in value are temporary in nature. The Company currently does not have the intent to sell these securities and has determined it is not more likely than not that it would be required to sell these fixed income securities before they recover their fair value.

Approximately 76% 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 94% of the mortgage and asset-backed holdings are rated AAA. The commercial mortgage backed securities portfolio is well diversified and of high quality with over 99% rated AA or above with approximately 18% of the underlying collateral having been defeased with U.S. Treasuries.

## Notes to Consolidated Financial Statements *(continued)*

As of December 31, 2010, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.1% of invested assets.

### ***Variable Interest Entities***

The Company invests in energy, private equity and real estate limited partnerships and other entities subject to VIE analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of December 31, 2009, the Company determined that it was the primary beneficiary of two VIEs in the energy investment sector, and as such, these VIEs were consolidated in the Company's 2009 financial statements. The carrying value of assets and liabilities, and the Company's maximum exposure to loss of the consolidated VIEs were immaterial to the Company. These entities were deconsolidated in 2010 upon adoption of the revised guidance in ASC 810 when the Company determined that it did not have a controlling financial interest in the VIEs.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323, *Investments – Equity Method and Joint Ventures*. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. For these VIEs, the Company absorbs a portion, but not majority, of this variability. The carrying value of assets was \$94 and \$87 as of December 31, 2010 and December 31, 2009, respectively and the Company's maximum exposure to loss was \$123 and \$99 as of December 31, 2010 and December 31, 2009, respectively for unconsolidated VIEs in which the Company has a significant variable interest. The assets are included in Other Investments on the consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. There is no recourse provision to the general credit of the Company for any VIE beyond the full amount of the Company's loss exposure.

### ***Investments in Mortgage Loans***

As of December 31, 2010 and 2009, the carrying values of commercial mortgage loans were \$1,206 and \$1,121 respectively. The carrying values reflect allowances of \$14 and \$6 as of December 31, 2010 and 2009, respectively. Additionally, the Company's participation in any one commercial mortgage loan acquired does not exceed 49% of the loan value. As of December 31, 2010, the average total loan size was \$2, and the average loan participation size was \$1. The number of loans in the portfolio increased from 2,469 as of December 31, 2009, to 2,948 as of December 31, 2010. Approximately 90% of the loans are full or partial recourse to borrowers.

### ***Derivatives***

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each domestic insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. Beginning in January 2008, the Company, as part of its risk management program, 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, as part of its risk management program and diversification strategy, entered into two equity swap agreements with a total notional amount of \$335. For the year ended December 31, 2008, these contracts incurred a \$99 net gain. These contracts matured in January 2009 resulting in realized gains of \$25 for the twelve months ended December 31, 2009. As of December 31, 2010, the Company had no material derivative agreements in place.

### **(4) Deferred Policy Acquisition Costs and Acquired In-Force Policy Intangibles**

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

Years Ended December 31,	2010	2009	2008
Balance at beginning of year	\$ 2,636	\$ 2,541	\$ 2,045
Acquisition costs deferred and other	4,892	4,787	3,991
Acquired in-force policy intangibles <sup>(1)</sup>	—	—	494
Amortization charged to income	(4,757)	(4,692)	(3,989)
Balance at end of year	\$ 2,771	\$ 2,636	\$ 2,541

<sup>(1)</sup> For 2008, the acquired in-force policy intangible was recognized in conjunction with the Company's purchase of Safeco on September 22, 2008 and the acquisition of Indiana Seguros S.A. through the Company's Brazilian subsidiary, Liberty International Brazil Ltda. on January 9, 2008.



## (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 claims and claim 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 utilized 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 and sustained 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.

In the third quarter of 2009, the Company completed its biennial ground-up asbestos reserve study. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal review, potential exposures of certain policyholders were individually evaluated using the Company's proprietary stochastic model, which is consistent with published actuarial papers on asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. The remaining policyholders (those with less potential exposure) were evaluated using aggregate methods that utilized information and experience specific to these insureds. The study resulted in an increase to reserves of \$383, which included an increase of \$70 to the allowance for uncollectible reinsurance. The previous comprehensive study was completed in 2007. The Company also completed its study on the environmental claims liability in 2009, resulting in immaterial adjustments to held reserves. During 2010 the Company monitored asbestos and environmental activity to determine whether or not any adjustment to reserves is warranted. Based on this review of actual emerged losses, no material adjustments were made.



## Notes to Consolidated Financial Statements *(continued)*

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, 2010, 2009, and 2008. Acquisition activity in 2009 and 2008 relates to the purchase of Safeco.

	2010	2009	2008
<b>Gross Asbestos:</b>			
January 1 reserves	\$ 2,665	\$2,539	\$ 2,526
Acquisitions	—	67	224
Incurred activity	134	384	146
Paid activity <sup>(1)</sup>	655	325	357
Ending reserves	\$ 2,144	\$2,665	\$2,539
<b>Net Asbestos:</b>			
January 1 reserves	\$ 1,171	\$ 901	\$ 848
Acquisitions	—	64	182
Incurred activity (net of change in allowance)	(104)	399	20
Paid activity	235	193	149
Total unpaid losses including allowance for unpaid reinsurance	\$ 832	\$1,171	\$ 901

<sup>(1)</sup> In 2010, the increase in paid activity is due to the payment of the 2009 settlement with Armstrong World Industries, with which the Company had been in various insurance coverage disputes.

Included in gross asbestos incurred for 2010, 2009, and 2008 are 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 \$1, \$0, and \$47 in 2010, 2009, and 2008, respectively. All remaining 2010 and 2008 gross paid losses are recoverable from Vantage.

	2010	2009	2008
<b>Gross Environmental:</b>			
January 1 reserves	\$ 527	\$ 620	\$ 621
Acquisitions	—	(25)	95
Incurred activity	35	50	13
Paid activity	80	118	109
Ending reserves	\$ 482	\$ 527	\$ 620
<b>Net Environmental:</b>			
January 1 reserves	\$ 409	\$ 495	\$ 486
Acquisitions	—	(25)	84
Incurred activity	(6)	4	(5)
Paid activity	45	65	70
Ending reserves	\$ 358	\$ 409	\$ 495

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 \$0, \$0, and \$1 in 2010, 2009, and 2008 respectively. All remaining 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); 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. Catastrophe losses are severe losses resulting from natural and man-made events, including risks such as fire, earthquake, windstorm, explosion, terrorism, and other similar events. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in an area affected by the event and the severity of the event. 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, 2010, 2009, and 2008 were \$1,091, \$709, and \$1,580, 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:

	2010	2009	2008
Balance as of January 1	<b>\$ 48,355</b>	\$48,311	\$42,531
Less: unpaid reinsurance recoverables <sup>(1)</sup>	<b>12,052</b>	12,423	12,429
Net balance as of January 1	<b>36,303</b>	35,888	30,102
Balance attributable to dispositions and acquisitions	—	56	4,918
Incurred attributable to:			
Current year	<b>20,033</b>	19,584	18,623
Prior years:			
Asbestos and environmental	<b>(7)</b>	312	6
All other	<b>(366)</b>	(999)	(1,081)
Discount accretion	<b>128</b>	154	167
Total incurred	<b>19,788</b>	19,051	17,715
Paid attributable to:			
Current year	<b>10,205</b>	9,583	9,064
Prior years	<b>9,138</b>	9,385	7,567
Total paid	<b>19,343</b>	18,968	16,631
Amortization of deferred retroactive reinsurance gain	<b>54</b>	74	82
Net adjustment due to foreign exchange	<b>(269)</b>	202	(298)
Add: unpaid reinsurance recoverables <sup>(1)</sup>	<b>11,526</b>	12,052	12,423
Balance as of December 31	<b>\$ 48,059</b>	\$48,355	\$48,311

<sup>(1)</sup> In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements, the Company has recorded retroactive reinsurance recoverable balances of \$1,992, \$2,067, and \$2,111 as of December 31, 2010, 2009, and 2008, respectively.

Incurred attributable to prior years, excluding asbestos and environmental, includes \$54, \$74, and \$82 of amortization of deferred retroactive gain in the years ended December 31, 2010, 2009, and 2008, respectively. In 2010, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to favorable prior year development driven by the personal automobile and LIU reinsurance lines of business. The personal automobile favorable development is driven by better than expected severity trends, and the LIU reinsurance favorable development is driven by better than expected frequency of large loss events. In 2009, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to favorable prior year development driven by the workers compensation and general liability lines of business. The workers compensation favorable development is driven by the involuntary market workers compensation pools and the general liability favorable development is due to better than expected frequency and severity trends. 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.

## Notes to Consolidated Financial Statements *(continued)*

For certain commercial lines of insurance, the Company offers experience-rated insurance contracts whereby the ultimate premium is dependent upon the claims incurred. As of December 31, 2010 and 2009, the Company held \$4,156 and \$4,384, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of \$635 and \$495 as of December 31, 2010 and 2009, respectively. For the years ended December 31, 2010, 2009, and 2008, the Company recognized a decrease in premium income of \$64, \$85, and \$77, respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of \$1,143 and \$1,175 as of December 31, 2010 and 2009, respectively.

As of December 31, 2010 and 2009, the reserve for unpaid claim reserves was reduced by \$4,823 and \$4,784, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were \$221 and \$228 as of December 31, 2010 and 2009, respectively.

### (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:

P&C	2010		2009		2008	
	Written	Earned	Written	Earned	Written	Earned
Direct	<b>\$31,222</b>	<b>\$30,752</b>	\$30,582	\$30,389	\$27,667	\$27,338
Assumed	<b>1,770</b>	<b>1,678</b>	1,590	1,641	1,640	1,642
Ceded <sup>(1)</sup>	<b>4,851</b>	<b>4,778</b>	4,921	5,233	4,750	4,369
Net premiums	<b>\$28,141</b>	<b>\$27,652</b>	\$27,251	\$26,797	\$24,557	\$24,611

<sup>(1)</sup> As of December 31, 2010 and 2009, the Company, through its domestic insurance subsidiaries, participated in homeowners quota share reinsurance contracts on a written premium basis, ceding 30.0% of its Personal Markets' homeowners premium and as of December 31, 2008, ceding 31.725% of total U.S. homeowners premium.

Life	2010		2009		2008	
	Written	Earned	Written	Earned	Written	Earned
Direct	<b>\$1,124</b>	<b>\$1,121</b>	\$1,065	\$1,052	\$968	\$971
Ceded	<b>74</b>	<b>74</b>	58	58	58	58
Net premiums	<b>\$1,050</b>	<b>\$1,047</b>	\$1,007	\$994	\$910	\$913

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, 2010.

S&P Rating	Reinsurance Recoverables	Collateral Held	Net Recoverables <sup>(2)</sup>
AAA	<b>\$ 3</b>	<b>\$ —</b>	<b>\$ 3</b>
AA+, AA, AA-	<b>2,884</b>	<b>1,237</b>	<b>1,716</b>
A+, A, A-	<b>6,205</b>	<b>1,341</b>	<b>5,114</b>
BBB+, BBB, BBB-	<b>7</b>	<b>4</b>	<b>5</b>
BB+ or below	<b>5</b>	<b>—</b>	<b>5</b>
Involuntary pools	<b>2,920</b>	<b>5</b>	<b>2,915</b>
Voluntary pools	<b>363</b>	<b>71</b>	<b>301</b>
Other <sup>(1)</sup>	<b>2,316</b>	<b>2,701</b>	<b>621</b>
Gross recoverables	<b>\$14,703</b>	<b>\$5,359</b>	<b>\$10,680</b>
Less: allowance	<b>393</b>	<b>—</b>	<b>—</b>
Net recoverables	<b>\$14,310</b>	<b>\$5,359</b>	<b>\$10,680</b>

<sup>(1)</sup> Includes \$784 and \$1,532 of recoverables from non-rated reinsurers and captive and program business, respectively.

<sup>(2)</sup> Net recoverables represent gross recoverables less applicable collateral that can be specifically applied against recoverable balances.

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.

The Company has an aggregate reinsurance recoverable from Nationwide Indemnity Company in the amount of \$1,638 and \$1,725 as of December 31, 2010, and 2009, respectively. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company. Additionally, the Company has significant reinsurance recoverable concentrations with Swiss Reinsurance Group, Munich Re, Everest Re Group and Berkshire Hathaway Group totaling \$1,443, \$501, \$464, and \$370, respectively, as of December 31, 2010, 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. As of December 31, 2010 and 2009, deferred gains related to these reinsurance arrangements were \$550 and \$592, 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, 2010, 2009, and 2008 was \$118, \$117, and \$115, respectively. Deferred gain amortization was \$54, \$72, and \$77 for the years ended December 31, 2010, 2009, and 2008, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were \$1,947 and \$2,019 as of December 31, 2010 and 2009, 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. Additional premium and loss activity related to each of these retroactive and prospective contracts was immaterial in 2010, 2009, and 2008. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph.

In 2007, the Company entered into a multi-year property catastrophe reinsurance agreement with Mystic Re II Ltd. (“Mystic Re II”), a Cayman Islands domiciled reinsurer, to provide \$150 of reinsurance coverage for the Company and its affiliates in the event of a Northeast and/or Florida hurricane event. In the first quarter 2009, the Company entered into another agreement with Mystic Re II to provide \$225 of additional reinsurance coverage for the Company in the event of a U.S. hurricane or earthquake event. The reinsurance agreements are collateralized through a trust and guarantee

received by Mystic Re II from the issuance of catastrophe bonds and provides coverage for hurricane or earthquake-related losses based on industry insured losses as reported by Property Claim Services along with company specific losses on the event. The Company has not recorded any recoveries under these programs. Mystic Re II does not have any other reinsurance in force.

### **Catastrophe Exposure**

The Company writes insurance and reinsurance contracts that cover catastrophic events, both natural and man-made. 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.

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 (the Terrorism Act) was enacted into Federal law and established the Terrorism Risk Insurance Program (the Program), a temporary Federal program in the Department of the Treasury, that provided for a system of shared public and private compensation for certain insured losses resulting from acts of terrorism or war committed by or on behalf of a foreign interest. The Program was scheduled to terminate on December 31, 2005. In December 2005, the Terrorism Risk Insurance Extension Act of 2005 (the Terrorism Extension Act) was enacted into Federal law, reauthorizing the Program through December 31, 2007, while reducing the Federal role under the Program. In December 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 was enacted into Federal law, extending coverage to include domestic acts of terrorism and reauthorizing the Program through 2014. The three acts are hereinafter collectively referred to as “the Acts.”

In order for a loss to be covered under the Program (subject losses), the loss must meet certain aggregate industry loss minimums and must be the result of an event that is certified as an act of terrorism by the U.S. Secretary of the Treasury. The annual aggregate industry loss minimum is \$100 through 2014. The original Program excluded from participation certain of the following types of insurance: Federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, and reinsurance. The Terrorism Extension Act exempted from coverage certain additional types of insurance, including commercial automobile, professional liability (other than directors and officers’), surety, burglary and theft, and farm-owners multi-peril. In the case of a war declared by Congress, only workers’ compensation losses are covered by the Acts.

## Notes to Consolidated Financial Statements *(continued)*

The Acts generally require that all commercial property casualty insurers licensed in the United States participate in the Program. Under the Program, a participating insurer is entitled to be reimbursed by the Federal Government for 85% of subject losses, after an insurer deductible, subject to an annual cap. The Federal reimbursement percentage is 85% through 2014.

The deductible for any calendar year is equal to 20% of the insurer's direct earned premiums for covered lines for the preceding calendar year. The Company's estimated deductible under the Program is \$1,692 for 2011. The annual cap limits the amount of aggregate subject losses for all participating insurers to \$100,000. Once subject losses have reached the \$100,000 aggregate during a program year, participating insurers will not be liable under the Program for additional covered terrorism losses for that program year. The Company has had no terrorism-related losses since the Program was established. Because the Acts are relatively new and their interpretation is untested, there is substantial uncertainty as to how they will be applied to specific circumstances. It is also possible that future legislative action could change the Acts. Further, given the unpredictable frequency and severity of terrorism losses, as well as the limited terrorism coverage in the Company's own reinsurance program, future losses from acts of terrorism, particularly "unconventional" acts of terrorism involving nuclear, biological, chemical or radiological events, could be material to the Company's operating results, financial position and/or liquidity in future periods. The Company will continue to manage this type of catastrophic risk by monitoring and controlling terrorism risk aggregations to the best of its ability.

### (8) Debt Outstanding

Debt outstanding as of December 31, 2010 and 2009 includes the following:

<b>Short-term and current maturities of long-term debt:</b>	<b>2010</b>	<b>2009</b>
Commercial paper	\$ —	\$ —
Revolving credit facilities	—	4
Current maturities of long-term debt	<b>1</b>	301
Total short-term and current maturities of long-term debt	<b>\$ 1</b>	\$ 305
<b>Long-term debt:</b>	<b>2010</b>	<b>2009</b>
7.25% Notes, due 2012	<b>\$ 204</b>	\$ 204
8.00% Notes, due 2013	<b>260</b>	260
7.86% Medium Term Notes, due 2013	<b>25</b>	25
5.75% Notes, due 2014	<b>500</b>	500
7.30% Notes, due 2014	<b>200</b>	200
5.588% Mortgage Loan, due 2015	<b>49</b>	49
6.70% Notes, due 2016	<b>249</b>	249
7.00% Junior Subordinated Notes, due 2067 <sup>(1)</sup>	<b>300</b>	300
8.50% Surplus Notes, due 2025	<b>140</b>	140
7.875% Surplus Notes, due 2026	<b>227</b>	227
7.625% Notes, due 2028	<b>3</b>	3
7.00% Notes, due 2034	<b>231</b>	231
6.50% Notes, due 2035	<b>471</b>	471
7.50% Notes, due 2036	<b>440</b>	440
7.80% Junior Subordinated Notes, due 2087 <sup>(2)</sup>	<b>700</b>	700
10.75% Junior Subordinated Notes, due 2088 <sup>(3)</sup>	<b>1,250</b>	1,250
7.697% Surplus Notes, due 2097	<b>435</b>	435
	<b>5,684</b>	5,684
Unamortized discount	<b>(49)</b>	(49)
Total long-term debt excluding current maturities	<b>\$5,635</b>	\$ 5,635

<sup>(1)</sup> The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.

<sup>(2)</sup> The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

<sup>(3)</sup> The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

### Debt Transactions and In-Force Credit Facilities

On May 12, 2010, LMAC entered into a \$200 unsecured revolving credit facility for general corporate purposes with a syndicate of lenders led by Bank of America, N.A. that terminates three years following the date the facility first becomes available. On November 5, 2010, LMAC and Ohio Casualty entered into an Amended and Restated Revolving Credit Agreement to allow both LMAC and Ohio Casualty to be joint and several co-borrowers under the facility, as well as to change certain covenants to reflect the combined financial statements of the co-borrowers. On December 20, 2010, the co-borrowers triggered the availability of the facility and established the specific terms of the financial covenants based on the current combined financial statements (after giving effect to certain reorganization transactions). To date, no funds have been borrowed under the agreement.



On May 11, 2010, Peerless Insurance Company ("PIC") became a member of the Federal Home Loan Bank of Boston. This membership provides the Company with access to a secured asset-based borrowing with loan maturities of up to 20 years. To date, no funds have been borrowed.

On March 26, 2010, Liberty Mutual Insurance Company ("LMIC") entered into a \$750 three-year committed repurchase agreement. In connection with the new repurchase agreement, LMIC terminated its existing \$750 364-day committed repurchase agreement. As of December 31, 2010, no borrowings were outstanding under the agreement.

On March 26, 2010, PIC entered into a \$250 three-year committed repurchase agreement. The repurchase agreement is guaranteed by LMIC. To date, no funds have been borrowed under the agreement.

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

The Company places commercial paper through a program issued by LMGI and guaranteed by LMIC. Effective December 14, 2009, the \$1,000 commercial paper program was reduced to \$400 and is backed by the three-year \$400 unsecured revolving credit facility. As of December 31, 2010, no commercial paper borrowings were outstanding.

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

On March 11, 2009, LMIC became a member of the Federal Home Loan Bank of Boston. This membership provides the Company with access to a secured asset-based borrowing with loan maturities of up to 20 years. To date, no funds have been borrowed.

On June 9, 2006, Liberty Mutual Insurance Europe Limited entered into a \$20 revolving loan facility. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of December 31, 2010, no borrowings were outstanding under the facility.

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

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.

Capital lease obligations as of December 31, 2010 and 2009 were \$177 and \$105, respectively, and are included in other liabilities in the accompanying consolidated balance sheets. Amortization of the lease obligation was \$15 and \$49 for the years ended December 31, 2010 and 2009, respectively. In 2010 and 2008, the Company entered into arrangements to sell and leaseback certain furniture and equipment. The weighted average interest rate on these leases is 3.68%. The transactions are accounted for as capital leases. As of December 31, 2010, the Company's amortization of the lease obligations under the sale-leaseback agreements through maturity is approximately \$30 for 2011, \$32 for 2012, \$33 for 2013, \$17 for 2014, and \$16 for 2015.

### **Interest**

The Company paid \$461, \$468, and \$406 of interest in 2010, 2009, and 2008, respectively.



## Notes to Consolidated Financial Statements *(continued)*

### (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) are:

Years ended December 31,	2010	2009	2008
Current tax expense (benefit):			
United States Federal	\$ 121	\$ 108	\$ 201
United States Federal benefit of net operating losses	(8)	(27)	—
State	5	6	1
Foreign	201	147	136
Total current tax expense	319	234	338
Deferred tax expense (benefit):			
United States Federal	294	(74)	(245)
Foreign	24	27	47
Total deferred tax expense (benefit)	318	(47)	(198)
Total Federal, state and foreign income tax expense	\$ 637	\$ 187	\$ 140

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,	2010	2009	2008
Expected Federal income tax expense	\$ 812	\$ 423	\$ 439
Tax effect of:			
Nontaxable investment income	(168)	(191)	(155)
Change in valuation allowance	(11)	4	15
Goodwill	(15)	(15)	(13)
Tax litigation	—	(1)	(76)
Revision to estimates	(21)	—	(24)
Medicare legislative change	55	—	—
State	5	6	1
Foreign	(69)	(27)	(84)
Other	49	(12)	37
Actual income tax expense	\$ 637	\$ 187	\$ 140

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

	2010	2009
Deferred tax assets:		
Unpaid claims discount	\$ 577	\$ 601
Unearned premium reserves	779	723
Net operating losses	161	172
Employee benefits	521	954
Retroactive reinsurance deferred gain	201	215
Credits	94	134
Other	898	867
	3,231	3,666
Less: valuation allowance	(153)	(160)
Total deferred tax assets	3,078	3,506
Deferred tax liabilities:		
Deferred acquisition costs	740	694
Net unrealized gains	734	401
Intangibles	407	403
Other	401	317
Total deferred tax liabilities	2,282	1,815
Net deferred tax assets	\$ 796	\$ 1,691

The decrease in the valuation allowance is primarily due to the dissolution of a foreign subsidiary offset by net operating losses generated in certain foreign subsidiaries where there is uncertainty as to 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 remaining net deferred tax assets after valuation allowance will be realized.

The Company's subsidiaries had alternative minimum tax carry forwards of \$86 and net operating loss carry forwards of \$460 as of December 31, 2010. The alternative minimum tax credits do not expire. However, 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:

2011	\$ 14
2012	24
2013	27
2014	45
2015	42
Thereafter	308
Total	\$ 460

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the U.S. where such earnings are permanently reinvested. As of December 31, 2010, unremitted earnings of foreign subsidiaries were \$1,791. 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 2007 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 as of December 31, 2008	<b>\$221</b>
Additions based on tax positions related to the current year	<b>16</b>
Additions for tax positions of prior years	<b>7</b>
Reductions for tax positions of prior years	<b>(22)</b>
Settlements	<b>(1)</b>
Balance as of December 31, 2009	<b>221</b>
Additions based on tax positions related to the current year	<b>1</b>
Additions for tax positions of prior years	<b>138</b>
Reductions for tax positions of prior years	<b>(39)</b>
Settlements	<b>—</b>
Balance as of December 31, 2010	<b>\$321</b>

Included in the tabular roll forward of unrecognized tax benefits is interest in the amount of \$84 and \$85 as of December 31, 2010 and 2009, respectively.

Included in the December 31, 2010 balances above are \$160 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, 2010, 2009, and 2008, the Company recognized approximately \$(2), \$18, and \$8 in interest and penalties. The Company had approximately \$80 and \$82 of interest and penalties accrued as of December 31, 2010 and 2009, 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 were \$42 and \$40, respectively, plus statutory interest on the income tax and deficiency interest refunds until paid. On June 10, 2009, the United States Court of Appeals for the First Circuit entered a judgment that dismissed the Government's notice of appeal. As a result, Liberty Mutual received a cash refund of \$126 from the U.S. Treasury in December 2009.

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

## (10) Benefit Plans

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 final average 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 non-qualified supplemental pension plans to restore to selected highly compensated employees the pension benefits to which they would be entitled under the Company's U.S. tax qualified, defined benefit pension plan had it not been for limits imposed by the Internal Revenue Code. 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 U.S. tax qualified, defined benefit pension plan consist primarily of investments in separate accounts established under a group annuity contract issued by a subsidiary life insurance company. The separate accounts invest primarily in fixed income securities and in the equity securities of companies in The Standard and Poor's 500 Index. As of December 31, 2010 and 2009, assets of the plans totaling \$3,749 and \$3,393, 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 2010, 2009, and 2008, 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 performance. In 2010, 2009, and 2008, the Company made matching contributions of \$148, \$162, and \$156, respectively, including the supplemental defined contribution plans.

The Safeco Cash Balance Plan (a defined benefit pension plan) was liquidated in 2010. As a result, the benefit obligation was eliminated from the Company's books resulting in a settlement charge of \$35.

Compensation expense related to the Company's long-term and short-term incentive compensation plans was \$406, \$434, and \$387 for the years ended December 31, 2010, 2009, and 2008, respectively.

## Notes to Consolidated Financial Statements *(continued)*

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, 2010 and 2009, and consolidated statements of income for the years ended December 31, 2010, 2009, and 2008.

	Pension		Supplemental Pension		Postretirement	
	2010	2009	2010	2009	2010	2009
<b>Change in benefit obligations:</b>						
Benefit obligation at beginning of year	\$ 4,907	\$ 4,634	\$ 328	\$ 324	\$ 803	\$ 781
Service costs	196	200	10	12	24	28
Interest costs	290	278	20	19	46	46
Amendments	(2)	—	—	—	(71)	10
Actuarial gains	(555)	(32)	(22)	(2)	(53)	(31)
Currency exchange rate change	1	11	—	—	—	—
Acquisitions	3	—	—	—	—	—
Benefits paid	(345)	(185)	(15)	(25)	(30)	(31)
Employee contributions	1	1	—	—	—	—
Other	—	—	—	—	—	—
<b>Benefit obligations at end of year</b>	<b>\$ 4,496</b>	<b>\$ 4,907</b>	<b>\$ 321</b>	<b>\$ 328</b>	<b>\$ 719</b>	<b>\$ 803</b>
<b>Accumulated benefit obligations</b>	<b>\$ 4,141</b>	<b>\$ 4,251</b>	<b>\$ 286</b>	<b>\$ 283</b>	<b>\$ 719</b>	<b>\$ 803</b>
<b>Change in plan assets:</b>						
Fair value of plan assets at beginning of year	\$ 3,640	\$ 3,141	\$ —	\$ —	\$ —	\$ 3
Actual return on plan assets	335	472	—	—	—	—
Currency exchange rate change	2	10	—	—	—	—
Acquisitions	3	—	—	—	—	—
Employer contribution	263	201	—	—	—	—
Benefits paid	(345)	(185)	—	—	—	(3)
Other	2	1	—	—	—	—
<b>Fair value of plan assets at end of year</b>	<b>\$ 3,900</b>	<b>\$ 3,640</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Funded status of Plan</b>	<b>\$ (596)</b>	<b>\$ (1,267)</b>	<b>\$ (321)</b>	<b>\$ (328)</b>	<b>\$ (719)</b>	<b>\$ (803)</b>
	Pension		Supplemental Pension		Postretirement	
	2010	2009	2010	2009	2010	2009
<b>Amounts recognized in the Balance Sheets:</b>						
Noncurrent assets	\$ 6	\$ 3	\$ —	\$ —	\$ —	\$ —
Current liabilities	—	(35)	(23)	(14)	(40)	(37)
Noncurrent liabilities	(602)	(1,235)	(298)	(314)	(679)	(766)
<b>Net liability at end of year</b>	<b>\$ (596)</b>	<b>\$ (1,267)</b>	<b>\$ (321)</b>	<b>\$ (328)</b>	<b>\$ (719)</b>	<b>\$ (803)</b>
<b>Amounts recognized in Accumulated Other Comprehensive Loss (Income):</b>						
Net loss (gain)	\$ 563	\$ 1,272	\$ 93	\$ 124	\$ (101)	\$ (46)
Prior service costs	26	34	3	6	(30)	(16)
Net transition (asset) liability	(1)	(8)	—	—	—	60
<b>Total</b>	<b>\$ 588</b>	<b>\$ 1,298</b>	<b>\$ 96</b>	<b>\$ 130</b>	<b>\$ (131)</b>	<b>\$ (2)</b>
<b>Other changes in Plan assets and projected benefit obligation recognized in Other Comprehensive (Income):</b>						
Net actuarial (gain)	\$ (628)	\$ (253)	\$ (22)	\$ (2)	\$ (54)	\$ (30)
Currency exchange rate change	1	1	—	—	—	—
Amortization of net actuarial (gain)	(82)	(58)	(9)	(10)	(1)	(2)
Prior service costs	(2)	—	—	—	(16)	10
Amortization of prior service cost	(6)	(6)	(3)	(2)	2	3
Transition obligation	—	—	—	—	(55)	—
Amortization of transition obligation	7	5	—	—	(5)	(9)
<b>Total<sup>(1)</sup></b>	<b>\$ (710)</b>	<b>\$ (311)</b>	<b>\$ (34)</b>	<b>\$ (14)</b>	<b>\$ (129)</b>	<b>\$ (28)</b>

<sup>(1)</sup> The amounts recognized in other comprehensive (income) for the years ended December 31, 2010 and 2009 include a \$(7) and \$68 deferred tax (liability) asset related to the Medicare Part D subsidy.

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 2011 fiscal year are \$3, \$6, and \$(5) for pension plans, \$8, \$1, and less than \$1 for supplemental pension plans, and \$(3), \$(3), and \$0 for postretirement welfare plans.

The net benefit costs for the years ended December 31, 2010, 2009, and 2008, include the following components:

<b>December 31, 2010</b>	Pension	Supplemental Pension	Postretirement
Components of net periodic benefit costs:			
Service costs	\$ 196	\$ 10	\$ 24
Interest costs	290	20	46
Expected return on plan assets	(260)	—	—
Settlement charge	35	—	—
Amortization of unrecognized:			
Net loss	47	9	1
Prior service cost	6	3	(2)
Net transition (assets) obligation	(7)	—	5
<b>Net periodic benefit costs</b>	<b>\$ 307</b>	<b>\$ 42</b>	<b>\$ 74</b>
<b>December 31, 2009</b>	Pension	Supplemental Pension	Postretirement
Components of net periodic benefit costs:			
Service costs	\$ 200	\$ 12	\$ 28
Interest costs	278	19	46
Expected return on plan assets	(251)	—	—
Settlement charge	2	—	—
Amortization of unrecognized:			
Net loss	55	10	2
Prior service cost	6	2	(3)
Net transition (assets) obligation	(5)	—	9
<b>Net periodic benefit costs</b>	<b>\$ 285</b>	<b>\$ 43</b>	<b>\$ 82</b>
<b>December 31, 2008</b>	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
<b>Net periodic benefit costs</b>	<b>\$ 138</b>	<b>\$ 33</b>	<b>\$ 65</b>

The measurement date used to determine pension and other postretirement is December 31, 2010.

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

December 31,	2010	2009
<b>Pension</b>		
Discount rate	6.50%	6.15%
Rate of compensation increase	3.70%	4.70%
<b>Supplemental Pension</b>		
Discount rate	6.50%	6.15%
Rate of compensation increase	3.90%	4.90%
<b>Postretirement</b>		
Discount rate	6.50%	6.15%

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

December 31,	2010	2009	2008
<b>Pension</b>			
Discount rate	6.15%	6.00%	6.50%
Expected return on plan assets	6.75%	6.75%	7.50%
Rate of compensation increase	4.70%	4.70%	4.70%
<b>Supplemental Pension</b>			
Discount rate	6.15%	6.00%	6.50%
Rate of compensation increase	4.90%	4.90%	4.90%
<b>Postretirement</b>			
Discount rate	5.98%	6.00%	6.50%
Expected return on plan assets	—	7.15%	7.15%

The discount rate assumption used to determine the benefit obligations was based on a yield curve approach where the cash flow related to the benefit plans' liability stream was discounted at an interest rate specifically applicable to the timing of the cash flow. The process calculated the present value of these cash flows and determined the equivalent single discount rate that produced the same present value of the future cash flows. On an annual basis, the Company reviews the discount rate assumption used to determine the benefit obligations and the composition of various yield curves to ensure that the assumed discount rate reflects the Company's best estimate of the rate of return inherent in a portfolio of high-quality debt instruments that would provide the cash flows necessary to settle the Company's projected benefit payments.

## Notes to Consolidated Financial Statements *(continued)*

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

The weighted-average healthcare cost trend rates are expected to be 8.8% in 2011 graded down to 5.5% in 2018. 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	\$ 66	\$(51)
Effect on total service and interest costs	\$ 11	\$ (8)

### **Plan Assets**

The assets of the domestic Plan represent 97% and 93% of the total Plan assets as of December 31, 2010 and 2009, respectively. The Company's overall investment strategy for the domestic Plans' assets is to achieve a mix of approximately 65% of investments for near-term benefit payments and 35% for long-term growth with a wide diversification of asset types, fund strategies, and fund managers. The domestic Plan's goal is to achieve a total return in the range of 6%-8% annually with sufficient liquidity to meet the benefit needs of the domestic Plan.

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

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

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

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

**Fixed maturities** – Achieve superior performance against Barclay's Aggregate Bond Index and Merrill High Yield Index over a 3 to 5 year period.

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

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

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

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

**Other equities** – Represents other foreign equities.

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

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

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

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of December 31, 2010 and 2009.

Fair Value Measurements as of December 31, 2010					Fair Value Measurements as of December 31, 2009				
Asset Category	Total	Quoted Prices in Active Markets for Identical Assets Level 1 <sup>(1)</sup>	Significant Observable Inputs Level 2 <sup>(1)</sup>	Significant Unobservable Inputs Level 3 <sup>(1)</sup>	Asset Category	Total	Quoted Prices in Active Markets for Identical Assets Level 1 <sup>(1)</sup>	Significant Observable Inputs Level 2 <sup>(1)</sup>	Significant Unobservable Inputs Level 3 <sup>(1)</sup>
Cash, cash equivalents and short-term investments	\$ 325	\$ 325	\$ —	\$ —	Cash, cash equivalents and short-term investments	\$ 465	\$ 465	\$ —	\$ —
Fixed maturities:					Fixed maturities:				
U.S. government and agency securities	361	351	10	—	U.S. government and agency securities	301	292	9	—
RMBS/CMO/ABS/CMBS	974	—	974	—	RMBS/CMO/ABS/CMBS	945	—	945	—
Corporate and other	995	2	993	—	Corporate and other	853	23	830	—
U.S. large cap equities	604	603	—	1	U.S. large cap equities	513	513	—	—
U.S. mid and small cap equities	154	154	—	—	U.S. mid and small cap equities	122	122	—	—
European equities	148	145	—	3	European equities	153	150	—	3
Asian equities	230	230	—	—	Asian equities	184	184	—	—
Other equities	20	13	1	6	Other equities	19	12	3	4
Private equity investments	86	—	—	86	Private equity investments	83	—	—	83
Real estate investments	3	—	—	3	Real estate investments	2	—	—	2
Total	\$3,900	\$1,823	\$1,978	\$99	Total	\$ 3,640	\$ 1,761	\$ 1,787	\$ 92

<sup>(1)</sup> See Note 11 for descriptions of the three levels of fair value presentation.

<sup>(1)</sup> See Note 11 for descriptions of the three levels of fair value presentation.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
	Balance January 1, 2010	Actual Return on Plan Assets Still Held	Actual Return on Plan Assets Sold	Actual Return on Plan Asset Purchases, Sales, & Settlements	Balance December 31, 2010
U.S. large cap equities	\$ —	\$ —	\$ —	\$ 1	\$ 1
European equities	3	—	—	—	3
Private equity investments	83	(4)	11	(4)	86
Real estate investments	2	1	—	—	3
Other equities	4	1	—	1	6
Total	\$ 92	\$ (2)	\$ 11	\$ (2)	\$ 99

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
	Balance January 1, 2009	Actual Return on Plan Assets Still Held	Actual Return on Plan Assets Sold	Actual Return on Plan Asset Purchases, Sales, & Settlements	Balance December 31, 2009
European equities	\$ 2	\$ —	\$ —	\$ 1	\$ 3
Private equity investments	95	(15)	5	(2)	83
Real estate investments	2	—	—	—	2
Other equities	4	—	—	—	4
Total	\$ 103	\$ (15)	\$ 5	\$ (1)	\$ 92



## Notes to Consolidated Financial Statements *(continued)*

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

### *Cash Flows*

#### *Contributions*

The Company contributed \$263 to the qualified plans, and directly funded \$15 to retirees in the supplemental pension plans in 2010. In addition, the Company directly funded \$30 to the postretirement benefit plans in 2010.

The Company expects to contribute approximately \$305 to the qualified plans, directly fund \$23 to retirees in the supplemental pension plans, and \$44 to the postretirement benefit plans gross of the Medicare Subsidy in 2011.

#### *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
2011	<b>\$186</b>	<b>\$23</b>	<b>\$44</b>	<b>\$(5)</b>
2012	<b>195</b>	<b>15</b>	<b>46</b>	<b>(5)</b>
2013	<b>207</b>	<b>41</b>	<b>41</b>	<b>—</b>
2014	<b>220</b>	<b>31</b>	<b>42</b>	<b>—</b>
2015	<b>234</b>	<b>31</b>	<b>44</b>	<b>—</b>
2016-2020	<b>1,412</b>	<b>145</b>	<b>226</b>	<b>—</b>

### **(11) Fair Value of Financial Instruments**

Fair value is the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses the market approach, which generally utilizes market transaction data for identical or similar instruments.

The hierarchy level assigned to each security in the Company's available for sale portfolio is based on the Company's assessment of the transparency and reliability of the inputs used in the valuation of each instrument at the measurement date. The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified based on the lowest level of input that is significant to the fair value measurement. The Company recognizes transfers between levels at the end of each reporting period. The three hierarchy levels are defined as follows:

- **Level 1** — Valuations based on unadjusted quoted market prices in active markets for identical assets or liabilities that the Company has the ability to access.
- **Level 2** — Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets or liabilities at the measurement date, quoted prices in markets that are not active, or other inputs that are observable, either directly or indirectly.
- **Level 3** — Valuations based on inputs that are unobservable and significant to the overall fair value measurement and involve management judgment. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants might use.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3.

The Company used the following methods and assumptions in estimating the fair value of its financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy:

#### ***Fixed Maturities***

At each valuation date, the Company uses various valuation techniques to estimate the fair value of its fixed maturities portfolio. The primary method for valuing the Company's securities is through independent third-party valuation service providers. For positions where valuations are not available from independent third-party valuation service providers, the Company utilizes broker quotes and internal pricing methods to determine fair values. The Company obtains a single non-binding price quote from a broker familiar with the security who, similar to the Company's valuation service providers, may consider transactions or activity in similar securities, as applicable, among other information. The brokers providing price quotes are generally from the brokerage divisions of leading financial institutions with market making, underwriting and distribution expertise regarding the security subject to valuation. The evaluation and prioritization of these valuation sources is systematic and predetermined resulting in a single quote or price for each financial instrument. The following describes the techniques generally used to determine the fair value of the Company's fixed maturities by asset class:

#### ***U.S. government and agency***

U.S. government and agency securities consist primarily of bonds issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. As the fair values of the Company's U.S. Treasury securities are based on unadjusted market prices, they are classified within Level 1. The fair value of U.S. government agency securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, reported trades, bids, offers and credit spreads. Accordingly, the fair value of U.S. government agency securities is classified within Level 2.

#### ***Mortgage-Backed Securities***

The Company's portfolio of residential mortgage-backed securities ("MBS") and commercial MBS are originated by both agencies and non-agencies, the majority of which are pass-through securities issued by U.S. government agencies. The fair value of MBS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of MBS is primarily classified within Level 2.

#### ***Asset-Backed Securities***

Asset-backed securities ("ABS") include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, credit card receivables, and collateralized loan obligation securities originated by a variety of financial institutions. The fair value of ABS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of ABS is primarily classified within Level 2.

## Notes to Consolidated Financial Statements *(continued)*

### *Municipals*

The Company's municipal portfolio comprises bonds issued by U.S. domiciled state and municipal entities. The fair value of municipal securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, broker quotes, issuer ratings, reported trades and credit spreads. Accordingly, the fair value of municipal securities is primarily classified within Level 2.

### *Corporate debt and other*

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair value of corporate and other securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of corporate and other securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

### *Foreign government securities*

Foreign government securities comprise bonds issued by foreign governments and their agencies along with supranational organizations. The fair value of foreign government securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, broker quotes, issuer ratings, reported trades of identical or comparable securities and credit spreads. Accordingly, the fair value of foreign government securities is primarily classified within Level 2.

### *Equity securities*

Equity securities include common and preferred stocks. Common stocks with fair values based on quoted market prices in active markets are classified in Level 1. Common stocks with fair values determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active are classified in Level 2. The fair value of preferred stock is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active. Accordingly, the fair value of preferred stock is primarily classified within Level 2.

### *Other investments*

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

### *Separate account assets*

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*

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**

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

The following tables summarize the Company's assets that are measured at fair value on a recurring basis as of December 31, 2010 and December 31, 2009:

As of December 31, 2010				
	Level 1	Level 2	Level 3	Total
<b>Assets, at Fair Value</b>				
U.S. government and agency securities	<b>\$2,152</b>	<b>\$ 1,024</b>	<b>\$ 16</b>	<b>\$ 3,192</b>
Mortgage and asset-backed securities:				
Residential	—	<b>9,854</b>	<b>179</b>	<b>10,033</b>
Commercial	—	<b>2,453</b>	<b>20</b>	<b>2,473</b>
Other mortgage and asset-backed securities	—	<b>1,734</b>	<b>14</b>	<b>1,748</b>
U.S. state and municipal	—	<b>12,718</b>	<b>14</b>	<b>12,732</b>
Corporate and other	—	<b>23,204</b>	<b>771</b>	<b>23,975</b>
Foreign government securities	—	<b>4,286</b>	<b>114</b>	<b>4,400</b>
Total fixed maturities, available for sale	<b>2,152</b>	<b>55,273</b>	<b>1,128</b>	<b>58,553</b>
Common stock	<b>1,212</b>	—	<b>18</b>	<b>1,230</b>
Preferred stock	—	<b>499</b>	<b>4</b>	<b>503</b>
Total equity securities, available for sale	<b>1,212</b>	<b>499</b>	<b>22</b>	<b>1,733</b>
Short-term investments	<b>119</b>	<b>191</b>	<b>3</b>	<b>313</b>
Other investments	—	<b>54</b>	<b>115</b>	<b>169</b>
Separate account assets	<b>1,794</b>	<b>1,938</b>	<b>161</b>	<b>3,893</b>
Other assets	<b>9</b>	<b>52</b>	<b>23</b>	<b>84</b>
Total assets	<b>\$5,286</b>	<b>\$58,007</b>	<b>\$1,452</b>	<b>\$64,745</b>
<b>Liabilities, at Fair Value</b>				
Life insurance obligations	<b>\$ —</b>	<b>\$ —</b>	<b>\$ (149)</b>	<b>\$ (149)</b>
Total liabilities	<b>\$ —</b>	<b>\$ —</b>	<b>\$ (149)</b>	<b>\$ (149)</b>

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

## Notes to Consolidated Financial Statements *(continued)*

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

	Balance January 1, 2010	Net Realized Gains (Losses)	Net Unrealized Gains (Losses)	Net Purchases, (Sales) and (Maturities)	Transfer In and/or Out of Level 3	Balance December 31, 2010
U.S. government and agency securities	\$ 44	\$ —	\$ 1	\$ (17)	\$ (12)	\$ 16
Mortgage and asset-backed securities:						
Residential	6	—	2	175	(4)	179
Commercial	15	—	(1)	17	(11)	20
Other mortgage and asset-backed securities	53	(1)	5	(26)	(17)	14
U.S. state and municipal	21	—	—	(1)	(6)	14
Corporate and other	848	2	(6)	(105)	32	771
Foreign government securities	7	—	(1)	107	1	114
Total fixed maturities	994	1	—	150	(17)	1,128
Common stock	14	1	2	6	(5)	18
Preferred stock	3	1	—	—	—	4
Total equity securities	17	2	2	6	(5)	22
Short-term investments	59	(2)	(3)	(51)	—	3
Other investments	64	14	(1)	3	35	115
Separate account assets	187	45	(34)	(37)	—	161
Other assets	19	1	—	3	—	23
Total assets	\$ 1,340	\$ 61	\$ (36)	\$ 74	\$ 13	\$ 1,452
Life insurance obligations	\$ (143)	\$ (33)	\$ —	\$ 27	\$ —	\$ (149)
Total liabilities	\$ (143)	\$ (33)	\$ —	\$ 27	\$ —	\$ (149)

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

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held as of December 31, 2010 and 2009.

For the years ended December 31, 2010, 2009, and 2008, there were impairments of \$26, \$22, and \$29, respectively, recognized for items measured at fair value on a nonrecurring basis (principally direct investments in oil and gas production ventures, which are based on independent external studies). Impairment charges for the above are reflected in insurance operating costs and expenses in the consolidated statements of income.

The Company did not have significant transfers between Levels 1 and 2 during the year ended December 31, 2010.

For fixed maturities and equity securities, transfers into Level 3 were \$106 and transfers out of Level 3 were \$(93) for the year ended December 31, 2010. These transfers were primarily due to re-evaluation of the observability of pricing inputs.

The Company has elected to apply the fair value option to certain financial instruments in limited circumstances. The fair value option election is made on an instrument by instrument basis. All periodic changes in the fair value of the elected instruments are reflected in the income statement. The impact of the fair value option elections is immaterial to the Company.

The fair values and carrying values of the Company's financial instruments excluded from ASC 820 as of December 31, 2010 and 2009, are as follows:

	2010		2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Other investments	<b>\$2,898</b>	<b>\$2,898</b>	\$2,493	\$2,493
Mortgage loans	<b>1,206</b>	<b>1,216</b>	1,121	1,062
Cash and cash equivalents	<b>4,930</b>	<b>4,930</b>	4,847	4,847
Individual and group annuities	<b>2,055</b>	<b>2,439</b>	2,079	2,280
Debt	<b>5,636</b>	<b>5,902</b>	5,940	5,728

**Other investments:** Fair values represent (1) the Company's equity in partnership net assets and (2) equity investments in privately held businesses carried at fair value.

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

**Cash and cash equivalents:** The carrying amounts reported in the consolidated balance sheets for these instruments approximate fair values.

**Individual and group annuities:** Fair values of liabilities under fixed investment-type insurance contracts are estimated using discounted cash flow calculations at pricing rates as of December 31, 2010 and 2009. Also included are variable investment-type insurance contracts, for which carrying value approximates fair value as of December 31, 2010 and 2009.

**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 as of December 31, 2010 and 2009.

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

## (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 is currently in coverage litigation with Kentile Floors, Inc., a former manufacturer of floor tile products, some of which contained asbestos. In November 1992, Kentile filed a voluntary petition for bankruptcy relief under Chapter 11 (Reorganization) of the Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York, and Metex Manufacturing Corporation ("Metex") emerged from the Chapter 11 Bankruptcy proceeding as the "Reorganized Debtor." Metex claims it has rights to the policies issued to Kentile, but this issue has not yet been resolved by the bankruptcy court.



## Notes to Consolidated Financial Statements *(continued)*

In 2008, certain excess insurers of Kentile initiated a declaratory judgment action against Kentile, Metex and the other insurers of Kentile, including the Company, in state court in New York seeking, among other relief, products coverage without aggregate limits from the Company.

The Company intends to vigorously defend its position in this coverage litigation, including opposing any argument that the Kentile policies do not contain aggregate limits for products claims. Management believes that the ultimate liability, if any, to Metex will not be resolved for at least one year and very likely may 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 operation.

The Company leases certain office facilities and equipment under operating leases expiring in various years through 2018. Rental expense amounted to \$278, \$280, and \$224 for the years ended December 31, 2010, 2009, and 2008, 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 2043. Rental income amounted to \$25, \$28, and \$30 for the years ended December 31, 2010, 2009, and 2008, 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
2011	\$ 174	\$ 1	\$ 27	\$ 148
2012	164	1	25	140
2013	123	1	26	98
2014	88	1	22	67
2015	63	1	27	37
2016 – 2035	83	20	46	57
2036 – 2055	—	20	—	20
2056 – 2101	—	93	—	93
Total	\$ 695	\$ 138	\$ 173	\$ 660

As of December 31, 2010, the Company had unfunded capital commitments related to traditional private equity partnerships of \$905, other partnerships (primarily energy) of \$1,154, and real estate partnerships of \$346.

As of December 31, 2010, the Company had commitments to purchase various mortgage-backed securities settling in 2011, at a cost of \$84 with a fair value of \$84, which are included as fixed maturities in the consolidated balance sheets.

As of December 31, 2010, the Company had \$383 of undrawn letters of credit outstanding secured by assets of \$460.

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, 2010 and 2009, the liability balance was \$248 and \$291, respectively. As of December 31, 2010 and 2009, included in other assets were \$10 and \$12, 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 \$1,651, which are subject to ratings and surplus 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 specified surplus decreases occur, the funds may be required to be placed in trust and invested in assets acceptable to the Company. \$186 is held in trust as of December 31, 2010. 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 \$16,039 and \$14,704 as of December 31, 2010 and 2009, 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 and may only be paid from unassigned surplus. 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, is adequate to its financial needs and does not exceed the insurer's unassigned surplus. 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 2011 that may be made prior to regulatory approval is \$3,153.

### **(14) Subsequent Events**

Management has assessed material subsequent events through March 16, 2011, the date the financial statements were available to be issued.

## 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, 2010 and 2009, 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, 2010. 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, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2009, the Company changed its method of accounting for other-than-temporary impairments. In 2008, the Company changed its method of accounting and reporting for deferred compensation and postretirement benefit aspects of split dollar life insurance arrangements.

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, 2010, 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 16, 2011 expressed an unqualified opinion thereon.

*Ernst & Young LLP*

*Boston, Massachusetts  
March 16, 2011*

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

### The Board of Directors Liberty Mutual Holding Company Inc.

Management of Liberty Mutual Holding Company Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect 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.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010, based on the framework established in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on its assessment, management concluded that the Company's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements as of December 31, 2010.

Ernst & Young LLP, our independent registered public accounting firm, has issued its report on the effectiveness of the Company's internal control over financial reporting, which follows this report.



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



David H. Long, *President*



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

## Report of Independent Registered Public Accounting Firm on the Effectiveness of Internal Control Over Financial Reporting

### 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, 2010 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 assessment 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.

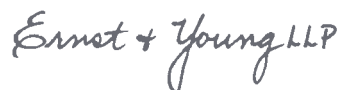
We conducted our audit in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit 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, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company'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 company; (2) provide reasonable assurance that transactions

are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company'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 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.

In our opinion, Liberty Mutual Holding Company Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, 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 standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Liberty Mutual Holding Company Inc. as of December 31, 2010 and 2009, 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, 2010 and our report dated March 16, 2011 expressed an unqualified opinion thereon.

The logo for Ernst & Young LLP, featuring the company name in a stylized, handwritten-style script.

*Boston, Massachusetts  
March 16, 2011*

## Board of Directors

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New York, New York*

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Boston, Massachusetts*

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*Chairman and  
Chief Executive Officer*

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*President*

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*Executive Vice President*

### **A. Alexander Fontanes**

*Executive Vice President and Chief  
Investment Officer*

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### **Timothy M. Sweeney**

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Chief Financial Officer*

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General Counsel*

### **James M. McGlennon**

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### **Helen E.R. Sayles**

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### **John D. Doyle**

*Vice President and Comptroller*

### **Dexter R. Legg**

*Vice President and Secretary*

### **Laurance H.S. Yahia**

*Vice President and Treasurer*



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General Manager, Claims

**Paul A. Rodliff**  
Executive Vice President and Chief  
Underwriting Officer

**Tracy A. Ryan**  
Executive Vice President and Chief  
Product Officer

**Mark A. Butler**  
President, Distribution and Service  
Management

**Mark J. Moitoso**  
Executive Vice President and  
Manager, Distribution and  
Service Management

**Douglas M. Nelson**  
Executive Vice President and  
Manager, Major Accounts

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**David R. Dwartz**  
**David E. Eaglen**  
**Deborah L. Michel**  
**George D. Townsend**  
**Peter L. Wise**

**Jean M. Scarrow**  
Chief Operating Officer  
Group Benefits

**James M. Hinchley**  
Chief Operating Officer  
Liberty Mutual Reinsurance

**Carol P. Sipe**  
President and Chief Executive Officer  
Summit Holdings

## Liberty Mutual Agency Corporation

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President and Chief Executive Officer

**Scott R. Goodby**  
President, Regional Companies Group

**Thomas M. Troy**  
Chief Operating Officer

**Marvin K. Braxton**  
President and  
Chief Executive Officer  
Colorado Casualty

**Phillip J. Broughton**  
President and  
Chief Executive Officer  
America First Insurance

**Julie A. Burnett**  
President and  
Chief Executive Officer  
Liberty Northwest

**Michael R. Christiansen**  
President and  
Chief Executive Officer  
Peerless Insurance

**Spencer J. Donkin**  
President and  
Chief Executive Officer  
Golden Eagle Insurance

**David J. Lancaster**  
President and  
Chief Executive Officer  
Indiana Insurance

**Michael J. Plavnicky**  
President and  
Chief Executive Officer  
Montgomery Insurance

**Michael A. Winner**  
President and  
Chief Executive Officer  
Ohio Casualty

**Michael H. Hughes**  
President, Safeco Insurance

**Matthew D. Nickerson**  
Chief Operating Officer

**James M. MacPhee**  
Senior Vice President and  
Chief Product Officer

**Glenn T. Shapiro**  
Senior Vice President and  
Manager, Claims

**Timothy A. Mikolajewski**  
President, Liberty Mutual Surety

**David M. Carey**  
Executive Vice President,  
Field Operations

**Ronald F. Goetsch**  
Executive Vice President and  
Manager, Claims

**Roderick A. Williams**  
Executive Vice President and  
Chief Underwriting Officer

## Personal Markets

**Timothy M. Sweeney**  
President

**Melanie J. Foley**  
Executive Vice President and  
Manager, Distribution

**Edward J. Gramer III**  
Executive Vice President and  
General Manager, Claims

**Stephen J. McAnena**  
Executive Vice President and  
Chief Product Officer

**Cheryl K. Neal**  
Executive Vice President and  
Chief Operating Officer,  
Individual Life

**Gregory C. Gordon**  
Senior Vice President and  
Manager, Marketing

**International**

**Local Business Operations**

**Luis Bonell**

*Chief Executive Officer  
Liberty International Holdings Inc.*

**Joe H. Hamilton**

*Executive Vice President and  
Chief Strategy and  
Business Development Officer*

**Victor A. Meintjes**

*Executive Vice President and  
Chief Operating Officer  
Latin America*

**Roberto Salas**

*Executive Vice President and  
Chief Operating Officer  
Europe*

**Luciano Suzuki**

*Executive Vice President and  
Chief Operating Officer  
Asia Pacific*

**Susana Agustin**

*President  
Liberty ART and  
Liberty Seguros  
Argentina*

**Pablo Barahona**

*President  
Liberty Seguros  
Chile*

**Martin Bridger**

*Managing Director  
Liberty Insurance  
Singapore*

**José María Dot**

*President  
Liberty Seguros  
Spain*

**John Fu**

*President  
LMG Insurance  
Thailand*

**Mauricio García**

*President  
Liberty Seguros  
Colombia*

**Nick Helms**

*President  
Liberty International  
Hong Kong*

**Michał Kwieciński**

*President  
Liberty Direct  
Poland*

**Gustavo Luengo**

*President  
Seguros Caracas de Liberty Mutual  
Venezuela*

**Luis Maurette**

*President  
Liberty Seguros  
Brazil*

**José Antonio de Sousa**

*President  
Liberty Seguros  
Portugal*

**Jackson Tang**

*Managing Director  
Liberty Insurance Company  
China*

**Carlos Vanegas**

*President  
Liberty Insurance  
Vietnam*

**I. Ragip Yergin**

*President  
Liberty Sigorta  
Turkey*

**Liberty International Underwriters (LIU)**

**Daniel T.N. Forsythe**

*Chief Executive Officer*

**Gordon J. McBurney**

*President and  
Chief Underwriting Officer*

**Michael J. Abdallah**

*President and  
Chief Executive Officer  
LIU Asia Pacific*

**David A. Cohen**

*President  
LIU U.S.*

**Mike Molony**

*President  
LIU Canada*

**Sean Rocks**

*Chief Executive Officer  
Liberty Mutual Insurance Europe*

**Nick Metcalf**

*Chief Executive Officer  
Liberty Syndicate Management*

# Annual Meeting

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

**P**olicyholders of Liberty Mutual Insurance Company (a stock insurance company), Liberty Mutual Fire Insurance Company (a stock insurance company), Employers Insurance Company of Wausau (a stock insurance company) and Liberty Mutual Personal Insurance Company (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 02116.



