Liberty Mutual Group 2009 Annual Report

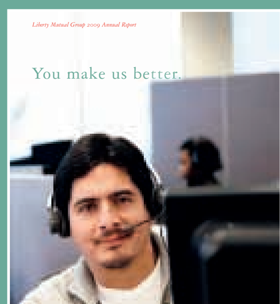
You make us better.

About the cover:

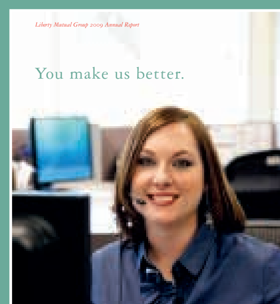
The cover you see on this copy of the Liberty Mutual 2009 Annual Report is actually one of seven covers, each featuring a Customer Response Center employee.

Liberty Mutual introduced its first call center in Mishawaka, Ind., in 1994, and has since added four more in Tampa, Fla., New Castle, Pa., Springfield, Mass., and Phoenix, Ariz. The approximately 900 customer service representatives who work in these locations provided service to more than 5.8 million customers in all 50 states in 2009.

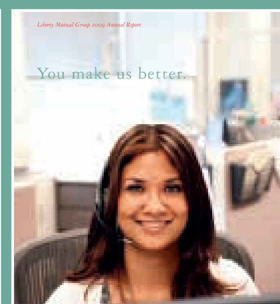
The Liberty Mutual Customer Response Centers have been among the top ten insurance call centers in the J.D. Power and Associates National Auto Study for the past two years.



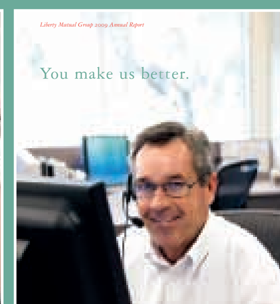
VICTOR HUGO ALBAN



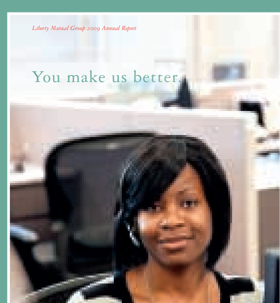
ANNE BOETTCHER



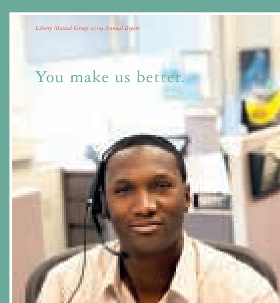
LAURA GONZALEZ



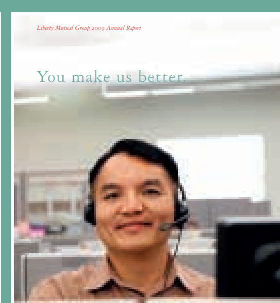
JOHN KING



JENNIFER LOUIS



CURTIS LLOYD



PATRICK NGUYEN

As a company, we like our customers to challenge us. That's because we know that, to successfully adapt to changing market conditions and customer needs, we must actively listen and respond to what you say. In other words, it's you, our customers, who make us better. In this year's report we feature four relationships where our customers do just that: a personal lines alumni affinity account in Colorado; a major, Philadelphia-based provider of cable TV, broadband internet and telephone services; an independent agency in Dallas; and used-car dealers in Poland. What these relationships have in common, and what makes them work, is a willingness for both sides to talk and listen.

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Policyholder Message

Given the dismal economic and competitive environment, both in the U.S. and globally, I'd have to characterize our performance in 2009 as darn good, if not remarkable. Overall, our core businesses performed well despite intense competition, particularly in commercial lines.

The lack of major hurricanes helped, but we experienced a higher-than-anticipated number of local catastrophes – mostly hail and wind in the Midwest and winter storms in the Northwest and Northeast. As a result, we ended up about where we expected for total catastrophe losses.

Overall, our performance in 2009 was strong and consistent with expectations. Specifically, we grew revenues by 7.8 percent to $31.1 billion, and we produced $1 billion in net income. Pre-tax operating income was $1.2 billion, a decrease from 2008. And policyholders' equity increased $4.1 billion to $14.5 billion, while consolidated assets totaled $109.5 billion, a $5.4 billion increase over 2008.

So, once again, I'm pleased to say our balance sheet is stronger, our investment portfolio remains sound and we are conservatively reserved.

"The big story from our Commercial Markets strategic business unit, and Liberty Mutual Group for that matter, was our exit from direct selling and the creation of a new Middle Market operating unit, which sells exclusively through agents and brokers under the Liberty Mutual brand."

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

Turning to our individual business results, each of our core businesses – Commercial Markets, Agency Markets, Personal Markets and Liberty International – strengthened its franchise and weathered the economic downturn reasonably well. Not surprisingly, top-line growth was challenging for some, but earnings generally held up.

The big story from our Commercial Markets strategic business unit, and Liberty Mutual Group for that matter, was our exit from direct selling and the creation of a new Middle Market operating unit, which sells exclusively through agents and brokers under the Liberty Mutual brand. That transition has been a challenge, particularly in a down economy, but we believe we've turned the corner as made evident by improved retention and increased new business opportunities.

Direct selling in the commercial marketplace had been a cornerstone of Liberty Mutual's strategy for so long that there was a great deal of sadness, indeed reluctance, to make this difficult decision. I wish the best for all our direct sales people who've left the organization over the past year, and I thank them for helping make Liberty Mutual the great company it is today.

Agency Markets, our largest strategic business unit, reported strong performance in 2009 with Safeco Insurance completing its first full year as a member of Liberty Mutual Group. We are especially pleased with both the pace of Safeco's integration and the quality of its people, who rapidly and eagerly assimilated themselves to their new home.

Today, with Safeco's national focus on personal auto and home insurance, the Regional Companies Group's local focus on commercial lines, and the second-largest Surety operation in the industry, Agency Markets is a leader in the independent agency channel.

Our Personal Markets business, with its multi-channel distribution model, continued to grow profitably, one of very few in the industry to do so as there was a steep drop in car and home sales. Our unique combination of a large and growing direct sales force, highly trained call-center employees and online capabilities has paid particular dividends in our Affinity Marketing program, which has taken off in earnest over the last decade, last year topping $4 billion in auto and home insurance premiums. I thank our affinity friends and distributors for their help in achieving this success.

Finally, Liberty International generated strong growth and profit and continued to strengthen its businesses around the globe, although the economic slowdown continues to impede growth in Europe. Of particular note is our status as the first U.S. property and casualty insurance company to be granted permission to open branches in Beijing and Zhejiang, China, the latter being a province of more than 47 million people on China's southeastern coast. In addition, Liberty International created Vietnam's first multi-function call center, and Liberty International Underwriters celebrated its tenth anniversary with the opening of insurance and reinsurance operations in Brazil.

Looking to the operating environment, the speed of economic recovery clearly remains the biggest determinant factor for business success in 2010 and beyond.

We assume a moderate recovery this year, and our outlook for the ensuing years remains conservative. Long-term inflation remains a concern. However, with or without inflation, interest rates will eventually go up. In response, we are positioning our portfolio for the probability of higher interest rates in the relatively near term, and for higher inflation over the longer term. We hope we're wrong about inflation, but the prudent course is to be prepared.

We're also keeping an eye on developments in the area of financial regulation. Although property and casualty insurers, including Liberty Mutual, did not contribute to the financial crisis and took no government funds, our large size and association as a competitor with AIG's insurance operations expose us to the risk of being deemed systemically risky. That, in turn, invites federal oversight and, potentially, federal taxation disguised as bailout fees.

We don't want to pay for bailouts when we did not contribute to the problem in any way, so we're keeping an eye on developments in Washington, D.C., and Europe, where regulatory developments could hamper our flexibility.

While we face these and other challenges, we enter the next decade with the best employees in the business, highly optimistic about our prospects for success, and well positioned to take advantage of opportunities arising from market disruption.

"We enter the next decade with the best employees in the business, highly optimistic about our prospects for success, and well positioned to take advantage of opportunities arising from market disruption."

In closing, I thank our third-party friends, brokers and agents for their support, and our customers and policyholders for their loyalty and their business. We look forward to serving you for a long time to come.

As always, I also thank the Board of Directors for its support and counsel. We recognize that the role of a board member in any large institution is significantly more onerous than it was not too many years ago. And we appreciate the additional time and attention we've asked of them over the past 12 months.

Finally, it's with sadness that we say goodbye to Bob Muleski, our Corporate Actuary. Bob leaves us the way a good corporate actuary should: with a stronger balance sheet, a better understanding of our insurance risks and a great staff to pick up where he left off. We wish Bob and Kathy a wonderful retirement.

Edmund F Kelly

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

More Flexible

It's easy to explain what makes Liberty Mutual's relationship with Comcast Corporation a success.

"It's simple. When Comcast's representatives talk, we listen," said Liberty Mutual Account Manager David Paust. Along with Customer Service Manager Angela Kline, Paust manages the Comcast relationship for Liberty Mutual, which includes servicing Comcast's workers compensation, commercial auto and general liability claims.

Based in Philadelphia, Comcast is one of the nation's leading providers of entertainment, information and communication products and services. The company's 100,000 employees provide cable television, broadband internet and telephone service to more than 23 million customers in 39 states and the District of Columbia.

What makes the relationship succeed, Paust emphasized, is the team approach that his two primary contacts – Kathy Coupe, director of Risk Management; and Deborah Saunders, senior director of Claims – bring to the business. Coupe serves

Left: Comcast's Deborah Saunders and Kathy Coupe talk with Liberty Mutual Account Manager David Paust. Above: Saunders meets with her claims team.

on the Liberty Mutual National Market Risk Management Advisory Board, and Saunders is a member of the Customer Advisory Board for RISKTRAC®, Liberty's customer-facing risk management information system.

"Kathy and Deborah give us continual feedback," Paust said. "I could cite many examples of how their input has helped us design training modules, forms, processes and more."

This collaboration, Paust said, pays off where it counts. "Comcast's loss rate for its workers compensation claims is significantly below other companies in its class."

"We're a very vocal customer," said Coupe, a 21-year Comcast employee. "We're not shy about bringing things to Dave's attention. He gets things done, even if we're suggesting Liberty try a different approach."

"Comcast and Liberty Mutual take a 'team approach,'" added ten-year Comcast employee Saunders, whose four-person claims team interacts with Liberty on a daily basis, "and that really helps us focus on our common goals."

"More than ever, we are seeing the benefits of our long-term partnership with Liberty Mutual," she continued. "Our account team has access to the breadth of Liberty's resources, and uses its knowledge of the Comcast program to identify what's most likely to fit our needs and improve our results."

One result of the two companies' collaborative approach was the establishment of a dedicated and centralized claims office in Duluth, Georgia, which provides Comcast a high level of service and smoothly executes the company's comprehensive service instructions.

Another example is the rollout of enhancements to RISKTRAC, which Saunders' claims team members use every day to manage workers compensation and general liability claims. "Before we piloted the latest enhancements with the other advisory board members, we gave Comcast several months to try it out," Paust said.

Left to right: the lobby of Comcast Corporation in Philadelphia; City Hall; and, Comcast Risk Management Director Kathy Coupe.

"Our company culture is relationship-oriented, and we really view Liberty Mutual as a partner. We want longevity. We want consistency. We want to partner to find solutions that work for both of us." – Kathy Coupe

"We didn't hold back," Saunders said. "Most of the people on my team are on RISKTRAC all day, so I couldn't imagine a better group to test the functionality and efficiency of the system."

"Deborah and her team made valuable suggestions that we built into the product before its release, and those enhancements have been well received by our other customers," Paust added.

So where does this collaborative approach originate? It's ingrained in the company, Coupe said. "Our company culture is relationship-oriented, and we really view Liberty Mutual as a partner. We want longevity. We want consistency. We want to partner to find solutions that work for both of us."

More Engaged

"We have very little capacity to teach our new producers, especially those with sales skills but no industry experience, how to be successful insurance agents."

Mike Sterlacci, president and chief executive officer of Dallas-based SIG Insurance, a Safeco Insurance agency, made this statement, and most of his independent insurance agency peers would likely nod in agreement.

The best teachers, Sterlacci knew, are the insurance carriers themselves, and that's why, when serving as president of Safeco's National Advisory Council, he pushed hard for producer training. He wasn't alone.

"Mike was one of many agents who approached us about producer training, and we took their frustration to heart," said Mike Donich, agent capabilities manager with Seattle-based Safeco, Liberty Mutual Agency Markets' personal lines company. "They wanted someone with a vested interest in their business to furnish training, not a generic insurance education school."

After working closely with several Safeco agencies to understand the challenges of bringing new producers onboard, Donich designed and launched a new Safeco Producer Development Program in Spring 2009 with an emphasis on engaging and establishing deep relationships with new producers.

"Lack of prospects is one of the main reasons why new producers fail," Donich said. "Sure, they have technical training and high-level consultative sales skills, but then they go back to the office and wait for the phone to ring." In response, the Safeco program incorporates a prospecting "module" that helps a new producer develop a personal plan based on the seven most common prospecting categories, including internet and web-based sources, referrals and networking.

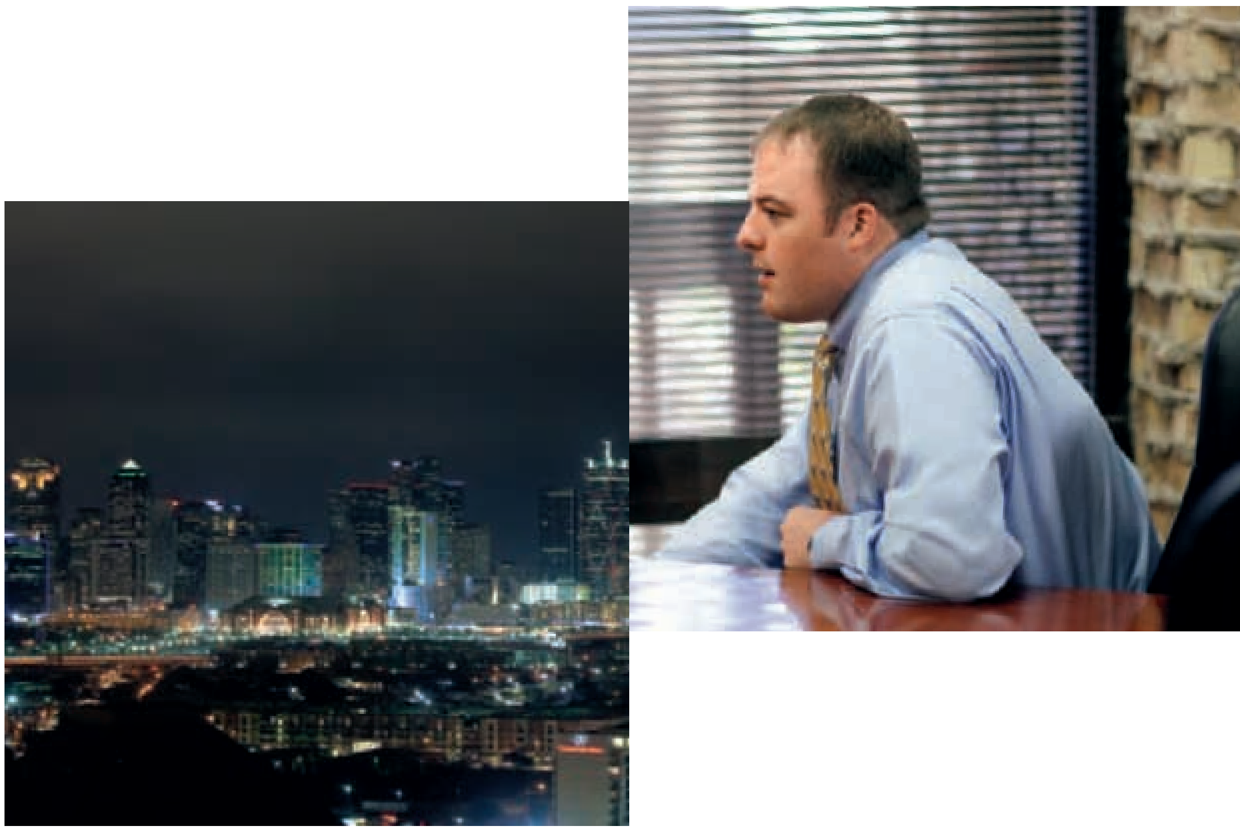
Gene Greiner, a new producer with SIG Insurance, was typical of the program's 32 participants in its first year. A graduate of Baylor University with degrees in finance and risk management, Greiner was working as a financial analyst with a defense contractor. "After a few years I was really disheartened and realized I needed more interaction with people," Greiner said.

Left: Safeco Producer Development Program Graduate Gene Greiner. Above: Safeco Insurance Territory Manager Hunter Clark talks with SIG Insurance President and CEO Mike Sterlacci.

As it turned out, a close friend, who worked at SIG Insurance, suggested Greiner apply for a sales position. A month after doing so, he was hired as a personal lines producer and enrolled in Safeco's program. "I knew Gene had the personality and the drive, he just needed the skills and tactics," Sterlacci said.

"It was awesome and very comprehensive," Greiner said after he and eight classmates participated in the five-week program, which includes webinars and a week of in-person training in Seattle. "You really learn how to get a potential client to open up and talk with you. They want a good price quote, of course, but you also need them to like you. If you're to quote effectively and develop a long-term relationship, you need to know where they're coming from."

Training didn't end upon Greiner's return to SIG Insurance in Dallas. "This isn't a once-and-done program," Donich said. "It's all about continual agent focus.



Left to right: The Dallas skyline, producer Gene Greiner and the SIG Insurance reception area.

"Lack of prospects is one of the main reasons why new producers fail. Sure, they have technical training and high-level consultative sales skills, but then they go back to the office and wait for the phone to ring." – Mike Donich

"We formally keep in touch with our graduates, checking in on their progress and bringing them new capabilities."

Greiner's progress was something to celebrate. Greiner sold 18 policies in the first six weeks after graduating, versus an average of five policies in two months for new producers outside the program. He attributes much of his success to Safeco's program.

"Psychologically, every salesperson I've known needs some success quickly," Sterlacci said, "and Safeco gave Gene the jumpstart he needed."

Agency Markets' Regional Companies Group has had similar success in commercial lines. Since June 2008, 90 new producers have graduated from its New Producer Program, all receiving the Accredited Advisor in Insurance designation. The program combines agency mentoring, online coursework and peer interaction, and training at the regional company to become familiar with product lines and underwriting appetite, and most importantly, to develop a rapport with those they will work with in the future.

More Productive

Like many colleges and universities, the University of Colorado-Boulder (CU-Boulder) hosts a fair each spring for its soon-to-graduate students. Among other activities, students can order their caps and gowns, college rings and diploma frames, and have their commencement portraits taken.

They can also request auto and renters insurance quotes which, chances are, they'll need soon after graduating.

"Such fairs can have a big impact on our personal insurance sales to graduates, and the CU-Boulder Alumni Association has made them particularly effective," said Yesel Alcantar, who manages Liberty Mutual's seven-year-old affinity relationship with the 190,000-member alumni association. With more than 650 accounts and a nearly ten-fold advantage over its closest competitor, Liberty Mutual dominates the market for members of alumni associations.

Credit for the Grad Fair's effectiveness as a way to sell insurance, she said,

goes to Kari Kennedy, business partnerships manager for the Association. "Insurance probably isn't on our students' radar screens when they approach graduation," Kennedy said. "In fact, ask almost any student if they need rental, auto or other personal insurance, and they'll probably say, 'I need to ask my parents.'"

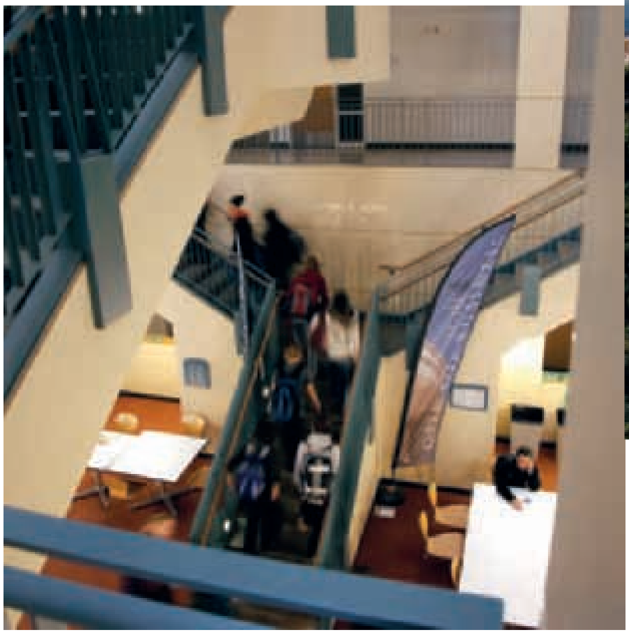
It's for that reason that Kennedy includes parents on the CU-Boulder Bookstore's Grad Fair invitation list."We have 90,000 alumni households situated on Colorado's front range, and many parents are willing to drive to the CU-Boulder campus and join their sons and daughters at the Fair," Kennedy said. "We furnish the list to the bookstore, which mails invitations to local alumni households in addition to promoting the event on campus."

At the Grad Fair itself, the Liberty Mutual table, staffed with one or two personal lines sales representatives from the local area, is adjacent to the Alumni Association table. "Parents find Liberty Mutual's sales reps to be very engaging. In fact, it's usually the parent, not the student, who says, 'Wait. We should talk to these guys,'" Kennedy said.

Left: The University of Colorado-Boulder Alumni Association's Kari Kennedy meets with Liberty Mutual's Yesel Alcantar. Above: Liberty Mutual Sales Representative Jeremy Mauler speaks with student Sarah Lindsay at the Grad Fair.

Once the dialogue begins, Alcantar emphasized that it's not a hard sell. "We know insurance isn't top-of-mind for most students, so our representatives talk in broad terms about the value of insurance, and they place a lot of emphasis on insurance fundamentals," she said. In fact, the CU-Boulder Bookstore Grad Fair makes Liberty Mutual's program 25 percent more effective than other, similar-sized, alumni association relationships that Alcantar manages.

For her part, Kennedy said she finds the Association's members appreciate Liberty Mutual's discounted group rates, which she promotes through direct mail, an electronic newsletter and "Advantages," a page on the Association's website.



Left to right: The CU-Boulder student center and campus, and Kari Kennedy, the Alumni Association's business partnerships manager.

"Kari understands the long-term benefits to the CU-Boulder Alumni Association of an affinity relationship with Liberty Mutual. And, by getting parents involved, she has introduced a sales technique that many of our other alumni association partners will likely follow." – Yesel Alcantar

"Once CU-Boulder alumni buy Liberty Mutual insurance, they tend to stay with us, which I attribute to our high service levels and availability, whether it's over the phone, in person or via the internet," Alcantar said.

"None of this would happen without Kari," Alcantar stressed. "She understands the long-term benefits to the CU-Boulder Alumni Association of an affinity relationship with Liberty Mutual. And, by getting parents involved, she has introduced a sales technique that many of our other alumni association partners will likely follow."

More Confident

Something wasn't right. In 2008, Liberty Mutual's one-year-old start-up auto insurance business in Poland, Liberty Direct, noticed that some small-business customers were repeatedly buying compulsory auto policies on the internet, and then canceling them two-to-three months after purchase.

Upon closer inspection, the company learned that these businesses – used-car dealers – were buying auto policies for the cars on their lots with 12 installment payments, then cancelling those policies when they sold the cars. The quick cancellations and the costly process of partial premium refunds made this segment uneconomical for Liberty Direct. "It created a lot of work, and no money," said Actuarial and Underwriting Director Mariusz Kozłowski.

An obvious solution was a steep increase in price to compensate for the higher costs, but Liberty Direct chose another path. "Used-car dealers are a huge market in Poland, and they're a great way to access car

owners for personal coverage," Kozłowski noted. "Since Poland joined the European Union in 2004 and trade barriers disappeared, more than one million used cars a year have poured into the country from Germany, France and other wealthier Western European nations. Of these cars, more than 60 percent are bought through used-car dealers, so ignoring this market was not an option."

Challenged by Liberty Direct President Michał Kwieciński to turn a disadvantage into an opportunity, Kozłowski personally visited eight used-car dealers in the Warsaw region, spoke with many more by phone, and ultimately found a solution that benefits both sides. "We learned a lot, which helped direct our approach," he said.

The answer, simple as it sounds, was to charge used-car dealers one zloty (about 30 cents) per day per car for coverage. "Since the cars seldom leave the dealers' lots, such a small premium is enough to cover claims and operating costs. Payment continues until dealers sell the car, which avoids a cumbersome refund process," Kozłowski said.

Left: Piotr Podstawka, owner of EURO PLUS, a used car dealership that piloted Liberty Direct's program, and his manager, Tomasz Olszewski. Above: Liberty Direct's Lukasz Babol and Mariusz Kozłowski.

In addition to the low cost, Liberty Direct made the product easy to buy, whether by phone, email, fax or via the web. "We thought approximately 50 percent of dealers would prefer the website and were surprised to learn that the actual number was 98 percent," said Lukasz Babol, who helped design the web application and its interface to Liberty Direct's IT system. As Vehicle Sales Team Manager, he now manages the ten sales consultants responsible for convincing new owners to stay with Liberty Direct.

Today, 1,800 used-car dealers have signed on with the Liberty Direct program, insuring a much-higher-than-anticipated 5,000 vehicles per month. The response of Dorota Zajac who, with her husband, owns a dealership in suburban Warsaw, was typical. "It seemed too good to be true, but we quickly learned that it frees us from paperwork and gives us more time to sell cars."

Left to right: Liberty Direct Regional Consultant Tomasz Poradzewski and Dorota Zajac, a used car dealer; Warsaw from across the Vistula River; and, the EURO PLUS used car dealership.

"None of this would have happened without first making a concerted effort to reach out to used-car dealers. Only by conversing with our customers did we end up with an improved product offering; one that benefits both Liberty Direct and the used-car dealers." – Mariusz Kozłowski

While they had success with the dealers, they still had to convince car buyers to continue with Liberty Direct's coverage. Sales and Marketing Director Rafal Karski explained: "When a used-car dealer sells a car, he or she alerts Liberty Direct by phone or over the web, and provides contact information for the buyer. Then our call center gets to work."

By law, Liberty Direct's insurance coverage remains with the car, and the new owner has 30 days to decide whether to stay with Liberty Direct or resign from coverage, so the challenge is to convince the buyer to keep the Liberty coverage.

Here too the company's meeting with success. "So far, more than 25 percent of used car buyers convert to a long-term policy," Karski said.

"None of this would have happened without first making a concerted effort to reach out to used-car dealers," Kozłowski said. "Only by conversing with our customers did we end up with an improved product offering; one that benefits both Liberty Direct and the used-car dealers."

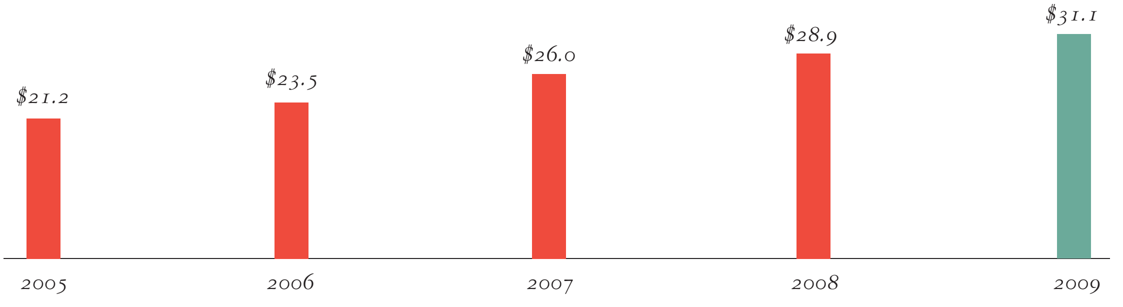
Company Overview

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

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

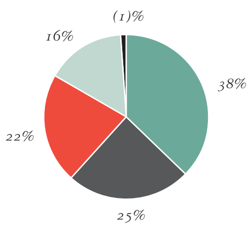
Boston-based Liberty Mutual Group is a diversified global insurer and fifth-largest property and casualty insurer in the U.S. based on 2008 direct written premium. The company also ranks 86th on the Fortune 500 list of largest corporations in the U.S. based on 2008 revenue. As of December 31, 2009, Liberty Mutual Group had $109.5 billion in consolidated assets, $95.0 billion in consolidated liabilities and $31.1 billion in annual consolidated revenue.

Revenues
(in billions)



Strategic Business Units

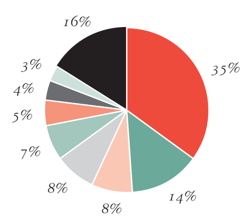
($28.3 billion in 2009 net written premium)



Agency Markets 38%
International 25%
Personal Markets 22%
Commercial Markets 16%
Other (1%)

Significant Lines of Business

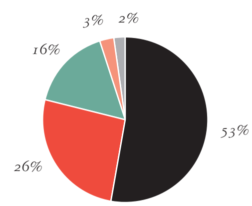
($28.3 billion in 2009 net written premium)



Private Passenger Automobile 35%
Workers Compensation 14%
Commercial Multi-Peril/Fire 8%
Homeowners 8%
International Local Business 7%
Commercial Automobile 5%
General Liability 4%
LIU Reinsurance 3%
Other 16%

Distribution Channels

(Based on 2009 direct written premium)



Independent Agents 53%
Direct Sales Force 26%
Brokers 16%
Exclusive Agents 3%
Other 2%

Liberty Mutual Group's pre-tax operating income for 2009 was $1.2 billion, a decrease of 25.2 percent from 2008. Net investment income was approximately $2.5 billion on cash flow of $2.5 billion. The Group's property and casualty combined ratio decreased to 99.9 percent in 2009 from 100.1 percent in 2008, and policyholders' equity increased by $4.1 billion to $14.5 billion.

Pre-tax Operating Income

(in millions)

Left to right:
J. Paul Condrin, III
President
Commercial Markets

Gary R. Gregg
President
Agency Markets

Timothy M. Sweeney
President
Personal Markets

David H. Long
President
Liberty International

A. Alexander Fontanes
Executive Vice President and
Chief Investment Officer



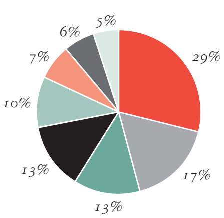
Agency Markets

By the Numbers

- third-largest personal lines writer among independent agents
- fifth-largest commercial lines writer among independent agents
- second-largest Surety writer in the U.S.
- 4.8 million Safeco personal lines policies in force with average premium of $1,000
- 1.3 million Regional Companies commercial lines policies in force with average premium of $3,900
- 29,700 Summit policies in force with average premium of $16,800
- 11,700 employees
- 128 offices

Product Mix

Based on 2009 net written premium



Personal Automobile 29%
Commercial Multi-Peril 17%
Workers Compensation 13%
Homeowners 13%
Commercial Automobile 10%
Surety 7%
General Liability 6%
Other 5%

Agency Markets delivers personal and commercial insurance products and services to independent agents and brokers and the customers they serve. Its unique national-regional approach leverages the responsiveness of regional operations with the power of national resources.

Operating Units:

Safeco® Insurance (Personal Lines)

Regional Companies (Commercial Lines)

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

Liberty Mutual Surety™

Summit™ (Southeast Workers Compensation)

Financial Results

	2009	2008	2007
Revenues	$11.9 B	$8.2 B	$5.6 B
Pre-tax operating income	$1.5 B	$909 M	$834 M
Cash flow from operations	$1.1 B	$750 M	$1.2 B
GAAP combined ratio	93.5%	95.4%	91.6%

Personal Markets

Liberty Mutual's Personal Markets provides full lines of coverage for private passenger automobile, homeowners, valuable possessions and personal liability through its own sales force in more than 350 offices throughout the U.S., two direct response centers, appointed third-party producers and the internet. It also offers a wide range of traditional and variable life insurance and annuity products. Personal Markets' largest source of new business is its more than 12,000 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.

Financial Results

	2009	2008	2007
Revenues	$7.0 B	$6.7 B	$6.5 B
Pre-tax operating income	$654 M	$350 M	$773 M
Cash flow from operations	$1.0 B	$718 M	$1.0 B
GAAP combined ratio	94.8%	99.4%	92.0%
Policies in force	5,404,216	5,193,492	4,961,751

Distribution

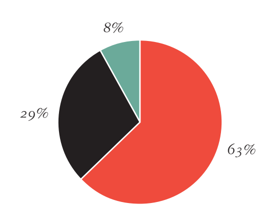
- Direct sales force
- Telesales centers
- Internet
- Third-party producers

By the Numbers

- ninth-largest writer of personal lines insurance in the U.S.
- number one in sponsored affinity programs
- five million auto and home policies
- 10,800 employees
- more than 12,000 affinity relationships
- 1,900 field sales reps
- 500 telesales counselors

Product Mix

Based on 2009 net written premium



Private Passenger Automobile 63%
Homeowners 29%
Life and Other 8%

Commercial Markets

Distribution

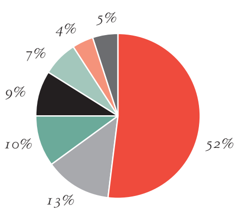
- National and regional brokers
- Agents
- Employee benefits brokers and consultants

By the Numbers

- second-largest writer of workers compensation insurance in the U.S.
- 21,000 customers
- 8,300 employees
- 137 offices

Product Mix

Based on 2009 net written premium



Workers Compensation 52%
Group Disability and Life 13%
General Liability 10%
Commercial Automobile 9%
Commercial Multi-Peril and Fire 7%
Reinsurance 4%
Other Lines 5%

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

- *National Market serves the complex needs of large companies;*
- *Middle Market serves mid-sized companies;*
- *Liberty Mutual Property provides property insurance programs to mid-sized and large companies;*
- *Specialty Lines provides specialty coverage focused on Commercial Affinity, Energy, Global and Umbrella;*
- *Group Benefits provides group disability and life products and services to companies with more than 250 employees; and,*
- *Liberty Mutual Reinsurance provides reinsurance programs for domestic and foreign insurance and reinsurance companies.*

Financial Results

	2009	2008	2007
Revenues	$6.0 B	$6.8 B	$6.5 B
Pre-tax operating income	$352 M	$202 M	$472 M
Cash flow from operations	$627 M	$1.3 B	$1.7 B
GAAP combined ratio	107.1%	109.6%	103.5%

Liberty International

Liberty International provides personal and small commercial lines insurance through operations in 14 countries: Venezuela, Argentina, Colombia, Brazil, Chile, Singapore, Thailand, Vietnam, China, Hong Kong, Spain, Portugal, Turkey and Poland. Additionally, Liberty International Underwriters, a global specialty commercial lines insurance and reinsurance business, writes a variety of specialty products including casualty, marine, construction, energy, inland marine, directors and officers, professional liability, aviation, property, surety and crisis management insurance through 40 offices in 18 countries throughout Asia, Australia, Europe, the Middle East, North America and South America. Liberty Syndicate 4472 at Lloyd's of London writes on a worldwide basis.

Country Operations:

(64 percent of international net written premium)

Asia

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

Europe

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

Latin America

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

Financial Results

	2009	2008	2007
Revenues	$7.6 B	$7.0 B	$6.1 B
Pre-tax operating income	$480 M	$683 M	$478 M
Cash flow from operations	$1.3 B	$1.1 B	$1.3 B
GAAP combined ratio	100.6%	98.4%	99.7%

Liberty International Underwriters (LIU)

(36 percent of international net written premium)

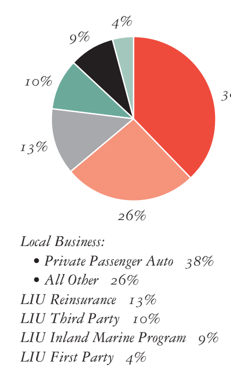
Liberty Syndicate Management
Liberty Mutual Insurance Europe
LIU Australia
LIU Canada
LIU Dubai
LIU Hong Kong
LIU Singapore
LIU U.S.

By the Numbers

- second-largest U.S.-based international property and casualty insurance company
- 8,900 employees worldwide
- offices in 26 countries
- net written premium grew 5 percent in 2009 with a compound annual growth rate of 17 percent since 1998

Product Mix

Based on 2009 net written premium



Liberty International

Overview

Liberty International provides insurance products and services through two distinct approaches:

- *local insurance companies in foreign countries; and,*
- *Liberty International Underwriters (LIU), including Liberty's Lloyd's Syndicate.*

Rankings:

Number one insurer in Venezuela
Number two property/casualty company in Colombia
Among top ten property/casualty companies in:
- *Argentina*
- *Brazil*
- *Chile*
- *Portugal*
- *Singapore*
- *Thailand*

Financial Highlights

(dollars in millions) december 31	2009	2008	2007
LIBERTY MUTUAL GROUP			
Revenues	$31,094	$28,855	$25,952
Pre-tax operating income	1,184	1,583	1,736
Net income	1,023	1,113	1,501
Cash flow from operations	2,487	2,745	4,042
Total assets	109,475	104,039	94,713
GAAP combined ratio	99.9%	100.1%	100.2%
AGENCY MARKETS			
Revenues	$11,928	$ 8,245	$ 5,569
Pre-tax operating income	1,472	909	834
Cash flow from operations	1,141	750	1,183
Total assets	29,942	31,809	18,683
GAAP combined ratio	93.5%	95.4%	91.6%
PERSONAL MARKETS			
Revenues	$ 7,001	$ 6,684	$ 6,524
Pre-tax operating income	654	350	773
Cash flow from operations	1,012	718	1,027
Total assets	18,461	17,416	16,806
GAAP combined ratio	94.8%	99.4%	92.0%
COMMERCIAL MARKETS			
Revenues	$ 6,028	$ 6,804	$ 6,489
Pre-tax operating income	352	202	472
Cash flow from operations	627	1,295	1,661
Total assets	27,880	28,614	28,353
GAAP combined ratio	107.1%	109.6%	103.5%
INTERNATIONAL			
Revenues	$ 7,589	$ 7,049	$ 6,138
Pre-tax operating income	480	683	478
Cash flow from operations	1,328	1,119	1,269
Total assets	20,206	18,038	18,798
GAAP combined ratio	100.6%	98.4%	99.7%
OTHER*			
Revenues	$(1,452)	$ 73	$ 1,232
Pre-tax operating loss	(1,774)	(561)	(821)
Cash flow from operations	(1,621)	(1,137)	(1,098)

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

CONTENTS

Consolidated Statements of Income

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

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

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

Consolidated Balance Sheets

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

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

Consolidated Statements of Changes in Policyholders' Equity

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

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

Consolidated Statements of Cash Flows

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

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

Nature of Operations

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

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

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

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

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

Adoption of New Accounting Standards

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

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

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

Effective December 31, 2007, the Company adopted the guidance related to accounting for defined benefit pension and other postretirement plans as codified in ASC 715, *Compensation – Retirement Plans.* This guidance requires the Company to (a) recognize the funded status of its pension, supplemental pension and postretirement benefit plans on the consolidated balance sheet as an asset or liability, measured as the difference between plan assets at fair value and the benefit obligation as of the employer's fiscal year end, with a corresponding adjustment to accumulated other comprehensive income ("AOCI," a component of policyholders' equity), net of tax; and to (b) recognize as a component of AOCI, net of tax, actuarial gains or losses or prior service cost or credit that arise during the period but are not recognized as a component of net periodic benefit cost. These amounts will be subsequently recognized in the income statement pursuant to the Company's historical accounting policy for amortizing such amounts with a corresponding offset to AOCI. The guidance related to measuring plan assets and benefit obligations, as of the date of fiscal year-end statement of financial position, and in determining net periodic benefit cost continues to apply. The adoption of this guidance as of December 31, 2007 resulted in a decrease in other assets of $245, an increase in deferred tax assets of $155, an increase in other liabilities of $198, and a decrease in AOCI of $288 (net of tax). The adoption of this guidance did not affect the Company's results of operations or liquidity as it did not affect the determination of net periodic benefit costs.

Future Adoption of New Accounting Standards

In June 2009, the FASB issued revised guidance on the accounting for variable interests. The revised guidance, as codified in ASC 810, *Consolidations,* reflects the elimination of the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has (1) the power to direct the activities of an entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. Additionally, in February 2010, the FASB issued Accounting Standards Update (ASU) 2010-10, *Amendments for Certain Investment Funds,* which defers the revised consolidation requirements for a reporting entity's interest in an entity (1) that has all the attributes of an investment company or (2) for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies and amends the previous provisions for assessing whether fees paid to a legal entity's decision maker or service provider are variable interests. The Company is adopting this guidance effective January 1, 2010, and the adoption will not have a material impact on the Company.

Investments

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

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.

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

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

Derivatives

All derivatives are recognized on the balance sheet at fair value. On the date a contract is entered into, the Company designates the derivative as either (1) a hedge of a fair value of a recognized asset ("fair value hedge"), (2) an economic hedge ("non-designated derivative"), or (3) a cash flow hedge. Changes in the fair value of a derivative that is highly effective and is designated as a fair value hedge, along with the loss or gain on the hedged asset attributable to the hedged risk, are recorded in current period 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 income (loss) 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 & Acquired Policy In-Force Intangibles

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

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

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

As a result of the Company's acquisitions of the Ohio Casualty Corporation and Safeco Corporation, the Company recognized intangible assets equal to the fair value of the acquired in-force policies. Amortization of these assets occurred over the remaining policy term and were fully amortized as of December 31, 2009.

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 2009 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.

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

The cumulative effect of the change in the method of accounting resulted in an increase in the opening balance of unassigned equity as of January 1, 2007 of $287, net of tax. As of and for the year ended December 31, 2009, the accounting change resulted in increases in reinsurance recoverables (net), deferred taxes (net), unpaid claims and claim adjustment expense – property and casualty, other liabilities, and benefits, claims and claim adjustment expense of $25, $12, $48, $12, and $35, respectively, and decreases in unassigned equity, income tax expense and net income of $23, $12, and $23, respectively. As of and for the year ended December 31, 2008, the accounting change resulted in the following changes to previously reported balances (as a result of retrospective application of the accounting change): decreases in reinsurance recoverables (net), deferred taxes (net), unpaid claims and claim adjustment expense – property and casualty, other liabilities, income tax expense, and net income of $146, $131, $416, $104, $15, and $27, respectively, and increases in unassigned equity and benefits, claims and claims adjustment expense of $243 and $42, respectively. For the year ended December 31, 2007, the accounting change resulted in the following changes to previously reported balances (as a result of retrospective application of the accounting change): an increase in benefits, claims and claim adjustment expense of $26 and decreases in income tax expense and net income of $9 and $17, respectively. The held discounted reserves on these unpaid workers compensation claims, net of all reinsurance, as of December 31, 2009 and 2008 were $1,974 and $1,935, respectively.

The held discounted reserves on unpaid asbestos structured settlement claims as of December 31, 2009 and 2008 were $118 and $145, respectively.

Relating to future policy benefits, the discounting of the disability claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 4.5% to 7.0% in both 2009 and 2008. Unpaid disability claims and claim adjustment expenses as of December 31, 2009 and 2008, include liabilities at discounted values of $1,030 and $933, 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 5.8% and 6.0% for 2009, 2008, and 2007. Implied credited interest rates for foreign structured settlement contracts in force were between 2.5% and 6.0% in 2009, 2008, and 2007. Credited rates for domestic universal life contracts in force were between 3.5% and 6.3% in 2009, 2008, and 2007. Credited rates for foreign universal life contracts in force were between 1.3% and 6.0% in 2009, 2008, and 2007. 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 2009, 2008, and 2007), mortality assumptions (based on the Company's experience relative to standard industry mortality tables) and withdrawal assumptions (based on the Company's experience).

Policyholder Dividends

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

For domestic property-casualty insurance, certain insurance contracts, primarily workers compensation policies, are issued with dividend plans to be paid subject to approval by the insurer's board of directors. The premium related to such policies approximated 2%, 3%, and 4% of domestic property-casualty insurance premiums written for the years ended December 31, 2009, 2008, and 2007, 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 34%, 37%, and 39% of ordinary life insurance in force for the years ended December 31, 2009, 2008, and 2007, respectively. Participating policies approximate 23%, 30%, and 33% of premium for the years ended December 31, 2009, 2008, and 2007, respectively.

Long-Term Incentive and Performance Based Incentive Plans

The Company maintains short- and long-term incentive compensation plans. Long-term plans that vest over the requisite service period and are based upon notional units are accounted for under ASC 718, *Compensation – Stock Compensation,* using the intrinsic value method. Additionally, the Company provides various performance based incentive compensation to the majority of employees meeting the participation requirements of the respective plans. Compensation cost related to these plans is determined in accordance with plan formulas and recorded over the years the employee service is provided.

Revenue Recognition

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

Reinsurance

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

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

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

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 translated at historical rates. Gains and losses from balance sheet translation 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, 2009, 2008, and 2007 were $(1), $16, and $(6), respectively. These amounts have been included in insurance operating costs and expenses in the accompanying consolidated statements of income.

Income Taxes

The income tax provision is calculated under the liability method. 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.

Service Revenues and Expenses

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

Accumulated Other Comprehensive 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, 2009, 2008, and 2007 are as follows:

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

(2) ACQUISITIONS AND DISPOSITIONS

Safeco Corporation

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

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

The opening balance sheet was as follows:

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

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

Intangible Assets

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

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

[2] In addition to amortization, as of December 31, 2009, the above table reflects a purchase accounting adjustment to other intangibles of $10.

[3] Net of accumulated amortization of $47 and $9 as of December 31, 2009 and 2008, respectively.

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

Integration Activities

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

Indiana Seguros, S.A.

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

Ohio Casualty Corporation

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

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

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The opening balance sheet was as follows:

Assets:	
Total investments	$ 4,176
Cash and cash equivalents	105
Premium and other receivables	396
Reinsurance recoverables	584
Goodwill	1,054
Other assets	608
Total assets	$ 6,923

Liabilities:	
Unpaid claims and claim adjustment expenses	$ 2,698
Unearned premiums	698
Funds held under reinsurance treaties	113
Long-term debt	207
Other liabilities	427
Total liabilities	$ 4,143

Intangible Assets

	CARRYING VALUE DECEMBER 31, 2009	CARRYING VALUE DECEMBER 31, 2008	PERIOD (YEARS)	METHOD
Agency relationship	$132	$140	20	Straight-line
Non-compete agreements	—	1	2	Straight-line
Trademarks	33	33	Not subject to amortization	Not subject to amortization
State licenses	22	22	Not subject to amortization	Not subject to amortization
Total intangible assets(1) (2) (3)	$187	$196		

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

(2) In addition to amortization, the December 31, 2008 agency relationship amount reflects a purchase accounting adjustment of $87.

(3) Net of accumulated amortization of $22 and $13 as of December 31, 2009 and 2008, respectively.

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

Integration Activities

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

Dispositions

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

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

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.

(3) INVESTMENTS

Components of Net Investment Income

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

Components of Net Realized Investment Gains (Losses)

	Years ended December 31, 2009	2008	2007
Fixed maturities			
Gross realized gains	$ 173	$ 109	$ 124
Gross realized losses	(259)	(436)	(156)
Equities			
Gross realized gains	146	341	199
Gross realized losses	(64)	(801)	(48)
Other			
Gross realized gains	84	469	338
Gross realized losses	(54)	(12)	(21)
Net realized investment gains (losses)	$ 26	$ (330)	$ 436

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

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

Components of Change in Net Unrealized Investment Gains (Losses)

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

Available for Sale Investments

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

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

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

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

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

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

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

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

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

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

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

	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES
U.S. government and agency securities	$ (6)	$ 386	$ (2)	$ 10
Residential mortgage and ABS securities	(17)	1,190	(123)	425
Commercial mortgage and ABS securities	(2)	266	(47)	464
Other mortgage and ABS securities	(7)	303	(20)	48
U.S. state and municipal	(36)	1,215	(80)	591
Corporate and other	(31)	1,395	(353)	2,607
Foreign government securities	(49)	884	(33)	150
Common stock	(3)	34	(30)	132
Preferred stock	—	—	(86)	351
Total	$ (151)	$ 5,673	$ (774)	$ 4,778

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

	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES
U.S. government and agency securities	$ (1)	$ 25	$ (1)	$ 9
Residential mortgage and ABS securities	(180)	582	(52)	218
Commercial mortgage and ABS securities	(192)	1,396	(78)	454
Other mortgage and ABS securities	(50)	394	(13)	57
U.S. state and municipal	(491)	7,287	(211)	1,311
Corporate and other	(831)	7,168	(1,035)	4,322
Foreign government securities	(35)	116	(75)	300
Common stock	(60)	238	(21)	28
Preferred stock	(29)	159	(200)	233
Total	$(1,869)	$17,365	$(1,686)	$ 6,932

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

More than 78% of the Company's securitized portfolio is explicitly backed by the U.S. government (GNMA and SBA) or by government-sponsored entities (FHLMC and FNMA). Over 95% of these holdings remain rated AAA. The commercial mortgage-backed securities portfolio is well diversified and of high quality with 95% rated AA or above.

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

Variable Interest Entities

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

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

Investments in Mortgage Loans

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

Derivatives

The Company has a Derivative Use Policy, which has been approved by the Investment Committee of each insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. Beginning in January 2008, the Company, as part of its risk management program, diversification, and economic hedging strategies, entered into several futures contracts related to the equities market with notional amounts totaling $599. All futures contracts expired in March 2008, and the Company realized gains of $26 on these transactions. In March 2008, the Company entered into an equity swap agreement with a notional amount of $600. This contract was terminated in December 2008, and the Company realized gains of $187 on this transaction. In August 2008, the Company entered into two equity swap agreements with a total notional amount of $335. For the year ended December 31, 2008, these contracts incurred a $99 net gain. These contracts expired in January 2009, resulting in realized gains of $25 for the year ended December 31, 2009.

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

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(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,		
	2009	2008	2007
Balance at beginning of year	$ 2,541	$ 2,045	$ 1,710
Acquisition costs deferred	4,787	3,991	3,455
Acquired in-force policy intangibles [1]	—	494	161
Amortization charged to income	(4,692)	(3,989)	(3,281)
Balance at end of year	$ 2,636	$ 2,541	$ 2,045

[1] 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. on January 9, 2008. For 2007, the acquired in-force policy intangible was recognized in conjunction with the Company's purchase of Ohio Casualty on August 24, 2007.

(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. Between comprehensive studies, the Company monitors asbestos activity to determine whether or not any adjustment to reserves is warranted. The Company also completed its annual study on the environmental claims liability, resulting in immaterial adjustments to held reserves.

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, 2009, 2008, and 2007. Acquisition activity in 2009 and 2008 relates to the purchase of Safeco, and acquisition activity in 2007 relates to the purchase of Ohio Casualty.

	2009	2008	2007
Gross Asbestos:			
January 1 reserves	$ 2,539	$ 2,526	$ 2,541
Acquisitions	67	224	53
Incurred activity	384	146	413
Paid activity	325	357	481
Ending reserves	$ 2,665	$ 2,539	$ 2,526
Net Asbestos:			
January 1 reserves	$ 812	$ 761	$ 872
Acquisitions	64	182	39
Incurred activity	314	18	90
Paid activity	193	149	240
Ending reserves	997	812	761
Allowance for reinsurance on unpaid losses[(1)]	174	89	87
Total unpaid losses including allowance for unpaid reinsurance	$ 1,171	$ 901	$ 848

[(1)] In 2009, the increase to the allowance for reinsurance on unpaid losses is primarily due to the completion of the third quarter asbestos study.

Included in gross asbestos incurred for 2009, 2008, and 2007 are significant amounts attributable to claims against 1985 and prior policies issued by EICOW and its affiliates, which are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of Prudential Property and Casualty Insurance Company, Prudential General Insurance Company, and Prudential Commercial Insurance Company (collectively referred to as "PruPac") included $175 and $118 of gross and net asbestos reserves, respectively. Any increase in asbestos reserves related to PruPac is reinsured by Vantage Casualty Insurance Company ("Vantage") and guaranteed by Prudential Financial, Inc. The Company had gross paid losses associated with these reserves of $0, $47, and $56 in 2009, 2008, and 2007, respectively. All 2008 and 2007 gross paid losses are recoverable from Vantage.

	2009	2008	2007
Gross Environmental:			
January 1 reserves	$ 620	$ 621	$ 585
Acquisitions	(25)	95	56
Incurred activity	50	13	57
Paid activity	118	109	77
Ending reserves	$ 527	$ 620	$ 621
Net Environmental:			
January 1 reserves	$ 495	$ 486	$ 414
Acquisitions	(25)	84	56
Incurred activity	4	(5)	64
Paid activity	65	70	48
Ending reserves	$ 409	$ 495	$ 486

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, $1, and $1 in 2009, 2008, and 2007, respectively. All 2008 and 2007 gross paid losses are recoverable from Vantage.

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(6) UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

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

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

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

Catastrophes are an inherent risk of the property-casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and financial position. 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, 2009, 2008, and 2007 were $883, $1,580, and $379, 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:

	2009	2008	2007
Balance as of January 1	$48,311	$42,531	$38,113
Less: unpaid reinsurance recoverables[1]	12,423	12,429	12,411
Net balance as of January 1	35,888	30,102	25,702
Balance attributable to dispositions and acquisitions	37	4,918	2,133
Incurred attributable to:			
Current year	19,603	18,623	15,106
Prior years:			
Asbestos and environmental	312	6	147
All other	(999)	(1,081)	(256)
Discount accretion	154	167	110
Total incurred	19,070	17,715	15,107
Paid attributable to:			
Current year	9,583	9,064	7,176
Prior years	9,385	7,567	5,969
Total paid	18,968	16,631	13,145
Amortization of deferred retroactive reinsurance gain	74	82	83
Net adjustment due to foreign exchange	202	(298)	222
Add: unpaid reinsurance recoverables[1]	12,052	12,423	12,429
Balance as of December 31	$48,355	$48,311	$42,531

[1] 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 $2,067, $2,111, and $2,166 as of December 31, 2009, 2008, and 2007, respectively.

Incurred attributable to prior years, excluding asbestos and environmental, includes $74, $82, and $83 of amortization of deferred retroactive gain in the years ended December 31, 2009, 2008, and 2007, respectively. 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. In 2007, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is due to favorable trends in personal auto and commercial multiple peril, partially offset by reserve increase for workers compensation. This development in workers compensation is composed of unfavorable development caused by higher than expected severity, partially offset by favorable development due to the impact of Florida reform.

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, 2009 and 2008, the Company held $4,384 and $4,612, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of $495 and $566 as of December 31, 2009 and 2008, respectively. For the years ended December 31, 2009, 2008, and 2007, the Company recognized a decrease in premium income of $85, $77, and $105, respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of $994 and $956 as of December 31, 2009 and 2008, respectively.

As of December 31, 2009 and 2008, the reserve for unpaid claim reserves was reduced by $4,784 and $4,690, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were $228 and $231 as of December 31, 2009 and 2008, 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:

	2009		2008		2007	
	WRITTEN	EARNED	WRITTEN	EARNED	WRITTEN	EARNED
Direct	$31,647	$31,441	$28,635	$28,309	$24,844	$24,250
Assumed	1,606	1,657	1,640	1,642	1,320	1,375
Ceded[1]	4,995	5,307	4,808	4,427	3,626	3,738
Net premiums	$28,258	$27,791	$25,467	$25,524	$22,538	$21,887

[1] The Company, through its domestic insurance subsidiaries, entered into homeowners quota share reinsurance contracts on a written premium basis effective December 31, 2009, ceding 30.0% of its Personal Markets' homeowners premium and effective December 31, 2008, ceding 31.725% of total U.S. homeowners premium.

The following table summarizes the Company's reinsurance recoverables by reinsurers' Standard & Poor's ("S&P") rating (or the rating of any guarantor) as of December 31, 2009.

S&P RATING	REINSURANCE RECOVERABLES	COLLATERAL HELD	NET RECOVERABLES[2]
AAA	$ 1,055	$ 648	$ 407
AA+, AA, AA-	1,702	590	1,189
A+, A, A-	6,430	1,511	5,242
BBB+, BBB, BBB-	11	2	9
BB+ or below	5	—	5
Involuntary pools	3,033	6	3,027
Voluntary pools	377	69	308
Other[1]	2,570	2,948	710
Gross recoverables	15,183	5,774	10,897
Less: allowance	434	—	—
Net recoverables	$14,749	$ 5,774	$10,897

[1] Includes $963 and $1,607 of recoverables from non-rated reinsurers and captive and program business, respectively.

[2] 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 $1,725 and $1,995 as of December 31, 2009 and 2008, 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 $1,499, $499, $482, and $413, respectively, as of December 31, 2009, 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, 2009 and 2008, deferred gains related to these reinsurance arrangements were $592 and $620, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the years ended December 31, 2009, 2008, and 2007 was $117, $115, and $114, respectively. Deferred gain amortization was $72, $77, and $57 for the years ended December 31, 2009, 2008, and 2007, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2,019 and $2,060 as of December 31, 2009 and 2008, respectively.

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

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

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. 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 $1,757 for 2010. 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, 2009 and 2008 includes the following:

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

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

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

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

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

Short-term and current maturities of long-term debt

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

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

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

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

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

Long-term debt excluding current maturities

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

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

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

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

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

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

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

Interest

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

(9) INCOME TAXES

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

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

	YEARS ENDED DECEMBER 31,		
	2009	2008	2007
Current tax expense (benefit):			
United States Federal	$ 143	$ 220	$ 411
United States Federal benefit of net operating losses	(27)	—	—
State	6	1	—
Foreign	112	117	100
Total current tax expense	234	338	511
Deferred tax expense (benefit):			
United States Federal	(79)	(241)	130
Foreign	32	43	30
Total deferred tax (benefit) expense	(47)	(198)	160
Total Federal, state and foreign income tax expense	$ 187	$ 140	$ 671

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,		
	2009	2008	2007
Expected Federal income tax expense	$ 423	$ 439	$ 760
Tax effect of:			
Nontaxable investment income	(191)	(155)	(110)
Change in valuation allowance	4	15	—
Goodwill	(15)	(13)	(15)
Tax litigation	(1)	(76)	(19)
Revision to estimates	—	(24)	3
State	6	1	—
Foreign	(27)	(84)	(22)
Other	(12)	37	74
Actual income tax expense	$ 187	$ 140	$ 671

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

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

	2009	2008
Deferred tax assets:		
Unpaid claims discount	$ 601	$ 615
Unearned premium reserves	724	721
Net operating losses	172	266
Employee benefits	930	1,011
Retroactive reinsurance deferred gain	217	225
Credits	133	83
Net unrealized losses and other – than – temporary impairments	—	880
Other	907	581
	3,684	4,382
Less: valuation allowance	(160)	(131)
Total deferred tax assets	3,524	4,251
Deferred tax liabilities:		
Deferred acquisition costs	694	665
Net unrealized gains	471	—
Intangibles	297	392
Other	371	159
Total deferred tax liabilities	1,833	1,216
Net deferred tax assets	$ 1,691	$ 3,035

The increase in the valuation allowance is primarily due to foreign currency translation adjustments. 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 net operating loss carry forwards of $492, alternative minimum tax credit carry forwards of $51, and foreign tax credit carry forwards of $68 as of December 31, 2009. 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:

2010	$ 3
2011	14
2012	24
2013	29
2014	38
Thereafter	384
Total	$492

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

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the U.S. where such earnings are permanently reinvested. As of December 31, 2009, unremitted earnings of foreign subsidiaries were $1,372. 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 January 1, 2007[1]	$ 194
Additions based on tax positions related to the current year	1
Additions for tax positions of prior years	34
Reductions for tax positions of prior years	(12)
Settlement	(11)
Increases in unrecognized tax benefits acquired or assumed in a business combination	15
Balance as of December 31, 2008	221
Additions based on tax positions related to the current year	16
Additions for tax positions of prior years	7
Reductions for tax positions of prior years	(22)
Settlements	(1)
Balance as of December 31, 2009	$ 221

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

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

Included in the December 31, 2009 balances above are $119 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal, state, and foreign income tax expense. During the years ended December 31, 2009, 2008, and 2007, the Company recognized approximately $18, $8, and $10 in interest and penalties. The Company had approximately $82 and $66 of interest and penalties accrued as of December 31, 2009 and 2008, respectively.

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 Standard and Poor's 500 Index. As of December 31, 2009 and 2008, assets of the plans totaling $3,393 and $2,893, 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 2009, 2008, and 2007, employees could contribute a percentage of their annual compensation on a before and after-tax basis, subject to Federal limitations. The benefits are based on the employee's contribution amount and Company profitability. In 2009, 2008, and 2007, the Company made matching contributions of $162, $156, and $128, respectively, including the supplemental defined contribution plans. The increases in 2009 and 2008 were primarily due to the Safeco and Ohio Casualty acquisitions.

Compensation expense related to the Company's long-term and short-term incentive compensation plans was $434, $387, and $557 for the years ended December 31, 2009, 2008, and 2007, respectively.

The following table sets forth the assets, obligations, and assumptions associated with the various U.S., Canadian, and certain foreign subsidiary pension and postretirement benefits. The amounts are recognized in the accompanying consolidated balance sheets as of December 31, 2009 and 2008, and consolidated statements of income for the years ended December 31, 2009, 2008, and 2007.

	PENSION		SUPPLEMENTAL PENSION		POST-RETIREMENT	
	2009	2008	2009	2008	2009	2008
Change in benefit obligations:						
Benefit obligation at beginning of year	$ 4,634	$ 3,839	$ 324	$ 238	$ 781	$ 554
Service costs	200	142	12	10	28	22
Interest costs	278	251	19	15	46	40
Amendments	—	—	—	—	10	—
Actuarial (gains) losses	(32)	425	(2)	69	(31)	56
Currency exchange rate change	11	(32)	—	(1)	—	(1)
Acquisitions	—	164	—	11	—	80
Benefits paid	(185)	(156)	(25)	(18)	(31)	(33)
Employee contributions	1	1	—	—	—	—
Other	—	—	—	—	—	63
Benefit obligations at end of year	$ 4,907	$ 4,634	$ 328	$ 324	$ 803	$ 781
Accumulated benefit obligations	$ 4,251	$ 4,029	$ 283	$ 278	$ 803	$ 781
Change in plan assets:						
Fair value of plan assets at beginning of year	$ 3,141	$ 3,696	$ —	$ —	$ 3	$ 17
Actual return on plan assets	472	(542)	—	—	—	(2)
Currency exchange rate change	10	(22)	—	—	—	—
Acquisitions	—	158	—	—	—	—
Employer contribution	201	5	—	—	—	21
Benefits paid	(185)	(156)	—	—	(3)	(33)
Other	1	2	—	—	—	—
Fair value of plan assets at end of year	$ 3,640	$ 3,141	$ —	$ —	$ —	$ 3
Funded status of Plan	$(1,267)	$(1,493)	$(328)	$(324)	$(803)	$(778)

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	Pension		Supplemental Pension		Post-retirement	
	2009	2008	2009	2008	2009	2008
Amounts recognized in the Statement of Financial Position:						
Noncurrent assets	$ 3	$ 3	$ —	$ —	$ —	$ —
Current liabilities	(35)	(1)	(14)	(21)	(37)	(31)
Noncurrent liabilities	(1,235)	(1,495)	(314)	(303)	(766)	(747)
Net liability at end of year	$(1,267)	$(1,493)	$(328)	$(324)	$(803)	$(778)
Amounts recognized in Accumulated Other Comprehensive Loss (Income):						
Net loss (gain)	$ 1,272	$ 1,581	$ 124	$ 136	$ (46)	$ (13)
Prior service costs	34	40	6	8	(16)	(29)
Net transition (asset) liability	(8)	(12)	—	—	60	68
Total	$ 1,298	$ 1,609	$ 130	$ 144	$ (2)	$ 26
Other changes in Plan assets and projected benefit obligation recognized in Other Comprehensive (Income) Loss:						
Net actuarial (gain) loss	$ (253)	$ 1,234	$ (2)	$ 69	$ (30)	$ 59
Currency exchange rate change	1	(1)	—	—	—	—
Amortization of net actuarial (gain) loss	(58)	(11)	(10)	(5)	(2)	2
Prior service costs	—	—	—	—	10	—
Amortization of prior service cost	(6)	(6)	(2)	(3)	3	3
Amortization of transition obligation	5	5	—	—	(9)	(9)
Total	$ (311)	$ 1,221	$ (14)	$ 61	$ (28)	$ 55

The amounts recognized in accumulated other comprehensive (income) loss in 2009 include a $68 deferred tax 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 2010 fiscal year are $78, $8, and $(6), respectively for pension and supplemental plans and $1, $(2), and $9, respectively, for retiree welfare plans.

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

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

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

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

The measurement date used to determine pension and other postretirement measurements is December 31, 2009.

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

	December 31,	
	2009	2008
Pension		
Discount rate	6.15%	6.00%
Rate of compensation increase	4.70%	4.70%
Supplemental Pension		
Discount rate	6.15%	6.00%
Rate of compensation increase	4.90%	4.90%
Postretirement		
Discount rate	6.15%	6.00%

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

	December 31,		
	2009	2008	2007
Pension			
Discount rate	6.00%	6.50%	6.00%
Expected return on plan assets	6.75%	7.50%	7.50%
Rate of compensation increase	4.70%	4.70%	4.70%
Supplemental Pension			
Discount rate	6.00%	6.50%	6.00%
Rate of compensation increase	4.90%	4.90%	4.90%
Postretirement			
Discount rate	6.00%	6.50%	6.00%
Expected return on plan assets	7.15%	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. In 2009, the yield curve was developed from a December 31, 2009 Hewitt Top Quartile Yield Curve. 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. The equivalent single discount rate was then rounded to the nearest 5 basis points. In 2008 and 2007, the yield curve was developed from the December 31, 2008 and 2007 Citigroup Pension Discount Curve. 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. The equivalent single discount rate was then rounded to the nearest 25 basis points.

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 8.0% in 2010 graded down to 5.5% in 2016. Healthcare cost trend rate assumptions have a material impact on the postretirement benefit obligation. A one-percentage point change in assumed healthcare cost trend rates would have the following effects:

	1% Point Increase	1% Point Decrease
Effect on Postretirement Benefit Obligation	$ 89	$(69)
Effect on total service and interest costs	$ 11	$ (8)

Plan Assets

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

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

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

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

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

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

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

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

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

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

Other equities – Represents other foreign equities.

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

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

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

	FAIR VALUE MEASUREMENTS AS OF DECEMBER 31, 2009			
ASSET CATEGORY	TOTAL	QUOTED PRICES IN ACTIVE MARKET FOR IDENTICAL ASSETS LEVEL 1[1]	SIGNIFICANT OBSERVABLE INPUTS LEVEL 2[1]	SIGNIFICANT UNOBSERVABLE INPUTS LEVEL 3[1]
Cash, cash equivalents and short-term investments	$ 465	$ 465	$ —	$ —
Bonds:				
U.S. government and agencies	301	292	9	—
RMBS/CMO/ABS/CMBS	945	—	945	—
Corporate and other	853	23	830	—
U.S. large cap equities	513	513	—	—
U.S. mid and small cap equities	122	122	—	—
European equities	153	150	—	3
Asian equities	184	184	—	—
Other equities	19	12	3	4
Private equity investments	83	—	—	83
Real estate investments	2	—	—	2
Total	$3,640	$1,761	$1,787	$ 92

[1] See Note 11 for descriptions of the three levels of fair value presentation.

	FAIR VALUE MEASUREMENTS USING SIGNIFICANT UNOBSERVABLE INPUT (LEVEL 3)				
	EUROPEAN EQUITIES	PRIVATE EQUITY	REAL ESTATE	OTHER EQUITIES	TOTAL
Beginning balance as of December 31, 2008	$ 2	$ 95	$ 2	$ 4	$103
Actual return on plan assets:					
Relating to assets still held at the reporting date	—	(15)	—	—	(15)
Relating to assets sold during the year	—	5	—	—	5
Purchases, sales & settlements	1	(2)	—	—	(1)
Transfers in/(out) of Level 3	—	—	—	—	—
Balance as of December 31, 2009	$ 3	$ 83	$ 2	$ 4	$ 92

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

Cash Flows

Contributions

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

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

Expected Future Benefit Payments

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

	PENSION	SUPPLEMENTAL PENSION	POST-RETIREMENT WELFARE PLANS	POST-RETIREMENT MEDICARE SUBSIDY
2010[1]	$ 326	$ 14	$ 42	$ (5)
2011	178	12	44	(5)
2012	186	77	45	(6)
2013	197	14	46	(7)
2014	211	17	48	(7)
2015–2019	1,343	112	268	(47)

[1] The increase in the 2010 pension benefit payment amount is driven by the expected final distributions from the Safeco Cash Balance Plan.

(11) FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820 establishes a framework for measuring fair value and disclosures about fair value measurements. It provides guidance on how to measure fair value when required under existing accounting standards and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the Company's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Certain derivatives recorded at fair value are impacted by the application of this guidance. The Company has variable annuity contracts containing embedded derivatives.

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

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

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

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

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

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

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

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

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

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

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

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

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

Notes to Consolidated Financial Statements (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

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

For the years ended December 31, 2009, 2008, and 2007, there were impairments of $22, $29, and $40, respectively, recognized for items measured at fair value on a nonrecurring basis (principally direct investments in oil and gas production ventures, which are based on independent external studies). Impairment charges for the above are reflected in insurance operating costs and expenses in the consolidated statements of income.

The fair values and carrying values of the Company's financial instruments excluded from ASC 820 as of December 31, 2009 and 2008, are as follows:

	2009		2008	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Other investments	$2,493	$2,493	$2,569	$2,569
Mortgage loans	1,121	1,062	1,090	1,054
Cash and cash equivalents	4,847	4,847	5,848	5,848
Individual and group annuities	2,079	2,280	1,963	1,998
Debt	5,940	5,728	6,089	3,956

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, which approximates cost, where market value data is unavailable for the underlying investment.

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

Cash 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, 2009 and 2008. Also included are variable investment-type insurance contracts, for which carrying value approximates fair value as of December 31, 2009 and 2008.

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, 2009 and 2008.

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.

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

The Company leases certain office facilities and equipment under operating leases expiring in various years through 2024. Rental expense amounted to $280, $224, and $215 for the years ended December 31, 2009, 2008, and 2007, 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 $28, $30, and $35 for the years ended December 31, 2009, 2008, and 2007, 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
2010	$ 180	$ 1	$ 30	$ 151
2011	154	1	23	132
2012	112	1	20	93
2013	74	1	20	55
2014	60	1	16	45
2015 – 2034	115	21	35	101
2035 – 2054	—	20	—	20
2055 – 2102	—	94	—	94
Total	$ 695	$ 140	$ 144	$ 691

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

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

As of December 31, 2009, the Company had $648 of undrawn letters of credit outstanding secured by assets of $947.

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, 2009 and 2008, the liability balance was $291 and $313, respectively. As of December 31, 2009 and 2008, included in other assets were $12 and $10, 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 $1,627, 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. $176 is held in trust as of December 31, 2009. 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 $14,704 and $12,330 as of December 31, 2009 and 2008, respectively. The Company's domestic insurance subsidiaries prepare the statutory basis financial statements in accordance with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual ("NAIC APP"), subject to any deviations prescribed or permitted by the insurance commissioners of the various insurance companies' states of domicile. The Company does not have any material permitted practices that deviate from the NAIC APP.

Dividends

The insurance subsidiaries' ability to pay dividends is restricted under applicable insurance law and regulations. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Under the insurance laws of Wisconsin, the domiciliary state of Liberty Mutual Fire Insurance Company ("LMFIC") and EICOW, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC, and EICOW could negatively affect LMGI's ability to pay principal and interest on the notes held at LMGI, as could a redomestication, merger, or consolidation of LMIC, LMFIC, or EICOW to a different domiciliary state. The maximum dividend payout in 2010 that may be made prior to regulatory approval is $1,464.

(14) SUBSEQUENT EVENTS

Management has assessed material subsequent events through March 5, 2010, the date the financial statements were available to be issued.

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

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, 2009 and 2008, 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, 2009. 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, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, 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 and for the discounting of the long-term indemnity portion of workers compensation claims. In 2008, the Company changed its method of accounting and reporting for deferred compensation and postretirement benefit aspects of split dollar life insurance arrangements and, in 2007, changed its method of accounting and reporting for defined benefit pension and other postretirement plans.

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, 2009, 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 5, 2010 expressed an unqualified opinion thereon.

Ernst + Young LLP

Boston, Massachusetts
March 5, 2010

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 or 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, 2009, 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, 2009.

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

Edmund F. Kelly

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

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, 2009, 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, 2009, 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, 2009 and 2008, 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, 2009 and our report dated March 5, 2010 expressed and unqualified opinion thereon.

Ernst + Young LLP

Boston, Massachusetts
March 5, 2010

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New York, New York

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Chief Operating Officer
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Michael J. Abdallah
Regional President
Asia Pacific

David A. Cohen
President
U.S. Global

Mike Molony
Regional President
Canada

Sean Rocks
Regional President
Europe

Nick Metcalf
Chief Executive Officer
Liberty Syndicate Management

Annual Meeting

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

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

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