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

Quarter Ended March 31, 2006

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

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three months ended March 31, 2006 and 2005. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2005 Annual Report, First Quarter 2006 Consolidated Financial Statements (unaudited) and First Quarter 2006 Financial Supplement located on the Company's Investor Relations web site at www.libertymutual.com/investors. The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

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Cautionary Statement Regarding Forward-Looking Statements

This report contains forward-looking statements that are intended to enhance the reader's ability to assess the Company's future financial and business performance. Forward-looking statements include, but are not limited to, statements that represent the Company's beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "may," "expects," "should," "believes," "anticipates," "estimates," "intends" or similar expressions. Because these forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond the Company's control or are subject to change, actual results could be materially different.

In particular, the sufficiency of the Company's reserves for (i) asbestos, (ii) environmental, and (iii) toxic tort (i.e., claims that arise primarily from exposure to chemical or other hazardous substances, including welding rod and silica related claims ((i), (ii), and (iii) together "A&E"), as well as its results of operations, financial condition and liquidity, to the extent impacted by the sufficiency of the Company's A&E reserves, are subject to a number of potential adverse developments including adverse developments involving A&E claims and the related level and outcome of litigation, the willingness of parties, including the Company, to settle disputes, the interpretation of aggregate policy coverage limits, the Company's ability to recover reinsurance for A&E and other claims, the legal, economic, regulatory, and legislative environments, and their impact on the future development of A&E claims, and the impact of bankruptcies of various asbestos producers and related peripheral businesses.

Some of the other factors that could cause actual results to differ include, but are not limited to, the following: the Company's inability to obtain price increases due to competition or otherwise; the performance of the Company's investment portfolios, which could be adversely impacted by unanticipated developments in U.S. and global financial markets, interest rates and rates of inflation; weakening U.S. and global economic conditions; insufficiency of, or changes in, loss reserves; the occurrence of catastrophic events, both natural and man-made, including terrorist acts, with a severity or frequency exceeding the Company's expectations; exposure to, and adverse developments involving, environmental claims and related litigation; the impact of claims related to exposure to potentially harmful products or substances, including, but not limited to, lead paint, silica and other potentially harmful substances; adverse changes in loss cost trends, including inflationary pressures in medical costs and auto and home repair costs; developments relating to coverage and liability for mold claims; the effects of corporate bankruptcies on surety bond claims; adverse developments in the cost, availability and/or ability to collect reinsurance; the ability of the Company's subsidiaries to pay dividends to the Company; adverse results or other consequences from legal proceedings; the impact of regulatory investigations or reforms, including governmental actions regarding the compensation of brokers and agents and the purchase and sale of nontraditional products and related disclosures; unusual loss activity resulting from adverse weather conditions, including storms, hurricanes, hail, snowfall and winter conditions; repatriation of foreign earnings; judicial expansion of policy coverage and the impact of new theories of liability; the impact of legislative actions, including Federal and state legislation related to asbestos liability reform; larger than expected assessments for guaranty funds and mandatory pooling arrangements; a downgrade in the Company's claims-paying and financial strength ratings; the loss or significant restriction on the Company's ability to use credit scoring in the pricing and underwriting of Personal Lines policies; and amendments and changes to the risk-based capital requirements. The Company's forward-looking statements speak only as of the date of this report or as of the date they are made and should be regarded solely as the Company's current plans, estimates and beliefs. For a detailed discussion of these and other cautionary statements, visit the Company's Investor Relations web site at www.libertymutual.com/investors. The Company undertakes no obligation to update these forward-looking statements.

EXECUTIVE SUMMARY

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

Three Months Ended March 31, 2006 - Consolidated Results of Operations

- Revenues for the three months ended March 31, 2006 were $5.448 billion, an increase of $477 million or 9.6% over the same period in 2005.

- Pre-tax income for the three months ended March 31, 2006 was $404 million, a decrease of $1 million from the same period in 2005.

- Net income for the three months ended March 31, 2006 was $292 million, a decrease of $104 million or 26.3% from the same period in 2005.

- Cash flow from operations for the three months ended March 31, 2006 was $498 million, a decrease of $360 million or 42.0% from the same period in 2005.

- The combined ratio before catastrophes[1], net incurred losses attributable to prior years[2] and discount accretion for the three months ended March 31, 2006 was 96.1%, a decrease of 0.8 points from the same period in 2005. Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the Company's combined ratio increased 1.0 point over 2005 to 100.1% in 2006.

Financial Condition as of March 31, 2006

- Total assets increased to $81.177 billion as of March 31, 2006, an increase of $2.353 billion or 3.0% over December 31, 2005.

- Policyholders' equity was $8.792 billion as of March 31, 2006, a decrease of $66 million or 0.7% from December 31, 2005.

- After-tax net unrealized gains on fixed maturities and equity securities, as of March 31, 2006 were $355 million, a decrease of $414 million or 53.8% from December 31, 2005.

- Statutory surplus as regards policyholders for the combined operations of Liberty Mutual Insurance Company ("LMIC") and its U.S. affiliates was $10.096 billion, an increase of $227 million or 2.3% over December 31, 2005.

- The consolidated debt-to-capital ratio including accumulated other comprehensive income ("AOCI") as of March 31, 2006 was 23.8%, an increase of 0.4 points over December 31, 2005. Excluding AOCI, the consolidated debt-to-capital ratio was 23.8%, a decrease of 0.4 points from December 31, 2005.

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[1] Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, hurricanes Charley, Frances, Ivan and Jeanne ("2004 hurricanes") hurricanes Katrina, Rita and Wilma ("2005 hurricanes"). Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums. After-tax amounts are presented net of a 35% marginal tax rate. All tables within this document conform to this presentation.

[2] Net incurred losses attributable to prior years is defined as incurred losses attributable to prior years (excluding prior year losses related to natural catastrophes and the events of September 11, 2001) including both earned premium attributable to prior years and amortization of retroactive reinsurance gains and excluding discount accretion.

Other 2006 1st Quarter Highlights

Real Estate Transaction

- On January 9, 2006, the Company completed the purchase of a commercial office building for approximately $482 million. The Company currently occupies approximately 16% of the office space.

Rating Actions

- On January 25, 2006, A.M. Best Co. affirmed the A (Excellent) financial strength rating of LMIC and its related property/casualty companies and upgraded the financial strength rating of Liberty Life Assurance Company of Boston to A (Excellent) from A- (Excellent). The outlook for all these ratings remains stable.

Other

Legal and Regulatory Matters

- The Company has received subpoenas and other requests for information from insurance, governmental and enforcement authorities as part of the on-going investigation of the insurance industry. As the sixth largest property and casualty insurer in the United States based on 2004 direct written premium, the Company expects that it may receive additional subpoenas or requests for information and be named in additional civil suits as the industry investigations continue.

Rating Actions

- On May 2, 2006, Moody's Investor Service affirmed the long-term ratings of Liberty Mutual Group, Inc. ("LMGI") and its subsidiaries and revised the outlook on the Company's long-term ratings to stable from negative.

CONSOLIDATED RESULTS OF OPERATIONS

The Company has identified consolidated pre-tax operating income ("PTOI") and net written premium as non-GAAP financial measures. PTOI is defined by the Company as net income excluding net realized gains (losses), Federal and foreign income taxes, extraordinary items, discontinued operations and cumulative effects of changes in accounting principles. PTOI is considered by the Company to be an appropriate indicator of underwriting and operating results and is consistent with the way the Company internally evaluates performance, except that limited partnership results recognized on the equity method are not included in internal PTOI. Net realized investment gains (losses) are significantly impacted by both discretionary and economic factors and are not necessarily indicative of operating results. Federal and foreign income taxes are significantly impacted by permanent differences and valuation allowances. References to "direct written premium" represent the amount of premium recorded for policies issued during a fiscal period excluding assumed reinsurance and ignoring the effects of ceded reinsurance. References to "net written premium" represent the amount of premium recorded for policies issued during a fiscal period including audits, retrospectively rated premium related to loss sensitive policies, and assumed premium, less ceded premium. Assumed and ceded reinsurance premiums include premium adjustments for reinstatement of coverage when a loss has used some portion of the reinsurance provided, generally under catastrophe treaties ("reinstatement premium"). In addition, the majority of workers compensation premium is adjusted to the "booked as billed" method through the Corporate & Other segment. "Premium earned," which is the portion of premium that applies to the expired part of the policy period, is a GAAP measure. The Company believes that net written premium is a performance measure useful to investors as it generally reflects current trends in the Company's sale of property and casualty insurance products.

The Company's discussions related to net income are presented on an after-tax GAAP basis. All other discussions are presented on a pre-tax GAAP basis, unless otherwise noted.

Effective January 1, 2006, the Company changed its methodology for allocation of corporate expenses and investment income. The effects of the change are immaterial to the results of the Strategic Business Units ("SBUs"). Prior period results have not been restated.

(1) Overview – Consolidated

Consolidated net written premium by significant line of business was as follows:

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Workers compensation	$1,440	$1,242	15.9%
Private passenger automobile	1,317	1,279	3.0
Commercial multiple peril / Fire	389	337	15.4
LIU[1] reinsurance	384	271	41.7
Homeowners	352	326	8.0
Commercial automobile	285	289	(1.4)
International local businesses [2]	285	253	12.6
General liability	196	188	4.3
LIU[1] first party [3]	125	74	68.9
LIU[1] third party[3]	110	94	17.0
Group disability	98	85	15.3
Surety	57	47	21.3
Assumed voluntary reinsurance	19	27	(29.6)
Other	253	145	74.5
Total net written premium	$5,310	$4,657	14.0%

1 Liberty International Underwriters (LIU).
2 Local international businesses, selling small commercial and other personal lines products locally; excluding private passenger automobile.
3 In the first quarter of 2006, LIU reclassified its inland marine specialty business to LIU first party from LIU third party.

Consolidated net written premium by strategic business unit was as follows:

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Personal Market	$1,195	$1,161	2.9%
Commercial Markets[1]	1,194	1,057	13.0
Agency Markets [1]	1,585	1,487	6.6
International	1,274	1,011	26.0
Corporate and Other[2]	62	(59)	NM
Total net written premium	$5,310	$4,657	14.0%

1 Effective July 2, 2005, the results of Wausau and Surety (formerly included Commercial Markets) are included in Agency Markets due to an organizational change. Prior periods have been restated to reflect this change.

2 Includes Individual Life operations.

Net written premium for the three months ended March 31, 2006 was $5.310 billion, an increase of $653 million or 14.0% over the same period in 2005. Significant changes by major line of business include:

- Workers compensation net written premium increased $198 million or 15.9% over the same period in 2005. The increase reflects new business growth and higher retention of expiring Commercial Market accounts, higher involuntary workers compensation premium due to the non-renewal of a ceded reinsurance program in 2006, exposure growth in Agency Markets' Wausau and Summit operations, and new business growth in Agency Markets' Regional Companies segment. Partially offsetting these increases is a more competitive rate environment and Florida state mandated rate decreases.
- Private passenger automobile net written premium increased $38 million or 3.0% over the same period in 2005. The increase is primarily due to organic growth in International's local businesses operations in Latin America, partially offset by a decrease in Agency Markets private passenger automobile business due primarily to a decrease in retention levels and new business activity.
- Commercial multiple peril / fire net written premium increased $52 million or 15.4% over the same period in 2005. The increase primarily reflects new business growth, higher retention and rate increases in Commercial Markets' LM Property segment and new business growth in Agency Markets.
- LIU reinsurance increased $113 million or 41.7% over the same period in 2005, primarily due to rate increases on property business.
- Homeowners net written premium increased $26 million or 8.0% over the same period in 2005 due primarily to a combination of new business growth and rate increases in the Company's Personal Market strategic business unit. Partially offsetting this increase was a decrease in retention and new business in the Company's Agency Markets' strategic business unit.
- International local businesses net written premium, excluding private passenger automobile net written premium, increased $32 million or 12.6% over the same period in 2005. The increase is the result of organic growth in Latin America.
- LIU first party net written premium increased $51 million or 68.9% primarily due to the establishment of an inland marine specialty program in the third quarter of 2005.
- Other net written premium increased $108 million or 74.5%, primarily because of growth in the immediate annuity and structured settlement lines.

More detailed explanations of the changes in net written premium by line of business are included in the related discussion of financial results for each strategic business unit.

For a fuller description of the Company's business operations, products and distribution channels, please visit the Company's Investor Relations web site at www.libertymutual.com/investors.

Results of Operations – Consolidated

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Revenues	$5,448	$4,971	9.6%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$554	$476	16.4%
Catastrophes[1]:			
- 2005 hurricanes	(24)	-	NM
- All other	(75)	(37)	102.7
Net incurred losses attributable to prior years:			
- Asbestos	(1)	-	NM
- All other[2]	(47)	(26)	80.8
Discount accretion[3]	(28)	(29)	(3.4)
Pre-tax operating income	379	384	(1.3)
Realized investment gains, net	25	21	19.0
Federal and foreign income tax expense	(112)	-	NM
Discontinued operations, net of tax	-	(9)	100.0
Net income	$292	$396	(26.3%)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 hurricanes and the 2005 hurricanes. Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of $16 million and $8 million for the three months ended March 31, 2006 and 2005, respectively. Net of amortization of deferred gains on retroactive reinsurance of $16 million and $12 million for the three months ended March 31, 2006 and 2005, respectively.

3 The Company discounts the long-term indemnity portion of its workers compensation claims as permitted by insurance regulations. The discount accretion on these claims is included in underwriting results as the loss reserves for voluntary and involuntary business accrete to nominal value. Asbestos structured settlements are discounted at 4.5%.

NM = Not Meaningful (represents increases or decreases greater than 200%, or changes from a net gain to a net loss, or vice versa).

Revenues for the three months ended March 31, 2006 were $5.448 billion, an increase of $477 million or 9.6% over the same period in 2005. The major components of revenues include net premium earned, net investment income, net realized investment gains/losses and fee and other revenues.

Net premium earned for the three months ended March 31, 2006 was $4.666 billion, an increase of $461 million or 11.0% over the same period in 2005. The increase reflects new business growth and higher retention levels across the Company's major lines of business, partially offset by a more competitive rate environment.

Net investment income for the three months ended March 31, 2006 was $560 million, a $5 million or 0.9% increase over the same period in 2005. The increase in net investment income reflects higher interest income due to a larger invested asset base and cash flow from operations. Partially offsetting these increases was a decrease in dividend income resulting from the termination of an equity investment program and a decrease in limited partnership income related to private equity investments. The Company's lower overall domestic book yield, due in part to the increased investment in tax-exempt securities in the second half of 2005 and continuing into 2006, was the primary factor constraining overall growth in investment income compared to 2005.

Net realized investment gains for the three months ended March 31, 2006 were $25 million, an increase of $4 million or 19.0% over the same period in 2005. The increase reflects a $27 million increase in equity gains due to the sale of international investments, the sale of securities distributed from private equity partnerships and a decrease in trading portfolio losses. These increases were partially offset by a $14 million increase in losses, primarily associated with the Company's recognition of impairments on securities previously anticipated to be held to recovery.

Fee and other revenues for the three months ended March 31, 2006 were $197 million, an increase of $7 million or 3.7% over the same period in 2005. The increase is primarily due to lease income earned from a commercial office building that was acquired in January 2006. Partially offsetting the increase was a decrease in fee revenue associated with Commercial Markets' servicing carrier operation.

Claims, benefits and expenses for the three months ended March 31, 2006 were $5.044 billion, an increase of $478 million or 10.5% over the same period in 2005. The increase primarily reflects business growth across the Company's major lines of business, a $63 million increase in catastrophe losses, a $29 million increase in incurred losses attributable to prior years and general cost increases[1]. The increase in incurred losses attributable to prior years is primarily due to International's local businesses operations. Partially offsetting these is a decrease in variable incentive compensation.

	Three Months Ended March 31,		
			Change
CONSOLIDATED	**2006**	**2005**	**(Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion			
Claims and claim adjustment expense ratio	69.1%	69.5%	(0.4)
Underwriting expense ratio	26.6	27.3	(0.7)
Dividend ratio	0.4	0.1	0.3
Subtotal	96.1	96.9	(0.8)
Catastrophes[1]			
- 2005 hurricanes	0.5	-	0.5
- All other	1.9	0.9	1.0
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	1.0	0.6	0.4
Discount accretion	0.6	0.7	(0.1)
Total combined ratio[2]	100.1%	99.1%	1.0

[1] The Company does not typically identify catastrophe losses from assumed voluntary reinsurance and Lloyd's Syndicate 4472 in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the 2004 hurricanes, 2005 hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been classified as catastrophes. Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

[2] The combined claim and expense ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined claim and expense ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less fee income (primarily related to the Company's involuntary market servicing carrier operations) and less installment charges; and the ratio of policyholder dividends to earned premium. Provisions for uncollectible premium and reinsurance are not included in the combined ratio.

The consolidated combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the three months ended March 31, 2006 was 96.1%, a decrease of 0.8 points from the same period in 2005. The decrease reflects a lower expense ratio due to a decrease in variable incentive compensation and other benefit costs and an increase in the percentage mix of International's inland marine specialty program business which has a lower expense ratio than the Company's other lines of business. Partially offsetting these decreases in the expense ratio was an increase in Personal Market's acquisition expense related to higher commissions and an increase in direct sales and service personnel costs. The claims and claim adjustment expense ratio decreased 0.4 points due primarily to lower loss frequency in the

[1] Incurred losses attributable to prior years is defined as net incurred losses attributable to prior years (excluding natural catastrophes and the events of September 11, 2001), excluding earned premium attributable to prior years and including discount accretion and amortization of retroactive reinsurance gains.

auto and homeowners lines of business (excluding catastrophes), as well as improved profitability in the LIU Reinsurance segment. Partially offsetting these decreases in the claims and claim adjustment expense ratio was the aforementioned increase in the percentage mix of International's inland marine specialty program business, which has a higher claims and claim adjustment expense ratio than the Company's other lines of business. The increase in the dividend ratio reflects Commercial Markets' recoupment of a previously paid dividend and Agency Markets' one-time reduction in its dividend reserve, both of which occurred in 2005 and did not recur in 2006.

Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the total combined ratio was 100.1%, an increase of 1.0 point over the same period in 2005. Catastrophe losses increased 1.5 points in the quarter primarily due to 2006 Midwest storm activity. Additionally, net incurred losses attributable to prior years increased 0.4 points over the same period in 2005, primarily related to reserve development of International local businesses operations.

PTOI for the three months ended March 31, 2006 was $379 million, a decrease of $5 million or 1.3% from the same period in 2005.

Federal and foreign income tax expense for the three months ended March 31, 2006 was $112 million, an increase of $112 million over the same period in 2005. The Company's effective tax rate for the three months ended March 31, 2006 was 27.8%, compared to 0.0% in the same period of 2005. The change in the effective rates in the two periods resulted primarily from the amortization of the domestic valuation allowance in 2005, which offsets the federal and foreign income tax expense in that period. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income, goodwill and foreign taxes.

Net income for the three months ended March 31, 2006 was $292 million, a decrease of $104 million or 26.3% from the same period in 2005, primarily due to higher income tax expense. In 2005, the Company recorded a $9 million loss, net of tax, in discontinued operations related to the disposal of its pension business in Spain.

PERSONAL MARKET

(1) Overview – Personal Market

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Private passenger automobile	$865	$865	-
Homeowners and other	330	296	11.5
Total net written premium	$1,195	$1,161	2.9%

Net written premium for the three months ended March 31, 2006 was $1.195 billion, an increase of $34 million or 2.9% over the same period in 2005. The increase is driven by new business growth, primarily in the homeowners line of business.

Private passenger automobile net written premium for the three months ended March 31, 2006 was unchanged at $865 million from the same period in 2005. In the quarter, private passenger automobile policies in force increased 2.2%, offset by lower average written premium per policy. The lower average written premium per policy reflects a reduction in involuntary market policies, a shift in state mix and a general improvement in the quality of the risks underwritten.

Homeowners and other net written premium for the three months ended March 31, 2006 was $330 million, an increase of $34 million or 11.5% over the same period in 2005. The increase is due to a 3.3% increase in policies in force and rate increases.

(2) Results of Operations – Personal Market

$ in Millions	Three Months Ended March 31, 2006	2005	Change
Revenues	$1,362	$1,341	1.6%
PTOI before catastrophes and net incurred losses attributable to prior years and discount accretion	$176	$189	(6.9%)
Catastrophes[1]:			
- 2005 hurricanes	(11)	-	NM
- All other	(48)	(27)	77.8
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[2]	-	7	(100.0)
Discount accretion	-	-	-
Pre-tax operating income	117	169	(30.8)
Realized investment gains, net	-	-	-
Federal and foreign income tax expense	(41)	(59)	(30.5)
Discontinued operations, net of tax	-	-	-
Net income	$76	$110	(30.9%)

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Net of earned premium attributable to prior years of zero and ($5) million for the three months ended March 31, 2006 and 2005, respectively.
NM = Not meaningful

Revenues for the three months ended March 31, 2006 were $1.362 billion, an increase of $21 million or 1.6% over the same period in 2005. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2006 was $1.276 billion, an increase of $19 million or 1.5% over the same period in 2005. The increase is primarily due to rate increases and new business growth in the homeowners line of business.

Net investment income for the three months ended March 31, 2006 was $71 million, an increase of $2 million or 2.9% over the same period in 2005. The increase reflects a higher invested asset base and positive cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three months ended March 31, 2006 were $1.245 billion, an increase of $73 million or 6.2% over the same period in 2005. The increase over prior year reflects higher 2006 catastrophe losses and an increase in acquisition expenses related to higher commissions and an increase in direct sales and service personnel, partially offset by lower claims frequency in the auto and homeowners lines of business (excluding catastrophes). In addition, the first quarter of 2005 reflects favorable incurred loss development attributable to prior years related to business assumed from involuntary pools, which did not recur in 2006.

	Three Months Ended March 31,		
PERSONAL MARKET	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion			
Claims and claim adjustment expense ratio	66.6%	68.3%	(1.7)
Underwriting expense ratio	24.8	21.9	2.9
Dividend ratio	-	-	-
Subtotal	91.4	90.2	1.2
Catastrophes[1]:			
- 2005 hurricanes	0.9	-	0.9
- All other	3.7	2.1	1.6
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	-	(0.6)	0.6
Discount accretion	-	-	-
Total combined ratio	96.0%	91.7%	4.3

[1] Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

Personal Market's combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2006 was 91.4%, an increase of 1.2 points over the same period in 2005. The increase in the expense ratio reflects an increase in acquisition expenses primarily due to higher commissions and an increase in direct sales and service personnel. The decrease in the claims and claim adjustment expense ratio reflects lower claims frequency trends in the auto and homeowners lines of business.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 96.0%, an increase of 4.3 points over the same period in 2005, primarily due to 2006 catastrophe activity.

PTOI for the three months ended March 31, 2006 was $117 million, a decrease of $52 million or 30.8% from the same period in 2005.

Federal and foreign income tax expense for the three months ended March 31, 2006 was $41 million, a decrease of $18 million or 30.5% from the same period in 2005, consistent with the change in profitability.

Net income for the three months ended March 31, 2006 was $76 million, a decrease of $34 million or 30.9% from the same period in 2005.

COMMERCIAL MARKETS

(1) Overview – Commercial Markets

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Business Market	$537	$482	11.4%
National Market	347	352	(1.4)
Liberty Mutual Property	85	45	88.9
Group Market	98	85	15.3
Other Markets	127	93	36.6
Total net written premium[1]	$1,194	$1,057	13.0%

1 Effective July 2, 2005, the results of Wausau and Surety (formerly included Commercial Markets) are included in Agency Markets due to an organizational change. Prior periods have been restated to reflect this change.

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Workers compensation	$739	$642	15.1%
Commercial automobile	113	120	(5.8)
General liability	109	115	(5.2)
Group disability / life	98	85	15.3
Commercial multiple peril / Fire	77	40	92.5
Assumed voluntary reinsurance	19	27	(29.6)
Other	39	28	39.3
Total net written premium	$1,194	$1,057	13.0%

Net written premium for the three months ended March 31, 2006 was $1.194 billion, an increase of $137 million or 13.0% over the same period in 2005. The increase in workers compensation is driven by new business growth and higher retention primarily within the Business Market segment. In addition, the non-renewal of a ceded reinsurance program increased Other Markets involuntary workers compensation premium in 2006. The increase in the commercial multiple peril/fire line of business primarily reflects new business growth, higher retentions and rate increases. Partially offsetting these increases was a decrease in assumed voluntary reinsurance business as a result of lower retention levels and program structure changes. Rates in all non-property lines declined due to more competitive market conditions, although margins remain attractive.

(2) Results of Operations – Commercial Markets

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Revenues	$1,104	$1,078	2.4%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$100	$105	(4.8%)
Catastrophes[1]:			
- 2005 hurricanes	(4)	-	NM
- All other	(8)	(3)	166.7
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[2, 3]	(14)	(6)	133.3
Discount accretion[3]	(22)	(21)	4.8
Pre-tax operating income[4]	52	75	(30.7)
Realized investment gains, net	-	-	-
Federal and foreign income tax expense	(17)	(26)	(34.6)
Discontinued operations, net of tax	-	-	-
Net income	$35	$49	(28.6%)

1. The Company does not typically identify catastrophe losses from assumed voluntary reinsurance in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the 2005 hurricanes, 2004 hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been classified as catastrophes. Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2. Net of earned premium attributable to prior years of $1 million and $9 million for the three months ended March 31, 2006 and 2005, respectively. Net of amortization of deferred gains on retroactive reinsurance of $7 million and $5 million for the three months ended March 31, 2006 and 2005, respectively.
3. The Company discounts the long-term indemnity portion of its workers compensation claims as permitted by insurance regulations. The discount accretion on these claims flows through underwriting results as the loss reserves accrete to nominal value. In 2006, Commercial Markets reclassified the discount accretion related to involuntary market workers compensation long-term indemnity claims from net incurred losses attributable to prior year to discount accretion. Results for 2005 reflect this reclassification.
4. In the first quarter of 2006, the Company reclassified the pre-2004 results of Commercial Markets' AVR business to Corporate and Other. This reclassification had no impact to first quarter 2005 results.

NM= Not meaningful

Revenues for the three months ended March 31, 2006 were $1.104 billion, an increase of $26 million or 2.4% over the same period in 2005. The major components of revenues include net premium earned, net investment income and fee and other revenues.

Net premium earned for the three months ended March 31, 2006 was $878 million, an increase of $35 million or 4.2% over the same period in 2005. The increase reflects the earned premium recognition of new business growth and improved customer retention partially offset by declining rate levels over the last twelve months.

Net investment income for the three months ended March 31, 2006 was $136 million, an increase of $3 million or 2.3% from the same period in 2005. The increase reflects a higher invested asset base and positive cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three months ended March 31, 2006 were $90 million, a decrease of $12 million or 11.8% from the same period in 2005. The decrease is primarily driven by lower fee revenues associated with the Company's involuntary market servicing carrier operations as serviced premium continues to decline. As a servicing carrier, the Company receives fee income for performing certain administrative duties for all participating involuntary pool members.

Claims, benefits and expenses for the three months ended March 31, 2006 were $1.052 billion, an increase of $49 million or 4.9% over the same period in 2005. The increase is driven by business growth, the non-renewal of a ceded reinsurance program and higher catastrophe losses.

	Three Months Ended March 31,		
COMMERCIAL MARKETS	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion			
Claims and claim adjustment expense ratio	80.9%	80.0%	0.9
Underwriting expense ratio	20.4	18.7	1.7
Dividend ratio	0.1	(0.5)	0.6
Subtotal	101.4	98.2	3.2
Catastrophes[1]:			
- 2005 hurricanes	0.5	-	0.5
- All other	1.1	0.4	0.7
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	1.8	0.8	1.0
Discount accretion	2.8	2.8	-
Total combined ratio	107.6%	102.2%	5.4

1. The Company does not typically identify catastrophe losses from assumed voluntary reinsurance in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the 2004 hurricanes, 2005 hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been classified as catastrophes. Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

Commercial Markets' combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2006 was 101.4%, an increase of 3.2 points over the same period in 2005. The increase in the underwriting expense ratio reflects a reduction in the expense reimbursement received from the Company's servicing carrier operations as a result of the decline in involuntary pool premium levels. The increase in the claims and claims adjustment expense ratio is driven in part by the non-renewal of a ceded reinsurance treaty related to involuntary pool results, as well as by lower rates. The increase in the dividend ratio reflects the recoupment of a previously paid dividend recorded in 2005 that did not recur in 2006.

Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the total combined ratio was 107.6%, an increase of 5.4 points over the same period in 2005. Catastrophe losses increased 1.2 points over the prior year due to higher natural catastrophe activity in 2006.

PTOI for the three months ended March 31, 2006, was $52 million, a decrease of $23 million or 30.7% from the same period in 2005.

Federal and foreign income tax expense for the three months ended March 31, 2006 was $17 million, a decrease of $9 million or 34.6% from the same period in 2005.

Net income for the three months ended March 31, 2006 was $35 million, a decrease of $14 million or 28.6% from the same period in 2005.

AGENCY MARKETS

(1) Overview – Agency Markets

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Regional Companies	$829	$795	4.3%
Wausau[1, 2]	408	373	9.4
Summit	291	272	7.0
Surety[2]	57	47	21.3
Total net written premium	$1,585	$1,487	6.6%

1 Includes the operations of Business Solutions Group.
2 Effective July 2, 2005, the results of Wausau and Surety (formerly included Commercial Markets) are included in Agency Markets due to an organizational change. Prior periods have been restated to reflect this change.

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Commercial Lines			
Workers compensation total	$796	$718	10.9%
- Wausau	330	299	10.4
- Summit	291	272	7.0
- All other	175	147	19.0
Commercial multiple peril	285	276	3.3
Commercial automobile	172	169	1.8
General liability	70	57	22.8
Surety	57	47	21.3
Other	46	40	15.0
Subtotal	$1,426	$1,307	9.1%
Personal Lines			
Private passenger automobile	$97	$114	(14.9%)
Homeowners	53	58	(8.6)
Other	9	8	12.5
Subtotal	$159	$180	(11.7%)
Total net written premium	$1,585	$1,487	6.6%

Net written premium for the three months ended March 31, 2006 was $1.585 billion, an increase of $98 million or 6.6% over the same period in 2005. The growth in commercial lines is mainly due to new business growth, partially offset by moderate rate decreases in all lines except surety which experienced modest rate increases. Additionally, growth in the workers compensation line of business reflects new business growth, the non-renewal of a ceded reinsurance program related to involuntary business, and increased exposure on existing accounts, partially offset by state mandated Florida rate decreases at Summit. The increase in commercial lines net written premium was partially offset by a decrease in private passenger automobile and homeowners net written premium due to lower rate, retention, and new business.

(2) Results of Operations – Agency Markets

$ in Millions	Three Months Ended March 31, 2006	2005	Change
Revenues	$1,479	$1,366	8.3%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$135	$120	12.5%
Catastrophes[1]:			
- 2005 hurricanes	(3)	-	NM
- All other	(19)	(7)	171.4
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[2]	19	17	11.8
Discount accretion	(4)	(5)	(20.0)
Pre-tax operating income	128	125	2.4
Realized investment gains, net	-	-	-
Federal and foreign income tax expense	(45)	(44)	2.3
Discontinued operations, net of tax	-	-	-
Net income	$83	$81	2.5%

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Net of earned premium attributable to prior years of $10 million and $1 million for the three months ended March 31, 2006 and 2005, respectively. Net of amortization of deferred gains on retroactive reinsurance of $3 million and $2 million for the three months ended March 31, 2006 and 2005, respectively.
NM = Not Meaningful

Revenues for the three months ended March 31, 2006 were $1.479 billion, an increase of $113 million or 8.3% over the same period in 2005. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2006 was $1.349 billion, an increase of $110 million or 8.9% over the same period in 2005. The growth in commercial lines (excluding workers compensation) is due primarily to increased new business partially offset by moderate rate decreases in all lines except surety. Growth in the workers compensation line of business reflects increased exposure on existing accounts and new business growth, partially offset by state mandated Florida rate decreases at Summit. Private passenger automobile and homeowners net earned premium decreased due to lower rate, retention, and new business.

Net investment income for the three months ended March 31, 2006 was $108 million, an increase of $2 million or 1.9% over the same period in 2005. The increase reflects a higher invested asset base and positive cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three months ended March 31, 2006 were $1.351 billion, an increase of $110 million or 8.9% over the same period in 2005. The increase is primarily due to business growth, higher catastrophe losses due to 2006 winter storms and tornadoes in the Midwest, and general cost increases.

AGENCY MARKETS	Three Months Ended March 31, 2006	2005	Change (Points)
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion			
Claims and claim adjustment expense ratio	65.2%	65.8%	(0.6)
Underwriting expense ratio	31.0	31.7	(0.7)
Dividend ratio	1.2	0.8	0.4
Subtotal	97.4	98.3	(0.9)
Catastrophes[1]:			
- 2005 hurricanes	0.2	-	0.2
- All other	1.4	0.6	0.8
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	(1.4)	(1.4)	-
Discount accretion	0.3	0.4	(0.1)
Total combined ratio	97.9%	97.9%	-

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

Agency Markets' combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the three months ended March 31, 2006 was 97.4%, a decrease of 0.9 points from the same period in 2005. The decrease in the quarter reflects a lower loss ratio due primarily to improved underwriting results at Wausau, partially offset by a change in business mix related to the decline in the Regional Companies personal lines net premium earned. This change in business mix was also the primary reason for the decrease in Agency Markets expense ratio during the quarter. The modest increase in the dividend ratio reflects a one-time change to a dividend reserve in 2005 which did not recur in 2006.

Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the total combined ratio was unchanged at 97.9% from the same period in 2005. Catastrophe losses increased by 1.0 point, due to winter storms and tornadoes in the Midwest.

PTOI for the three months ended March 31, 2006 was $128 million, an increase of $3 million or 2.4% over the same period in 2005.

Federal and foreign income tax expense for the three months ended March 31, 2006 was $45 million, an increase of $1 million or 2.3% over the same period in 2005.

Net income for the three months ended March 31, 2006 was $83 million, an increase of $2 million or 2.5% over the same period in 2005.

INTERNATIONAL

(1) Overview – International

International net written premium by market segment was as follows:

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
International Local Businesses	$640	$552	15.9%
Liberty International Underwriters	634	459	38.1
Total net written premium	$1,274	$1,011	26.0%

The Company's International operations provide insurance products and services through 1) Local Businesses, selling personal and small commercial lines products locally and 2) Liberty International Underwriters ("LIU") which sells specialty commercial lines insurance and reinsurance products worldwide.

International's five major lines of business are as follows:

(1) Local Businesses: personal and small commercial insurance;
(2) LIU Reinsurance: includes multi-line insurance and reinsurance with an emphasis on property, treaty casualty, personal accident, aviation and reinsurance through Lloyd's Syndicate 4472;
(3) LIU First Party: includes marine, energy, engineering, aviation, property and inland marine specialty;
(4) LIU Third Party: includes casualty, excess casualty, D&O, E&O, professional liability, and other; and
(5) LIU Other: includes workers compensation, commercial auto, and residual value.

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

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Local Businesses – private passenger auto	$355	$299	18.7%
Local Businesses – all other	285	253	12.6
LIU Reinsurance	384	271	41.7
LIU First Party[1]	125	74	68.9
LIU Third Party[1]	110	94	17.0
LIU Other	15	20	(25.0)
Total net written premium	$1,274	$1,011	26.0%

1 In the first quarter of 2006, LIU reclassified its inland marine specialty business to LIU First Party from LIU Third Party.

Net written premium for the three months ended March 31, 2006 was $1.274 billion, an increase of $263 million or 26.0% over the same period in 2005. The $88 million increase in the Company's local businesses operations reflects organic growth in Latin America, primarily Brazil and Venezuela. LIU Reinsurance increased $113 million primarily due to rate increases on property business. In addition, LIU's First Party line of business increased $51 million primarily due to the establishment of an inland marine specialty program in the third quarter of 2005. LIU's Third Party line of business increased $16 million primarily due to a reduction in the Company's utilization of reinsurance as compared to the prior period.

(2) Results of Operations – International

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Revenues	$1,115	$899	24.0%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$114	$78	46.2%
Catastrophes[1]:			
- 2005 hurricanes	-	-	-
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other[2]	(18)	-	NM
Discount accretion	-	-	-
Pre-tax operating income	96	78	23.1
Realized investment gains, net	15	1	NM
Federal and foreign income tax expense	(34)	(26)	30.8
Discontinued operations, net of tax	-	(9)	(100.0)
Net income	$77	$44	75.0%

1 The Company does not typically identify catastrophe losses from reinsurance assumed through Lloyd's Syndicate 4472 in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the 2004 hurricanes, 2005 hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been classified as catastrophes. Catastrophe losses include the impact of reinstatement premiums.

2 Net of earned premium attributable to prior years of $5 million and $3 million for the three months ended March 31, 2006 and 2005, respectively.

NM = Not Meaningful

Revenues for the three months ended March 31, 2006 were $1.115 billion, an increase of $216 million or 24.0% over the same period in 2005. The major components of revenues include net premium earned, net investment income and realized investment gains.

Net premium earned for the three months ended March 31, 2006 was $999 million, an increase of $193 million or 23.9% over the same period in 2005. Approximately $61 million of the increase reflects organic growth in the Company's local operations in Latin America. In addition, net earned premium from LIU's Reinsurance, First Party and Third Party operations increased $58 million, $56 million and $21 million, respectively, as a result of the increase in net written premium.

Net investment income for the three months ended March 31, 2006 was $89 million, an increase of $8 million or 9.9% over the same period in 2005. The increase is primarily driven by a higher invested asset base.

Realized investment gains for the three months ended March 31, 2006 were $15 million, an increase of $14 million over the same period in 2005. The increase primarily reflects trading activity in the equity portfolio.

Claims, benefits and expenses for the three months ended March 31, 2006 were $1.004 billion, an increase of $184 million or 22.4% over the same period in 2005. The increase in claims, benefits and expenses primarily reflects business growth and higher net incurred losses attributable to prior years of $20 million. Foreign exchange gains were $13 million higher than the same period in 2005 due to strengthening of the U.S. dollar.

	Three Months Ended March 31,		
INTERNATIONAL	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion			
Claims and claim adjustment expense ratio	66.1%	66.5%	(0.4)
Underwriting expense ratio	29.3	30.2	(0.9)
Dividend ratio	-	-	-
Subtotal	95.4	96.7	(1.3)
Catastrophes[1]:			
- 2005 hurricanes	-	-	-
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	-	-	-
- All other	1.9	-	1.9
Discount accretion	-	-	-
Total combined ratio	97.3%	96.7%	0.6

1. The Company does not typically identify catastrophe losses from reinsurance assumed through Lloyd's Syndicate 4472 in the tables above given the expected volatility associated with property-reinsurance coverage. However, due to the significant impact that the 2004 hurricanes, 2005 hurricanes and the events of September 11, 2001 had on the Company's results, these losses have been classified as catastrophes. Catastrophe losses include the impact of reinstatement premiums.

International's combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the three months ended March 31, 2006 was 95.4%, a decrease of 1.3 points from the same period in 2005. The decrease in the claims and claim adjustment expense ratio results from improved profitability in LIU Reinsurance. The decrease in the underwriting expense ratio is due to an increase in the percentage mix of inland marine specialty business, which has a lower expense ratio than International's other lines of business.

Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the total combined ratio was 97.3%, an increase of 0.6 points over the same period in 2005. The increase reflects loss development in the Company's local businesses operations, primarily in Europe

Pre-tax operating income for the three months ended March 31, 2006 was $96 million, an increase of $18 million or 23.1% over the same period in 2005.

Federal and foreign income tax expense for the three months ended March 31, 2006 was $34 million, an increase of $8 million or 30.8% over the same period in 2005, consistent with pre-tax income. Federal and foreign income taxes reflect volatility associated with different tax structures within countries that International operates.

In 2005, the Company recorded a $9 million loss, net of tax, in discontinued operations related to the disposal of certain pension business in Spain. Net income for the three months ended March 31, 2006 was $77 million, an increase of $33 million or 75.0% over the same period in 2005.

CORPORATE and OTHER

(1) Overview – Corporate and Other

Corporate and Other includes the following significant items:

- Individual Life, which provides life insurance and annuities for individuals and also issues structured settlement contracts and administers separate account contracts. Individual Life is licensed and sells its products in all 50 states, the District of Columbia and Canada.

- Certain discontinued operations, composed of: asbestos, environmental, and other toxic tort exposures, and other internal discontinued operations, primarily the run-off of the California workers compensation business of Golden Eagle Insurance Corporation ("Golden Eagle"), the discontinued channels business of Prudential agency business and effective 1/1/06, the pre-2004 Commercial assumed voluntary reinsurance business ("AVR").

- Interest expense on the Company's outstanding debt and gain or loss on extinguishment of debt.

- Internal reinsurance programs.

- Costs associated with certain long-term compensation plans and other corporate costs not allocated to the strategic business units. For presentation in this MD&A, domestic property and casualty operations' investment income was allocated based on planned ordinary investment income returns by investment category allocated to the business units. Investments are allocated as follows: fixed income equal to liabilities net of insurance assets (reinsurance, premiums receivable, etc.) and a combination of fixed income, equity and nontraditional investments supporting allocated statutory policyholders' surplus. For internal reporting purposes, the Company allocates expected long-term returns on invested assets, including realized investment gains. Under this internal reporting view, the difference between actual investment income and allocated investment income is included in Corporate and Other.

- Federal and foreign income taxes represent the difference between the consolidated income tax expense and the amounts recognized by the Personal, Commercial, Agency Markets and International business units. Domestic operations included in the business units reflect income tax at the 35% marginal U.S. Federal tax rate and do not reflect changes in the domestic valuation allowance (included in Corporate and Other), while International reflects the actual tax expense of each country including changes in the international valuation allowance.

- Net income (loss) related to energy and non-energy related limited partnership investments.

- Substantially all realized gains (losses) from the domestic property-casualty investment portfolio.

- Fee and other revenues include revenues from the Company's wholly owned subsidiary, Liberty Energy Holdings, LLC ("Liberty Energy"), and lease and other income on investment properties. Liberty Energy generates revenue from the production and sale of oil and gas.

(2) Results of Operations – Corporate and Other

	Three Months Ended March 31,		
$ in Millions	**2006**	**2005**	**Change**
Revenues	$388	$287	35.2%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$29	($16)	NM
Catastrophes[1]:			
- 2005 hurricanes	(6)	-	NM
- All other	-	-	-
Net incurred losses attributable to prior years:			
- Asbestos	(1)	-	NM
- All other[2]	(34)	(44)	(22.7)
Discount accretion	(2)	(3)	(33.3)
Pre-tax operating loss	(14)	(63)	(77.8)
Realized investment gains, net	10	20	(50.0)
Federal and foreign income tax benefit	25	155	(83.9)
Discontinued operations, net of tax	-	-	-
Net income	$21	$112	(81.3%)

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Net amortization of deferred gains on retroactive reinsurance of $6 million and $5 million for the three months ended March 31, 2006 and 2005, respectively.
NM = Not Meaningful

Revenues for the three months ended March 31, 2006 were $388 million, an increase of $101 million or 35.2% over the same period in 2005. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses and fee and other revenues.

Net premium earned for the three months ended March 31, 2006 was $164 million, an increase of $104 million or 173.3% over the same period in 2005. The increase is primarily due to immediate annuity and structured settlement growth.

Net investment income for the three months ended March 31, 2006 was $156 million, a decrease of $10 million or 6.0% from the same period in 2005. The decrease is primarily due to a $7 million decrease in private equity income.

Realized investment gains for the three months ended March 31, 2006 were $10 million, a decrease of $10 million or 50.0% from the same period in 2005.

Fee and other revenues for the three months ended March 31, 2006 were $58 million, an increase of $17 million or 41.5% over the same period in 2005. The increase is primarily due to lease income earned from a commercial office building that was acquired in January 2006.

Claims, benefits and expenses for the three months ended March 31, 2006 were $392 million, an increase of $62 million or 18.8% over the same period in 2005. The increase is primarily due to an increase in policyholder benefits related to immediate annuity and structured settlement business growth offset by a decrease of $43 million in insurance operating costs and other expenses primarily due to a decrease in variable incentive compensation and other benefit costs. Also included in these results are $35 million and $44 million of net incurred losses attributable to prior years in both periods for the three months ended 2006 and 2005, respectively. Net incurred losses attributable to prior years are primarily related to AVR, and other liability lines and workers compensation business of Golden Eagle in 2005.

Pre-tax operating loss for the three months ended March 31, 2006 was $14 million, a decrease of $49 million or 77.8% from the same period in 2005.

Federal and foreign income tax benefit for the three months ended March 31, 2006 was $25 million, a decrease of $130 million or 83.9% from the comparable period in 2005. See the Consolidated section for a discussion of taxes.

Net income for the three months ended March 31, 2006 was $21 million, a decrease of $91 million or 81.3% from the same period in 2005.

INVESTMENTS

General

The Company's investment strategy seeks long-term returns through disciplined security selection, portfolio diversity and an integrated approach to risk management. The Company selects and monitors investments to balance the goals of safety, stability, liquidity, growth and after-tax total return with its need to comply with regulatory investment requirements. A relatively safe and stable income stream is achieved by maintaining a broadly based portfolio of investment grade bonds. These holdings are supplemented by investments in additional asset types with the objective of further enhancing the portfolio's diversification and expected returns. These additional asset types include commercial mortgages and other real estate financing investments, non-investment-grade bonds and syndicated bank loans, common and preferred stock, private equity and direct investments in oil and gas ventures. Risk management is accomplished through asset liability management (including both interest rate risk and foreign currency risk), diversification, credit limits and a careful analytic review of each investment decision.

The Company's investment policy and strategy are reviewed and approved by the Investment Committee of its Board of Directors, which meets on a regular basis to review and consider investment activities, tactics and new investment classes. In addition, the Company has an experienced team of investment personnel responsible for managing and administering the investment portfolios of its domestic and foreign insurance operations.

Invested Assets

The following table summarizes the Company's invested assets by asset category at March 31, 2006 and December 31, 2005:

$ in Millions	**As of March 31, 2006**		**As of December 31, 2005**	
Invested Assets by Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$37,889	88.5%	$37,391	89.3%
Equity securities, available for sale, at fair value	2,137	5.0	1,908	4.6
Trading securities, at fair value	21	-	20	-
Limited partnerships and limited liability companies	1,256	2.9	1,040	2.5
Short-term investments	1,458	3.4	1,430	3.4
Other investments	85	0.2	84	0.2
Total invested assets	$42,846	100.0%	$41,873	100.0%

Total invested assets as of March 31, 2006 were $42.846 billion, a $973 million or 2.3% increase over December 31, 2005. The increase in invested assets was due primarily to cash flow from operations, deployment of existing cash and an increase in the Company's forward commitments to acquire securities which will be funded in the second quarter of 2006, partially offset by a decline in net unrealized gains.

Fixed maturities as of March 31, 2006 were $37.889 billion, an increase of $498 million or 1.3% over December 31, 2005. The improvement reflects the aforementioned increase in the amount of cash available to invest, partially offset by an increase in net unrealized losses in the portfolio due to higher market interest rates. Net unrealized gains of $429 million at December 31, 2005 declined $718 million in the first quarter to a net unrealized loss of $289 million as of March 31, 2006.

Equity securities available for sale as of March 31, 2006 were $2.137 billion, a $229 million or 12.0% increase over December 31, 2005. The increase primarily reflects $115 million in preferred stock acquisitions and net market appreciation on common stocks.

Limited partnerships and limited liability companies as of March 31, 2006 were $1.256 billion, a $216 million or 20.8% increase over December 31, 2005. The increase reflects new investment activity and an increase in the allocation of funds to existing commitments. The Company's investments in private equity limited partnerships are long-term in nature and largely illiquid. The Company makes allocations to these investments because the Company believes that they offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Short-term investments as of March 31, 2006 were $1.458 billion, a $28 million or 2.0% increase over December 31, 2005. The Company maintains a significant balance in this asset class in order to service the ongoing settlement of previously recorded losses associated with the 2004 and 2005 hurricanes.

As of March 31, 2006, the Company had unfunded private equity, commercial mortgages/real estate financing and energy commitments of $795 million, $224 million and $94 million, respectively. As of March 31, 2006, fixed maturities included commitments by the Company to purchase various residential mortgage-backed securities at a cost of $214 million and a fair market value of $213 million and various corporate and municipal securities at a cost of $187 million and a fair market value of $185 million.

As of March 31, 2006, no single issuer, other than U.S. Treasury, agency securities and mortgage-backed securities accounted for more than 1.08% of invested assets.

The following tables summarize the Company's fixed income portfolio by security type, credit quality and maturity at March 31, 2006 and December 31, 2005:

$ in Millions	**As of March 31, 2006**		**As of December 31, 2005**	
Fixed Maturities by Security Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
U.S. Treasury securities	$3,032	8.0%	$3,208	8.6%
U.S. mortgage and asset-backed securities	12,558	33.1	12,508	33.5
U.S. State and municipal	4,446	11.8	4,005	10.7
Corporate and other	13,830	36.5	13,885	37.1
Foreign	4,023	10.6	3,785	10.1
Total fixed maturities	$37,889	100.0%	$37,391	100.0%

During the first quarter of 2006, the Company, after consideration of investment opportunities, its tax status, and the current and prospective business environment, increased its tactical allocation to state, municipal and foreign securities by $441 million and $238 million, respectively, partially offset by a decrease in U.S. Treasury securities of $176 million.

$ in Millions	**As of March 31, 2006**		**As of December 31, 2005**	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$20,399	53.8%	$20,285	54.3%
AA+, AA, AA-	4,187	11.0	3,903	10.4
A+, A, A-	6,633	17.5	6,786	18.1
BBB+, BBB, BBB-	3,924	10.4	3,824	10.2
BB+, BB, BB-	1,703	4.5	1,325	3.6
B+, B, B-	1,010	2.7	1,238	3.3
CCC or lower	33	0.1	30	0.1
Total fixed maturities	$37,889	100.0%	$37,391	100.0%

For purposes of this disclosure, credit quality is primarily based upon Standard & Poor's ratings.

The Company's allocation in investment grade bonds decreased slightly to 92.7% at March 31, 2006 from 93.0% at December 31, 2005.

The remaining 7.3% of the Company's investments in fixed maturity securities are rated below investment grade. The decline in single B and increase in double B is largely driven by the upgrade in the ratings assigned to Venezuelan sovereign debt. The Company's holdings of below investment grade securities primarily consist of: (1) a diversified portfolio of high yield bonds within the domestic insurance portfolios; and (2) investments in emerging market sovereign debt primarily in support of the Company's international insurance companies.

$ in Millions	As of March 31, 2006		As of December 31, 2005	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,056	2.8%	$1,080	2.9%
Over 1 yr through 5 yrs	7,177	18.9	6,898	18.4
Over 5 yrs through 10 yrs	7,478	19.7	7,615	20.4
Over ten years	9,578	25.3	9,256	24.8
U.S. and foreign mortgage and asset-backed securities	12,600	33.3	12,542	33.5
Total fixed maturities	$37,889	100.0%	$37,391	100.0%

During 2006, after taking into consideration changes in investment opportunities and its view of the current and prospective business and economic environment, the Company made only minor adjustments to the average life of its fixed maturity portfolio.

Net Investment Income

The following table summarizes the Company's net investment income at March 31, 2006 and 2005:

$ in Millions	Three Months Ended March 31,	
Net Investment Income	**2006**	**2005**
Interest income – taxable	$498	$499
Interest income – tax-exempt	41	8
Dividends	7	22
Limited partnerships and limited liability companies	42	53
Other investment income	3	3
Gross investment income	591	585
Investment expenses	(31)	(30)
Net investment income	$560	$555

Net investment income for the three months ended March 31, 2006 was $560 million, a $5 million or 0.9% increase over the same period in 2005. The increase in net investment income reflects higher interest income due to a larger invested asset base and cash flow from operations. Partially offsetting these increases was a decrease in dividend income resulting from the termination of an equity investment program and a decrease in limited partnership income related to private equity investments. The Company's lower overall domestic book yield, due in part to the increased investment in tax-exempt securities in the second half of 2005 and continuing into 2006, was the primary factor constraining overall growth in investment income compared to 2005.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) at March 31, 2006 and 2005:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
<u>Three Months Ended March 31, 2006:</u>				
Fixed maturities	$10	($13)	$ -	($3)
Common and preferred stock	26	(2)	-	24
Other	4	-	-	4
Total	$40	($15)	$ -	$25
<u>Three Months Ended March 31, 2005:</u>				
Fixed maturities	$24	$ -	$ -	$24
Common and preferred stock	12	(1)	(14)	(3)
Other	-	-	-	-
Total	$36	($1)	($14)	$21

$ in Millions	**Three Months Ended March 31,**	
Components of Net Realized Investment Gains (Losses)	**2006**	**2005**
Fixed maturities:		
Gross realized gains	$ 28	$44
Gross realized losses	(31)	(20)
Equities:		
Gross realized gains	30	18
Gross realized losses	(6)	(21)
Other:		
Gross realized gains	5	3
Gross realized losses	(1)	(3)
Total net realized investment gains (losses)	$25	$21

Net realized investment gains for the three months ended March 31, 2006 were $25 million, an increase of $4 million or 19.0% over the same period in 2005. The increase reflects a $27 million increase in equity gains due to the sale of international investments, the sale of securities distributed from private equity partnerships and a decrease in trading portfolio losses. These increases were partially offset by a $14 million increase in losses, primarily associated with the Company's recognition of impairments on securities previously anticipated to be held to recovery.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment at March 31, 2006:

$ in Millions	**Less Than 12 Months**		**Greater Than 12 Months**	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Treasury securities	($59)	$2,002	($30)	$777
U.S. mortgage and asset-backed securities	(263)	8,949	(86)	1,393
U.S. State and municipal	(64)	2,991	(4)	91
Corporate and other	(264)	6,579	(115)	1,913
Foreign	(33)	1,774	(2)	65
Equities	(10)	148	(7)	58
Total	($693)	$22,443	($244)	$4,297

Unrealized losses increased from $509 million as of December 31, 2005 to $937 million as of March 31, 2006 primarily due to the continued increase in interest rates. Approximately 95% of the unrealized losses ($892 million), exist on holdings where the fair value as of March 31, 2006 was less than 10% below amortized cost. 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. The Company employs a systematic methodology utilizing a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in shareholders' equity. If the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to market and a realized loss is recorded. As a result of this review, the Company has concluded that the gross unrealized losses of fixed maturity securities as of March 31, 2006 are temporary.

The gross unrealized losses recorded on common equity securities and other investments at March 31, 2006 resulted primarily from decreases in quoted market values from the dates that certain investment securities were acquired as opposed to fundamental changes in the issuer's financial performance and near-term financial prospects. Therefore, these decreases are also viewed as being temporary in accordance with the Company's policy with respect to recognizing impairments in the investment portfolio.

LIQUIDITY AND CAPITAL RESOURCES

General

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

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. For ongoing business, the Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of March 31, 2006 totaled $42.846 billion.

Short-term debt outstanding at March 31, 2006 and December 31, 2005 was as follows:

$ in Millions	**As of March 31, 2006**	**As of December 31, 2005**
Commercial paper	$145	$100
Revolving credit facilities	40	35
Current maturities of long-term debt	-	10
Total short-term debt	$185	$145

Long-term debt outstanding at March 31, 2006 and December 31, 2005 was as follows:

$ in Millions	**As of March 31, 2006**	**As of December 31, 2005**
8.20% Surplus notes, due 2007	$121	$121
6.75% Notes, due 2008	15	15
5.00% Prudential notes due 2008	4	4
8.00% Prudential notes—series B due 2013	260	260
5.75% Senior notes, due 2014	500	500
8.50% Surplus notes, due 2025	150	150
7.875% Surplus notes, due 2026	250	250
7.63% Notes, due 2028	3	3
7.00% Senior notes, due 2034	250	250
6.50% Senior notes, due 2035	500	500
7.697% Surplus notes, due 2097	500	500
7.10% – 7.86%, Medium term notes, with various maturities	27	27
Subtotal	2,580	2,580
Unamortized discount	(24)	(25)
Total long-term debt excluding current maturities	$2,556	$2,555

The Company issues commercial paper from LMGI. The total amount authorized for this program is $600 million and the program is backed by a $750 million five-year revolving credit agreement. To date, no funds have been borrowed under the facility.

Liberty International Iberia S.L., S.C.S. entered into an 85 million euro / $100 million 364 day revolving credit agreement, which became effective October 14, 2005. The facility is available to provide working capital to the Company's international operations. The 364 day credit agreement is guaranteed by LMIC. To date, no funds have been borrowed under the facility.

The Company also has a Venezuelan subsidiary, Inversora Segucar, C.A., which has entered into a revolving credit facility to provide liquidity for working capital purposes. Inversora Segucar also has short-term loans outstanding. As of March 31, 2006, total short-term loans and borrowings under the Venezuelan credit facility were approximately $40 million.

The $40 million increase in short-term debt outstanding is primarily due to an increase of $45 million of commercial paper and a $5 million revolving credit facility, partially offset by a redemption of $10 million of 5% notes due in 2008 to Prudential Financial Inc. issued in connection with the 2003 acquisition of the U.S. personal lines property and casualty business of Prudential Financial Inc. (PruPac).

Consolidated interest expense for the three months ended March 31, 2006 was $48 million, an increase of $7 million or 17.1% over the same period in 2005.

Holding Company Liquidity and Capital Resources

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, the subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of March 31, 2006, the Company, through its downstream subsidiary LMGI, had $1.669 billion of debt outstanding.

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 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, as could a redomestication, merger or consolidation of LMIC, LMFIC or EICOW to a different domiciliary state. Additionally, in connection with the Company's reorganization in 2001 into a mutual holding company structure, the Company entered into Keep Well Agreements with the Massachusetts Commissioner of Insurance, LMIC and certain other affiliates which effectively limit LMIC and LMFIC from paying any dividends to the Company when the "total adjusted capital" of the respective insurer is below 300% of the "authorized control level," as such terms are defined in the Massachusetts risk-based capital regulations as of June 13, 2001. The Keep Well Agreements will terminate automatically upon the earlier of (i) the date that is five years from the effective date of the respective reorganization (November 28, 2006 as to LMIC and March 19, 2007 as to LMFIC), or (ii) the date upon which the Company, the respective insurer or

LMHC Massachusetts Holdings Inc. becomes subject to the public reporting requirements of the Securities and Exchange Commission.

As of December 31, 2005, the authorized control level risk-based capital and 2006 dividend capacity prior to needing regulatory approval for LMIC, LMFIC and EICOW were as follows:

$ in Millions	**RBC Ratio [1]**			**Dividend Capacity[2]**
RBC Ratios and Dividend Capacity	**2005**	**2004**	**Change**	**2006**
LMIC	495%	459%	36 points	$692
LMFIC	596%	473%	123 points	$5
EICOW	370%	346%	24 points	$86

[1] Authorized control level risk-based capital as defined by the NAIC.
[2] Represents maximum allowable dividend without prior regulatory approval in the state of domicile. LMIC's dividend capacity does not reflect an additional $100 million of capacity available for payment after December 26, 2006.

LMGI also has access to funds at Liberty Corporate Services LLC (the "service companies"). The service companies, which include Helmsman Insurance Agency, Summit Consulting and Helmsman Management Services, collects fees and other revenues for claims administration and agency services rendered for affiliated and non-affiliated insurance entities. In 2006, the services companies recorded $35 million in pre-tax income.

Statutory Surplus
Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $10.096 billion and $9.869 billion at March 31, 2006, and December 31, 2005, respectively. The increase in surplus reflects $149 million of net income, affiliated unrealized gains of $18 million, and unaffiliated unrealized gains of $58 million. The balance of the increase in statutory surplus primarily reflects changes in deferred taxes, foreign exchange, and non-admitted assets.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company's principal estimates include:

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and recoverables on premium attributable to prior years;
- reinsurance recoverables, including bad debt provision;
- impairments to the fair value of the investment portfolio;
- variable interest entities;
- deferred acquisition costs;
- the valuation of goodwill; and
- deferred income tax valuation allowance.

While the Company believes the amounts included in the consolidated financial statements reflect best estimates and appropriate assumptions, these amounts could ultimately be materially different from the amounts currently provided for in the consolidated financial statements.

Certain reclassifications have been made to the 2005 tables to conform to the 2006 tables.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $38.146 billion and $38.045 billion at March 31, 2006 and December 31, 2005, respectively. The increase was primarily due to business growth less the on-going settlement of claims.

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

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

As information develops that varies from past experience, provides additional data, or in some cases, augments data that previously was not considered sufficient for use in determining reserves, changes in the

Company's estimate of ultimate liabilities may be required. The effects of these changes are reflected in current operating results.

Asbestos and Environmental

The Company's asbestos and environmental (A&E) reserves for unpaid claims and claim adjustment expenses were $1.563 billion and $1.628 billion at March 31, 2006 and December 31, 2005, respectively, net of reinsurance and including an allowance for doubtful accounts, a year-to-date decrease of $65 million. The decrease is driven by paid activity in the first quarter of 2006.

The Company's asbestos reserves as of March 31, 2006 and December 31, 2005 were as follows:

$ in Millions	**As of March 31, 2006**	**As of December 31, 2005**
Gross reserves[1]	$1,376	$1,421
Ceded reserves[1]	351	355
Net reserves	$1,025	$1,066
Allowance for reinsurance on unpaid losses	109	110
Total asbestos reserves	**$1,134**	**$1,176**

[1] Excludes reserves guaranteed by Nationwide Mutual Insurance Company.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of PruPac included $175 million and $118 million of gross and net asbestos reserves, respectively. Any increase in asbestos reserves related to PruPac is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial Inc.

The estimation of asbestos claims and associated liabilities and the analysis of environmental claims considered prevailing applicable law and certain inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability, and the risks inherent in major litigation and other uncertainties, the Company believes that in future periods it is possible that the outcome of the continued uncertainties regarding asbestos and environmental related claims could result in liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

Reinsurance Recoverables

The Company reported reinsurance recoverables of $16.499 billion and $16.302 billion at March 31, 2006 and December 31, 2005, respectively, net of allowance for doubtful accounts of $329 million and $324 million, respectively.

The reinsurance recoverables from Nationwide Indemnity Co. have been fully guaranteed by its parent, Nationwide Mutual Insurance Co., which has a financial strength rating of A+ from Standard & Poor's and A+ from A.M. Best. The reinsurance recoverables from state mandated involuntary pools and associations represent the Company's servicing carrier business. As a servicing carrier, the Company retains no direct underwriting risk but instead cedes 100% of the involuntary market premium and losses back to the pool. Payment of losses is shared by the pool participants in proportion to their pool participation. Credit risk with respect to this servicing carrier business is the composite of the cumulative creditworthiness of all participants in their respective pools.

As part of its reinsurance security oversight, the Company has established a Standing Reinsurance Credit Committee (SRC) that meets quarterly to monitor and review the credit quality of the existing reinsurance portfolio, discuss emerging trends in the reinsurance marketplace, and ensure that the current portfolio of reinsurance is in compliance with the committee's security standards. The SRC is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company's purchase and use of reinsurance.

Approximately 94% of the Company's reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at March 31, 2006. Collateral held against outstanding gross reinsurance recoverable balances was $4.182 billion and $4.106 billion at March 31, 2006 and December 31, 2005, respectively.

The remaining 6% of the Company's net reinsurance recoverable balance is well diversified. No single reinsurer rated B++ or below by A.M. Best accounts for more than 2% of statutory surplus as regards policyholders. In addition, the average net reinsurance recoverable balance from individual reinsurers rated below A- or not rated by A.M. Best was approximately $1 million as of March 31, 2006.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. The Company evaluates and monitors the financial condition of its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. The Company reports its reinsurance recoverables net of an allowance for estimated uncollectible reinsurance recoverables. The allowance is based upon the Company's ongoing review of amounts outstanding, length of collection periods, changes in reinsurer credit standing and other relevant factors. Accordingly, the establishment of reinsurance recoverables and the related allowance for uncollectible reinsurance recoverables is also an inherently uncertain process involving estimates. Changes in these estimates could result in additional income statement charges.

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million as of March 31, 2006 and December 31, 2005) that are amortized into income using the effective interest method over the estimated settlement periods. At March 31, 2006 and December 31, 2005, deferred gains related to these reinsurance arrangements were $865 million and $878 million, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three months ended March 31, 2006 was $25 million, as compared to $24 million for the three months ended March 31, 2005. Amortization of the deferred gain for the three months ended March 31, 2006 was $16 million, as compared to $12 million for the three months ended March 31, 2005. Reinsurance recoverables related to these transactions including experience related profit accruals were $2.203 billion and $2.211 billion as of March 31, 2006 and December 31, 2005, 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, premium and loss activity subsequent to December 31, 2001 is now accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods.

Impairment Losses on Investments

The total impairment losses on investments for the three months ended March 31, 2006 were $15 million, a $14 million increase over the same period in 2005. The increase was primarily associated with the Company's recognition of impairment losses on securities previously anticipated to be held to recovery. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company's accounting policy for other-than-temporary impairment recognition requires other-than-temporary impairment charges to be recorded when it is determined that the Company is unlikely to recover its cost basis in an investment in the near-term. Factors considered in evaluating whether a decline in value is other-than-temporary include: (a) the length of time and extent to which the fair value has been below cost; (b) the financial condition and near-term prospects of the issuer; and (c) the intent and ability of the

Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale.

The Company employs a systematic methodology to evaluate declines in fair value below the book value for equity securities and other investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below carrying value is evaluated in a disciplined manner. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a recovery of fair value, the Company views the decline in market value of these investments as being temporary in accordance with the Company's impairment policy. However, the Company reserves the flexibility to trade any investment as deemed appropriate based on changes in credit or other market factors in managing the invested asset positions of the Company.

Effective January 1, 2006, the Company adopted FASB Statement of Position No. FAS 115-1 and FAS 124-1, Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments ("FSP FAS 115-1 and FAS 124-1"), which provides guidance on determining whether investment impairment is other-than-temporary regardless of the intent to sell and when a security is impaired due to fluctuations in interest rates. In the first quarter, the Company recognized $13 million of impairment losses on securities that previously were anticipated to be held to recovery or maturity, and were subsequently sold.

Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46"). FIN 46 requires certain variable interest entities ("VIEs") to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or the entity does not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 was revised in late 2003 (FIN 46(R)) and was effective January 1, 2004 for the Company for all new VIEs created or acquired after March 31, 2003. For VIEs created or acquired by the Company prior to March 31, 2003, the provisions of FIN 46 have been applied beginning in 2005.

The Company's exposure to investment structures subject to analysis under FIN 46(R), relates primarily to investments in energy and private equity limited partnerships that are accounted for under the equity method. The Company has determined that it is the primary beneficiary for two VIEs in the energy investment sector at March 31, 2006. In addition, the Company has investments in 5 VIEs for which it is not the primary beneficiary at March 31, 2006. The Company's investments in VIE's are not material to the Company's consolidated financial position, results of operations or cash flows as of March 31, 2006. The Company's maximum exposure to losses from VIEs is $53 million as of March 31, 2006, and there is no recourse provision to the general credit of the Company beyond the full amount of the Company's loss exposure.

Derivatives

The Company has a Derivative Use Policy (DUP) which has been approved by the Investment Committee and state insurance regulatory authorities. Pursuant to the DUP, the Company may enter into derivative transactions. As of March 31, 2006 the Company had several embedded derivative instruments in its portfolio, warrants and two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of March 31, 2006, the value of these instruments was immaterial. The Company recognized approximately $1 million in realized investment gains in the first quarter of 2006 associated with the derivative positions.

Deferred Policy Acquisition Costs

Total deferred policy acquisition costs were $1.592 billion and $1.476 billion as of March 31, 2006 and December 31, 2005, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses.

Goodwill and Intangibles

Goodwill and intangible assets were $818 million and $810 million at March 31, 2006 and December 31, 2005, respectively.

Deferred Income Taxes

The net deferred income tax asset was $1.839 billion and $1.627 billion as of March 31, 2006 and December 31, 2005, respectively, net of a valuation allowance of $104 million and $99 million, respectively. Management believes it is more likely than not that the Company's net deferred income tax asset will be realized based on the Company's ability and likelihood of generating future taxable income.

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

The Company provides for Federal and foreign income taxes based on amounts that it believes it ultimately will owe. Inherent in the provision for Federal and foreign income taxes are estimates regarding the deductibility of certain expenses and the realization of certain tax credits. In the event the ultimate deductibility of certain expenses or the realization of certain tax credits differs from estimates, the Company may be required to significantly change the provision for Federal and foreign income taxes recorded in the consolidated financial statements.

About the Company

Boston-based Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of entities ("LMG" or the "Company"), is a diversified global insurer and sixth largest property and casualty insurer in the U.S. based on 2004 direct written premium. The Company also ranks 102nd on the Fortune 500 list of largest corporations in the United States based on 2005 revenue. As of December 31, 2005, LMG had $78.824 billion in consolidated assets and $21.161 billion in annual consolidated revenue.

LMG, through its subsidiaries and affiliated companies, offers a wide range of property-casualty insurance products and services to individuals and businesses alike. In 2001 and 2002, the Company formed a mutual holding company structure, whereby the three principal mutual insurance companies, LMIC, LMFIC and EICOW, each became separate stock insurance companies under the ownership of Liberty Mutual Holding Company.

Functionally, the Company conducts its business through four strategic business units: Personal Market, Commercial Markets, Agency Markets (formerly Regional Agency Markets but now includes Wausau and Surety) and International. Each business unit operates independently of the others and has dedicated sales, underwriting, claims, actuarial, financial and certain information technology resources. Management believes this structure allows each business unit to execute its business strategy and/or to make acquisitions without impacting or disrupting the operations of the Company's other business units.

LMG employs over 39,000 people in more than 900 offices throughout the world. For a full description of the Company's business operations, products and distribution channels, please visit Liberty Mutual's Investor Relations web site at www.libertymutual.com/investors.