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

Quarter Ended September 30, 2006

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three and nine months Ended September 30, 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, Third Quarter 2006 Consolidated Financial Statements (unaudited), Third Quarter 2006 Financial Supplement and First and Second Quarter MD&As, 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 September 30, 2006 - Consolidated Results of Operations

- Revenues for the three months ended September 30, 2006 were $6.014 billion, an increase of $628 million or 11.7% over the same period in 2005.

- Pre-tax income for the three months ended September 30, 2006 was $794 million, an increase of $984 million over the same period in 2005. Results in the quarter include an $840 million decrease in catastrophe losses[1] from the same period in 2005, as prior year results included the impact of Hurricanes Katrina and Rita. Results in the period also include an increase of $69 million in realized capital gains.

- Net income for the three months ended September 30, 2006 was $556 million, an increase of $678 million over the same period in 2005.

- Cash flow from operations for the three months ended September 30, 2006 was $1.234 billion, a decrease of $173 million or 12.3% 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 September 30, 2006 was 94.7%, an increase of 3.1 points over 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 decreased 20.3 points from 2005 to 98.0% in 2006.

Nine Months Ended September 30, 2006 - Consolidated Results of Operations

- Revenues for the nine months ended September 30, 2006 were $17.512 billion, an increase of $1.865 billion or 11.9% over the same period in 2005.

- Pre-tax income for the nine months ended September 30, 2006 was $1.681 billion, an increase of $836 million or 98.9% over the same period in 2005. Results year-to-date include a $668 million decrease in catastrophe losses from the same period in 2005, as prior year results included the impact of Hurricanes Katrina and Rita. Results in the period also include a decrease of $68 million in realized capital gains.

- Net income for the nine months ended September 30, 2006 was $1.171 billion, an increase of $397 million or 51.3% over the same period in 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") and Hurricanes Katrina, Rita and Wilma ("2005 hurricanes"). Losses related to the 2005 hurricanes in both periods of 2005 do not include losses related to Hurricane Wilma as that event occurred in the fourth quarter of 2005. 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.

- Cash flow from operations for the nine months ended September 30, 2006 was $2.858 billion, a decrease of $296 million or 9.4% from the same period in 2005.

- The combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the nine months ended September 30, 2006 was 95.1%, an increase of 0.6 points over 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 decreased 6.0 points from 2005 to 99.7% in 2006.

Financial Condition as of September 30, 2006

- Total assets were $84.156 billion as of September 30, 2006, an increase of $5.332 billion or 6.8% over December 31, 2005.

- Policyholders' equity was $10.006 billion as of September 30, 2006, an increase of $1.148 billion or 13.0% over December 31, 2005.

- Statutory surplus as regards policyholders for the combined operations of Liberty Mutual Insurance Company ("LMIC") and its U.S. affiliates was $11.508 billion as of September 30, 2006, an increase of $1.639 billion or 16.6% over December 31, 2005.

- The consolidated debt-to-capital ratio including accumulated other comprehensive income ("AOCI") as of September 30, 2006 was 25.0%, an increase of 1.6 points over December 31, 2005. Excluding AOCI, the consolidated debt-to-capital ratio was 25.7%, an increase of 1.5 points over December 31, 2005.

Other 2006 3rd Quarter Highlights

Debt Transactions

- On August 15, 2006, Liberty Mutual Group Inc. ("LMGI") issued $250 million of 6.70% unsecured senior notes due 2016, and $500 million of 7.50% unsecured senior notes due 2036. The proceeds of the offerings were contributed to LMGI's wholly owned insurance subsidiary, LMIC.

Acquisition

- On September 5, 2006, the Company, through its Spanish subsidiary, Liberty Seguros Compania de Seguros y Reaseguros S.A., acquired a majority interest in Seker Sigorta A.S., a property and casualty insurer located in Turkey, from Sert Holding A.S.

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 September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Private passenger automobile	$1,499	$1,462	2.5%	$4,269	$4,175	2.3 %
Workers compensation	1,156	989	16.9	3,609	3,093	16.7
Homeowners	507	438	15.8	1,324	1,181	12.1
Commercial multiple peril / Fire	409	380	7.6	1,185	1,081	9.6
Commercial automobile	296	280	5.7	853	842	1.3
LIU[1] reinsurance	159	166	(4.2)	846	635	33.2
International local businesses [2]	272	219	24.2	827	703	17.6
General liability	211	150	40.7	642	512	25.4
LIU first party[3]	132	46	187.0	408	172	137.2
LIU third party[3]	106	97	9.3	338	304	11.2
Group disability	99	84	17.9	297	257	15.6
Surety	66	47	40.4	188	147	27.9
Assumed voluntary reinsurance	42	24	75.0	88	72	22.2
Other	205	164	25.0	939	450	108.7
Total net written premium	$5,159	$4,546	13.5%	$15,813	$13,624	16.1%

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 SBU was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Personal Markets	$1,487	$1,421	4.6%	$4,086	$3,945	3.6%
Commercial Markets[1]	1,002	776	29.1	3,125	2,644	18.2
Agency Markets [1]	1,469	1,364	7.7	4,516	4,202	7.5
International	1,036	851	21.7	3,527	2,785	26.6
Corporate and Other[2]	165	134	23.1	559	48	NM
Total net written premium	$5,159	$4,546	13.5%	$15,813	$13,624	16.1%

1 Effective July 2, 2005, the results of Wausau and Surety (formerly included in 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.
NM = Not Meaningful (represents increases or decreases greater than 200%, or changes from a net gain to a net loss, or vice versa).

Net written premium for the three and nine months ended September 30, 2006 was $5.159 billion and $15.813 billion, respectively, an increase of $613 million and $2.189 billion over the same periods in 2005. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $37 million and $94 million in the quarter and year-to-date, respectively. The increase in both periods is primarily due to organic growth in the Company’s International local business operations in Europe and Latin America, partially offset by a decrease in Agency Markets net written premium, due primarily to modest rate decreases. Personal Markets net written premium also decreased in both periods due primarily to a lower average written premium per policy, partially offset by a 2.5% increase in voluntary policies in force over the same period in 2005.
- Workers compensation net written premium increased $167 million and $516 million in the quarter and year-to-date, respectively. The increase in both periods reflects new business growth, strong retention and an increase in payroll exposure. Both periods also reflect the non-renewal of a ceded reinsurance program, which increased net written premium. These increases were partially offset by modest rate decreases in most states, mandated rate decreases in Florida and a significant decline in California rates due to workers compensation reform.
- Homeowners net written premium increased $69 million and $143 million in the quarter and year-to-date, respectively. The increase reflects rate increases and a 3.6% increase in Personal Markets policies in force driven by strong customer retention and new business growth.
- Commercial multiple peril / fire net written premium increased $29 million and $104 million in the quarter and year-to-date, respectively. The increase is primarily due to significant rate increases and strong retention in Commercial Markets and Wausau.
- LIU reinsurance decreased $7 million in the quarter and increased $211 million year-to-date. The year-to-date increase is primarily due to rate increases on property business as well as profit commission adjustments and lower reinstatement premiums related to ceded reinsurance contracts covering 2005 hurricane losses, while the decrease in the quarter was due to the re-estimation of ultimate premium on the 2005 year of accounts which resulted in higher net written premium in the third quarter of 2005.
- International local businesses net written premium (excluding private passenger automobile net written premium) increased $53 million and $124 million in the quarter and year-to-date, respectively. The increase in both periods reflects organic growth in Latin America.
- General liability net written premium increased $61 million and $130 million in the quarter and year-to-date, respectively. The increase in both periods primarily reflects new business growth in Commercial Markets’ National Market segment and Wausau and reduced reinsurance cessions in Agency Markets.

- LIU first party net written premium increased $86 million and $236 million in the quarter and year-to-date, respectively, primarily due to the establishment of an inland marine specialty program in the third quarter of 2005 and rate increases on energy business.
- Other net written premium increased $489 million year-to-date, primarily due to growth in immediate annuities and structured settlements.

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 SBU.

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

Results of Operations – Consolidated

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$6,014	$5,386	11.7%	$17,512	$15,647	11.9%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$710	$779	(8.9%)	$2,005	$1,855	8.1 %
Catastrophes[1]:						
- 2005 hurricanes[2,3]	(40)	(928)	(95.7)	(81)	(919)	(91.2)
- All other	(91)	(43)	111.6	(336)	(166)	102.4
Net incurred losses attributable to Prior years:						
- Asbestos	(1)	(208)	(99.5)	(2)	(210)	(99.0)
- All other[4]	(3)	69	NM	(137)	(5)	NM
Discount accretion[5]	(23)	(32)	(28.1)	(79)	(89)	(11.2)
Pre-tax operating income (loss)	552	(363)	NM	1,370	466	194.0
Realized investment gains, net	242	173	39.9	311	379	(17.9)
Federal and foreign income tax (expense) benefit	(238)	68	NM	(510)	(59)	NM
Discontinued operations, net of tax	-	-	-	-	(12)	(100.0)
Net income (loss)	$556	($122)	NM	$1,171	$774	51.3%

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. Losses related to the 2005 hurricanes for the three and nine months ended September 30, 2006 include the reversal of $39 million and $29 million, respectively, and the three and nine months ended September 30, 2005 include the reversal of $98 million in both periods of profit sharing on external reinsurance accrued in 2004 and the first half of 2005. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes are reported net of the Company’s reasonable assumption of expected catastrophe activity (defined as “net catastrophe reinsurance premium earned”). Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Assumed catastrophe losses related to the 2005 hurricanes are reported net of related net catastrophe reinsurance premium earned of $82 million and $91 million for the three and nine months ended September 30, 2005, respectively.

3 Losses incurred by LIU’s Reinsurance line of business related to Hurricane Rita were classified as part of normal operations in the third quarter of the prior year, but were reclassified as catastrophe losses in the fourth quarter of 2005. These losses have been classified as catastrophe losses in the current presentation.

4 Net of earned premium attributable to prior years of ($18) million and $16 million for the three and nine months ended September 30, 2006, respectively, and $31 million and $40 million for the comparable periods of 2005. Net of amortization of deferred gains on retroactive reinsurance of $15 million and $46 million for the three and nine months ended September 30, 2006, respectively, and $21 million and $79 million for the comparable periods of 2005.

5 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. 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 years to discount accretion. Results for 2005 reflect this reclassification. Asbestos structured settlements are discounted at 4.5%.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2006 were $6.014 billion and $17.512 billion, respectively, an increase of $628 million and $1.865 billion over the same periods 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 and nine months ended September 30, 2006 was $4.921 billion and $14.767 billion, respectively, an increase of $493 million and $1.802 billion over the same periods in 2005. The increase in both periods reflects the earned premium recognition of business growth consistent with the changes in net written premium. In addition, earned premium was lower in 2005 due to the accelerated recognition of ceded earned premium on reinsurance contracts covering losses related to the 2005 hurricanes.

Net investment income for the three and nine months ended September 30, 2006 was $664 million and $1.858 billion, respectively, an increase of $74 million and $120 million over the same periods in 2005. The increase in net investment income in both periods reflects higher interest income due to a larger invested asset base and continued strong cash flow from operations, as well as an increase in limited partnership and limited liability company income of $10 million and $22 million in the quarter and year-to-date, respectively, related to private equity investments. The increases in both periods were partially offset by higher investment expenses due primarily to an increase in staffing and fees for outside services. Another factor constraining net investment income growth in both periods was the lower yield on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities beginning in the second half of 2005 and continuing into 2006. In addition, dividend income in the quarter increased over the same period in 2005 due to an increase in investments in preferred stock and a significant dividend received on an equity investment. Year-to-date dividend income, however, decreased due to the termination of an equity investment program in the second quarter of 2005.

Net realized investment gains for the three and nine months ended September 30, 2006 were $242 million and $311 million, respectively, an increase of $69 million and a decrease of $68 million versus the same periods in 2005. The increase in net realized investment gains for the quarter was driven by a $235 million gain on the sale of a restricted equity holding. This was partially offset by an $84 million decrease in fixed maturity gains. The decrease in year-to-date net realized investment gains reflects fixed maturity gains in the prior year associated with the sale of targeted taxable securities as part of a strategic realignment that did not recur in 2006. These results were also impacted by an $11 million and $35 million increase in impairment losses for the three months and nine months ended September 30, 2006, respectively.

Fee and other revenues for the three and nine months ended September 30, 2006 were $187 million and $576 million, respectively, a decrease of $8 million and an increase of $11 million versus the same periods in 2005. The change in both periods reflects a decrease in revenues from the sale and production of oil and gas from the subsidiary operations of Liberty Energy Holdings, LLC (“Liberty Energy”), partially offset by lease income earned from a commercial office building acquired in January 2006. The year-to-date change also reflects an increase in premium financing activity in the Company’s International operations, partially offset by lower fee revenue 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 and nine months ended September 30, 2006 were $5.220 billion and $15.831 billion, respectively, a decrease of $356 million and an increase of $1.029 billion over the same periods in 2005. The decrease in the quarter is primarily due to lower catastrophe losses and a decrease in incurred losses attributable to prior years, partially offset by business growth and general cost increases in each of the Company’s SBUs. The change in both periods also reflects an increase in Personal Markets’ sales and service personnel costs and direct mail costs and higher profit share expenses related to the property and casualty business and operations acquired from Prudential Financial, Inc. (“PruPac”) and an increase in variable incentive compensation, other benefit costs and interest expense related to the Company’s August 2006 debt issuance. The year-to-date increase is also due to an increase in policyholder benefits related to immediate annuity and structured settlement business growth and an increase in catastrophe losses (excluding 2005 hurricanes), primarily due to wind and hail storms in the Midwest. Catastrophe losses, however, decreased in both periods, as prior year results included the impact of the 2005 hurricanes. Incurred losses attributable to prior years also decreased in both periods, as prior year results reflect the impact of the Company’s third quarter 2005 asbestos study, which did not recur in 2006.

CONSOLIDATED	Three Months Ended September 30, 2006	2005	Change (Points)	Nine Months Ended September 30, 2006	2005	Change (Points)
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion						
Claims and claim adjustment expense ratio	67.4%	68.9%	(1.5)	67.8%	68.6%	(0.8)
Underwriting expense ratio	27.0	22.5	4.5	27.0	25.8	1.2
Dividend ratio	0.3	0.2	0.1	0.3	0.1	0.2
Subtotal	94.7	91.6	3.1	95.1	94.5	0.6
Catastrophes[1]:						
- 2005 hurricanes	0.8	21.9	(21.1)	0.6	7.4	(6.8)
- All other	1.9	1.1	0.8	2.4	1.4	1.0
Net incurred losses attributable to prior years:						
- Asbestos	-	4.8	(4.8)	-	1.7	(1.7)
- All other	0.1	(1.8)	1.9	1.0	0.0	1.0
Discount accretion	0.5	0.7	(0.2)	0.6	0.7	(0.1)
Total combined ratio[2]	98.0%	118.3%	(20.3)	99.7%	105.7%	(6.0)

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 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 and nine months ended September 30, 2006 was 94.7% and 95.1%, respectively, an increase of 3.1 and 0.6 points from the comparable periods in 2005. The increase in both periods was primarily due to an increase in the underwriting expense ratio, partially offset by a decrease in the claims and claim adjustment expense ratio. The increase in the underwriting expense ratio for both periods reflects an increase in variable incentive compensation and other benefit costs. The increase in the underwriting expense ratio for both periods also reflects an increase in Personal Markets' acquisition expenses primarily due to an increase in sales and service personnel costs, an increase in direct mail costs, and higher profit share expenses related to PruPac. The decrease in the claims and claim adjustment expense ratio for both periods is driven primarily by earned premium growth in LIU's reinsurance segment due to significant rate increases and favorable loss frequency trends in Personal Markets' auto and homeowners business and Commercial Markets' workers compensation business.

Including the impact of catastrophes, net incurred losses attributable to prior years and discount accretion, the total combined ratio was 98.0% for the quarter and 99.7% year-to-date, a decrease of 20.3 and 6.0 points, respectively, from the same periods in 2005. Catastrophe losses decreased 20.3 and 5.8 points in the quarter and year-to-date, respectively, as prior year results included the impact of the 2005 hurricanes. The decrease in catastrophe losses was partially offset by higher 2006 non-hurricane storm activity, primarily in the Midwest. Net incurred losses attributable to prior years also decreased 2.9 and 0.7 points, respectively. In the third quarter of 2005, net incurred losses attributable to prior years increased by 4.7 points following the Company's completion of its 2005 asbestos study, which did not recur in 2006.

PTOI for the three and nine months ended September 30, 2006 was $552 million and $1.370 billion, respectively, an increase of $915 million and $904 million over the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $238 million and $510 million, respectively, an increase of $306 million and $451 million over the same periods in 2005. The Company's effective tax rates for the three and nine months ended September 30, 2006 were 30%, compared to (36%) and 7% for the same periods for 2005. The Company determines its estimated annual effective tax rate in accordance with APB Opinion No. 28. This rate is revised at the end of each successive interim period to reflect the Company's best current estimate of its annual effective tax rate. Any change in the estimated annual effective tax rate is reflected in the interim period results in which the change occurs. The increase in the Company's 2006 effective tax rate is primarily due to the reduction of the domestic valuation allowance to zero in 2005. The Company's effective tax rate differs from the Federal statutory rate of 35% principally due to tax-exempt investment income, goodwill, and foreign taxes.

Net income for the three and nine months ended September 30, 2006 was $556 million and $1.171 billion, respectively, an increase of $678 million and $397 million over the same periods in 2005.

PERSONAL MARKETS

(1) Overview – Personal Markets

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Private passenger automobile	$1,014	$1,023	(0.9%)	$2,853	$2,871	(0.6%)
Homeowners and other	473	398	18.8	1,233	1,074	14.8
Total net written premium	$1,487	$1,421	4.6%	$4,086	$3,945	3.6%

Net written premium for the three and nine months ended September 30, 2006 was $1.487 billion and $4.086 billion, respectively, an increase of $66 million and $141 million over the same periods in 2005. The increase in both periods reflects the following changes:

Private passenger automobile net written premium for the three and nine months ended September 30, 2006 was $1.014 billion and $2.853 billion, respectively, a decrease of $9 million and $18 million from the same periods in 2005. The decrease in both periods reflects lower average written premium per policy due to modest rate decreases, a shift in state mix, a reduction in involuntary market policies and a general improvement in the quality of the risks underwritten. Partially offsetting this decrease was an increase of 2.5% in voluntary policies in force over the same period in 2005 due to strong customer retention.

Homeowners and other net written premium for the three and nine months ended September 30, 2006 was $473 million and $1.233 billion, respectively, an increase of $75 million and $159 million over the same periods in 2005. The increase is due to rate increases, a 3.8% increase in policies in force over the same period in 2005 driven by strong customer retention and new business growth.

(2) Results of Operations – Personal Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,404	$1,362	3.1%	$4,160	$4,057	2.5%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$232	$270	(14.1%)	$636	$673	(5.5%)
Catastrophes[1]:						
- 2005 hurricanes	3	(264)	NM	(10)	(264)	(96.2)
- All other	(40)	(15)	166.7	(167)	(76)	119.7
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other[2]	20	92	(78.3)	20	99	(79.8)
Discount accretion	-	-	-	-	-	-
Pre-tax operating income	215	83	159.0	479	432	10.9
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax (expense)	(77)	(29)	165.5	(168)	(151)	11.3
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$138	$54	155.6%	$311	$281	10.7%

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 for the three and nine months ended September 30, 2006, and zero and ($4) million for the comparable periods of 2005.
NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2006 were $1.404 billion and $4.160 billion, respectively, an increase of $42 million and $103 million over the same periods in 2005. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2006 was $1.314 billion and $3.898 billion, respectively, an increase of $36 million and $84 million over the same periods in 2005. The increase in both periods reflects the earned premium recognition of business growth consistent with the changes in net written premium.

Net investment income for the three and nine months ended September 30, 2006 was $76 million and $220 million, respectively, an increase of $7 million and $20 million over the same periods in 2005. The increase in both periods reflects a higher invested asset base and strong cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three and nine months ended September 30, 2006 were $1.189 billion and $3.681 billion, respectively, a decrease of $90 million and an increase of $56 million versus the same periods in 2005. The decrease in the quarter reflects lower catastrophe losses and lower claims frequency (excluding catastrophes) in the auto and homeowners lines of business partially offset by a decrease in the amount of favorable incurred losses attributable to prior years. Also impacting both periods was an increase in acquisition expenses due to an increase in sales and service personnel costs, an increase in direct mail costs and higher profit share expense related to the PruPac business. The increase in year-to-date claims, benefits, and expenses is also due to a decrease in the amount of favorable incurred losses attributable to prior years, partially offset by lower catastrophe losses and lower claims frequency (excluding catastrophes) in the auto and homeowners lines of business. The decrease in catastrophe losses reflects the impact of the 2005 hurricanes in the prior year, partially offset by an increase in current year wind and hail storms, primarily in the Midwest.

	Three Months Ended September 30,			Nine Months Ended September 30,		
PERSONAL MARKETS	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion						
Claims and claim adjustment expense ratio	62.8%	63.6%	(0.8)	63.6%	65.4%	(1.8)
Underwriting expense ratio	25.1	20.5	4.6	25.3	22.2	3.1
Dividend ratio	-	(0.2)	0.2	-	(0.1)	0.1
Subtotal	87.9	83.9	4.0	88.9	87.5	1.4
Catastrophes[1]:						
- 2005 hurricanes	(0.2)	20.7	(20.9)	0.3	6.9	(6.6)
- All other	3.0	1.1	1.9	4.3	2.0	2.3
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	(1.5)	(7.2)	5.7	(0.5)	(2.6)	2.1
Discount accretion	-	-	-	-	-	-
Total combined ratio	89.2%	98.5%	(9.3)	93.0%	93.8%	(0.8)

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

Personal Markets' combined ratio before catastrophes and net incurred losses attributable to prior years for the three and nine months ended September 30, 2006 was 87.9% and 88.9%, respectively, an increase of 4.0 and 1.4 points over the same periods in 2005. The increase in both periods reflects a higher expense ratio due to an increase in acquisition expenses primarily related to an increase in sales and service personnel costs, an increase in direct mail costs, and higher profit share expense. The increase in both periods was partially offset by a decrease in the claims and claim adjustment expense ratio due to lower claims frequency trends (excluding catastrophes) 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 for the three and nine months ended September 30, 2006 was 89.2% and 93.0%, respectively, a decrease of 9.3 and 0.8 points from the same periods in 2005, as prior year results include lower catastrophe losses. The decrease in catastrophes include the impact of the 2005 hurricanes in the prior year, partially offset by an increase in current year wind and hail storms, primarily in the Midwest. These decreases were partially offset by a decrease in the amount of favorable incurred losses attributable to prior years in the auto and homeowners lines of business.

PTOI for the three and nine months ended September 30, 2006 was $215 million and $479 million, respectively, an increase of $132 million and $47 million over the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $77 million and $168 million, respectively, an increase of $48 million and $17 million over the same periods in 2005.

Net income for the three and nine months ended September 30, 2006 was $138 million and $311 million, respectively, an increase of $84 million and $30 million over the same periods in 2005.

COMMERCIAL MARKETS

(1) Overview – Commercial Markets

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Business Market	$361	$351	2.8%	$1,247	$1,147	8.7%
National Market [1]	288	214	34.6	925	839	10.3
Liberty Mutual Property	76	42	81.0	235	156	50.6
Group Market	99	84	17.9	297	257	15.6
Other Markets [1]	178	85	109.4	421	245	71.8
Total net written premium	$1,002	$776	29.1%	$3,125	$2,644	18.2%

1 Effective January 1, 2006, Liberty Mutual Alternative Markets, included within Other Markets, has been reorganized to include certain energy business that was previously included within National Market. Results for all years have been restated for this reorganization.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Workers compensation	$519	$422	23.0%	$1,705	$1,469	16.1%
Commercial automobile	110	96	14.6	317	316	0.3
General liability	120	72	66.7	376	289	30.1
Group disability / life	99	84	17.9	297	257	15.6
Commercial multiple peril / Fire	54	36	50.0	201	134	50.0
Assumed voluntary reinsurance	42	24	75.0	88	72	22.2
Other	58	42	38.1	141	107	31.8
Total net written premium	$1,002	$776	29.1%	$3,125	$2,644	18.2%

Net written premium for the three and nine months ended September 30, 2006 was $1.002 billion and $3.125 billion, respectively, an increase of $226 million and $481 million over the same periods in 2005. New business growth and strong customer retention were the primary drivers for premium increases in both periods across the business segments. In addition, Liberty Mutual Property's net written premium increased in both periods as a result of lower ceded reinstatement premium in 2006 versus 2005 and significant rate increases in 2006. The increase in workers compensation premium in both periods is also driven by the non-renewal of an involuntary market reinsurance treaty in Other Markets as well as an increase in the payroll exposure base in the Business and National Markets segments. Premium growth in general liability for both periods primarily reflects new business growth due to the addition of several National Market accounts. These increases were partially offset by lower year-to-date retrospectively rated policy premiums and modest rate decreases in both periods in all non-property lines.

Results of Operations – Commercial Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,229	$1,068	15.1%	$3,499	$3,208	9.1%
PTOI before catastrophes, net incurred losses attributable to prior years and discount accretion	$ 124	$110	12.7	$369	$324	13.9
Catastrophes[1]						
- 2005 hurricanes[2,3]	2	(116)	NM	(30)	(107)	(72.0)
- All other	(16)	(8)	100.0	(35)	(18)	94.4
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other [4]	(37)	(32)	15.6	(60)	(60)	-
Discount accretion[5]	(17)	(22)	(22.7)	(60)	(64)	(6.3)
Pre-tax operating income	56	(68)	NM	184	75	145.3
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax (expense)	(21)	24	NM	(65)	(26)	150.0
Discontinued operations, net of tax	-	-	-	-	-	-
Net income[5]	$35	($44)	NM	$119	$49	142.9%

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance 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 Assumed catastrophe losses related to the 2005 hurricanes are reported net of related net catastrophe reinsurance premium earned of $4 million and $13 million for the three and nine months ended September 30, 2005.

3 In the first quarter of 2006, the Company reclassified the pre-2004 results of Commercial Markets' assumed voluntary reinsurance business to Corporate and Other. This reclassification had no impact on 2005 results.

4 Net of earned premium attributable to prior years of ($19) million and ($22) million for the three and nine months September 30, 2006, respectively, and $21 million for the comparable periods in 2005. Net of amortization of deferred gains on retroactive reinsurance of $7 million and $22 million for the three and nine months ended September 30, 2006, respectively, and $13 million and $39 million for the comparable periods in 2005.

5 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 for voluntary and involuntary business 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

NM = Not Meaningful.

Revenues for the three and nine months ended September 30, 2006 were $1.229 billion and $3.499 billion, respectively, an increase of $161 million and $291 million over the same periods in 2005.

Net premium earned for the three and nine months ended September 30, 2006 was $996 million and $2.814 billion, respectively, an increase of $157 million and $296 million over the same periods in 2005. The increase in both periods reflects the earned premium recognition of business growth consistent with the changes in net written premium.

Net investment income for the three and nine months ended September 30, 2006 was $141 million and $417 million, respectively, an increase of $2 million and $8 million over the same periods in 2005. The increases reflect a higher invested asset base and strong cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and nine months ended September 30, 2006 were $92 million and $268 million, respectively, an increase of $2 million and a decrease of $13 million versus the same periods in 2005. The decrease year-to-date primarily reflects 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 and nine months ended September 30, 2006 were $1.173 billion and $3.315 billion, respectively, an increase of $37 million and $182 million over the same periods in 2005. The increase is primarily driven by business growth and the non-renewal of a ceded reinsurance program partially offset by lower catastrophe losses.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
COMMERCIAL MARKETS	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years						
Claims and claim adjustment expense ratio	80.4%	81.7%	(1.3)	79.2%	80.7%	(1.5)
Underwriting expense ratio	18.3	19.0	(0.7)	19.7	19.0	0.7
Dividend ratio	0.2	0.1	0.1	0.2	(0.8)	1.0
Subtotal	98.9	100.8	(1.9)	99.1	98.9	0.2
Catastrophes[1]						
- 2005 hurricanes	(0.2)	15.8	(16.0)	1.2	4.8	(3.6)
- All other	1.7	1.0	0.7	1.4	0.8	0.6
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	4.2	3.8	0.4	2.4	2.5	(0.1)
Discount accretion	1.8	3.0	(1.2)	2.4	2.9	(0.5)
Total combined ratio	106.4%	124.4%	(18.0)	106.5%	109.9%	(3.4)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance 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.

The Commercial Markets combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the three and nine months ended September 30, 2006 was 98.9% and 99.1%, respectively, a decrease of 1.9 and an increase of 0.2 points versus the same periods in 2005. Claims and claim adjustment expenses decreased in both periods due to favorable loss frequency trends primarily in workers compensation. The underwriting expense ratio also decreased in the quarter as modest growth in expenses was more than offset by premium growth including the impact of lower ceded reinstatement premium. On a year-to-date basis the underwriting expense ratio reflects the reduction in the expense reimbursement received from the Company's servicing carrier operations and lower ceding commissions. The increase of 1.0 point in the year-to-date dividend ratio is the result of a re-evaluation of the estimate for dividend reserves 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 for the three and nine months ended September 30, 2006 was 106.4% and 106.5%, respectively, a decrease of 18.0 and 3.4 points over the same periods in 2005. Catastrophe losses decreased 15.3 and 3.0 points from 2005, as prior year results included the impact of Hurricanes Katrina and Rita.

PTOI for the three and nine months ended September 30, 2006 was $56 million and $184 million, respectively, an increase of $124 million and $109 million versus the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $21 million and $65 million, respectively, an increase of $45 million and $39 million versus the same periods in 2005.

Net income for the three and nine months ended September 30, 2006 was $35 million and $119 million, respectively, an increase of $79 million and $70 million versus the same periods in 2005.

AGENCY MARKETS

(1) Overview – Agency Markets

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Regional Companies	$918	$887	3.5%	$2,578	$2,518	2.4%
Wausau	320	289	10.7	965	857	12.6
Summit	136	130	4.6	707	652	8.4
Surety	65	47	38.3	183	147	24.5
Other	30	11	172.7	83	28	196.4
Total net written premium	$1,469	$1,364	7.7%	$4,516	$4,202	7.5%

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Commercial Lines						
Workers compensation total:	$563	$506	11.3%	$1,985	$1,762	12.7 %
- Wausau	242	215	12.6	752	656	14.6
- Summit	136	130	4.6	707	652	8.4
- All other	185	161	14.9	526	454	15.9
Commercial multiple peril	331	318	4.1	906	880	3.0
Commercial automobile	186	184	1.1	535	526	1.7
General liability	71	60	18.3	209	170	22.9
Surety	66	47	40.4	188	147	27.9
Other	52	44	18.2	143	124	15.3
Subtotal	$1,269	$1,159	9.5%	$3,966	$3,609	9.9%
Personal Lines						
Private passenger automobile	$117	$123	(4.9%)	$327	$365	(10.4%)
Homeowners	73	74	(1.4)	196	204	(3.9)
Other	10	8	25.0	27	24	12.5
Subtotal	$200	$205	(2.4%)	$550	$593	(7.3%)
Total net written premium	$1,469	$1,364	7.7%	$4,516	$4,202	7.5%

Net written premium for the three and nine months ended September 30, 2006 was $1.469 billion and $4.516 billion, respectively, an increase of $105 million and $314 million over the same periods in 2005. The growth in both periods reflects an increase in workers compensation premium driven by new business growth, higher retention at Wausau and the Regional Companies, and an increase in exposure (including higher accrued audit and retrospective premiums) on existing accounts at Summit. These increases were partially offset by modest rate decreases in most states including mandated rate decreases in Florida and a significant decline in California rates due to workers compensation reform. The remainder of the growth in both periods reflects higher retentions and reduced reinsurance cessions in commercial lines and the non-renewal of a ceded involuntary workers compensation reinsurance program in 2006, partially offset by modest rate decreases in all lines except surety. These increases were partially offset by a decrease in personal lines net written premium in both periods due primarily to a decrease in policies in force and modest rate decreases.

(2) Results of Operations – Agency Markets

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,572	$1,482	6.1%	$4,595	$4,263	7.8%
PTOI before catastrophes, incurred losses attributable to prior years and discount accretion	$147	$146	0.7%	$452	$409	10.5%
Catastrophes[1]:						
- 2005 hurricanes	(1)	(50)	(98.0)	(4)	(50)	(92.0)
- All other	(35)	(7)	NM	(116)	(23)	NM
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other[2]	24	31	(22.6)	57	54	5.6
Discount accretion	(4)	(7)	(42.9)	(12)	(17)	(29.4)
Pre-tax operating income	131	113	15.9	377	373	1.1
Realized investment gains, net	-	3	(100.0)	-	6	(100.0)
Federal and foreign income tax expense	(46)	(41)	12.2	(132)	(133)	(0.8)
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$85	$75	13.3%	$245	$246	(0.4%)

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 $6 million and $37 million for the three and nine months ended September 30, 2006, respectively, and $6 million and $14 million for the comparable periods of 2005. Net of amortization of deferred gains on retroactive reinsurance of $3 million and $8 million for the three and nine months ended September 30, 2006, respectively, and $2 million and $13 million for the comparable periods of 2005.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2006 were $1.572 billion and $4.595 billion, respectively, an increase of $90 million and $332 million over the same periods in 2005. The major components of revenues include net premium earned and net investment income.

Net premium earned for the three and nine months ended September 30, 2006 was $1.433 billion and $4.190 billion, respectively, an increase of $88 million and $325 million over the same periods in 2005. The increase in both periods reflects the earned premium recognition of business growth consistent with the changes in net written premium.

Net investment income for the three and nine months ended September 30, 2006 was $116 million and $336 million, respectively, an increase of $4 million and $11 million from the same periods in 2005. The increases reflect a higher invested asset base and strong cash flow from operations, partially offset by lower investment yields.

Claims, benefits and expenses for the three and nine months ended September 30, 2006 were $1.441 billion and $4.218 billion, respectively, an increase of $75 million and $334 million over the same periods in 2005. The increase in both periods is primarily due to business growth, general cost increases and a reduction in the amount of favorable incurred loss development attributable to prior years primarily related to favorable surety results in 2005 that did not recur in 2006 partially offset by a decrease in workers compensation incurred losses attributable to prior years. Year-to-date results also reflect higher catastrophe losses, primarily due to 2006 storm activity in the Midwest.

	Three Months Ended September 30,			Nine Months Ended September 30,		
AGENCY MARKETS	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion						
Claims and claim adjustment expense ratio	66.5%	65.0%	1.5	65.7%	64.9%	0.8
Underwriting expense ratio	30.0	31.1	(1.1)	30.5	31.5	(1.0)
Dividend ratio	0.9	0.9	-	1.0	0.9	0.1
Subtotal	97.4	97.0	0.4	97.2	97.3	(0.1)
Catastrophes[1]:						
- 2005 hurricanes	-	3.7	(3.7)	0.1	1.3	(1.2)
- All other	2.5	0.6	1.9	2.8	0.7	2.1
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	(1.7)	(2.3)	0.6	(1.4)	(1.4)	-
Discount accretion	0.3	0.5	(0.2)	0.3	0.4	(0.1)
Total combined ratio	98.5%	99.5%	(1.0)	99.0%	98.3%	0.7

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 and nine months ended September 30, 2006 was 97.4% and 97.2%, respectively, an increase of 0.4 points and a decrease of 0.1 points versus the same periods in 2005. The increase in the claims and claim adjustment expense ratio in both periods is due to a higher loss ratio at Summit due to the effects of mandated rate decreases in Florida, higher workers compensation losses at Wausau and higher property (excluding catastrophes) losses. Partially offsetting the increases in both periods were favorable current accident year surety results and a lower expense ratio. The decrease in the underwriting expense ratio in both periods was driven by strong premium growth and lower net commission rates of the Regional Companies and Summit.

Including the impact of catastrophes, net incurred losses attributable to prior years, and discount accretion, the total combined ratio for the three and nine months ended September 30, 2006 was 98.5% and 99.0%, respectively, a decrease of 1.0 and an increase of 0.7 points versus the same periods in 2005. Catastrophe losses decreased 1.8 points in the quarter and increased 0.9 points year-to-date. The decrease in the quarter reflects higher catastrophe losses in 2005 versus 2006 due to Hurricanes Katrina and Rita partially offset by a reduction in the amount of favorable incurred loss development attributable to prior years primarily related to favorable surety results in 2005 that did not recur in 2006, partially offset by a decrease in workers compensation incurred losses attributable to prior years. The increase year-to-date is primarily due to 2006 storm activity in the Midwest.

PTOI for the three and nine months ended September 30, 2006 was $131 million and $377 million, respectively, an increase of $18 million and $4 million from the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $46 million and $132 million, respectively, an increase of $5 million and a decrease of $1 million versus the same periods in 2005.

Net income for the three and nine months ended September 30, 2006 was $85 million and $245 million, respectively, an increase of $10 million quarter and a decrease of $1 million year-to-date from the same periods in 2005.

INTERNATIONAL

(1) Overview – International

International net written premium by market segment was as follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
International Local Businesses	$640	$547	17.0%	$1,915	$1,652	15.9%
Liberty International Underwriters	396	304	30.3	1,612	1,133	42.3
Total net written premium	$1,036	$851	21.7%	$3,527	$2,785	26.6%

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 September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Local Businesses – private passenger auto	$368	$328	12.2%	$1,088	$949	14.6%
Local Businesses – all other	272	219	24.2	827	703	17.6
LIU Reinsurance	159	166	(4.2)	846	635	33.2
LIU First Party[1]	132	46	187.0	408	172	137.2
LIU Third Party[1]	106	97	9.3	338	304	11.2
LIU Other	(1)	(5)	(80.0)	20	22	(9.1)
Total net written premium	$1,036	$851	21.7%	$3,527	$2,785	26.6%

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 and nine months ended September 30, 2006 was $1.036 billion and $3.527 billion, respectively, an increase of $185 million and $742 million over the same periods in 2005. The increase in private passenger auto net written premium in both periods reflects organic growth in Europe and Latin America, primarily Brazil and Venezuela, while the increase in all other local businesses reflects organic growth in Latin America. In addition, the increase in LIU's First Party business in both periods was primarily due to the establishment of an inland marine specialty program in the third quarter of 2005 and rate increases on energy business. LIU's Third Party business also increased in both periods due primarily to a reduction in the Company's utilization of reinsurance as compared to prior periods and organic growth, primarily in casualty business. The year-to-date increase in LIU's Reinsurance line of business was primarily due to rate increases on property business as well as profit commission adjustments and lower reinstatement premiums related to ceded reinsurance contracts covering 2005 hurricane losses while the decrease in the quarter was due to the re-estimation of ultimate premium on the 2005 year of accounts which resulted in higher net written premium in the third quarter of 2005.

(2) Results of Operations – International

	Three Months Ended September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,201	$981	22.4%	$3,565	$2,860	24.7%
PTOI before catastrophes, incurred losses attributable to prior years and discount accretion	$152	$88	72.7%	$400	$247	61.9%
Catastrophes[1]:						
- 2005 hurricanes[2,3]	(40)	(402)	(90.0)	(28)	(402)	(93.0)
- All other	-	(19)	(100.0)	(18)	(49)	(63.3)
Net incurred losses attributable to Prior years:						
- Asbestos	-	-	-	-	-	-
- All other[4]	38	11	NM	(19)	10	NM
Discount accretion	-	-	-	-	-	-
Pre-tax operating income (loss)	150	(322)	NM	335	(194)	NM
Realized investment gains, net	1	13	(92.3)	25	12	108.3
Federal and foreign income tax (expense) benefit	(29)	88	NM	(95)	24	NM
Discontinued operations, net of tax	-	-	-	-	(12)	(100.0)
Net income (loss)	$122	($221)	NM	$265	($170)	NM

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to 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. Losses related to the 2005 hurricanes for the three and nine months ended September 30, 2006 include the reversal of $39 million and $29 million, respectively, and the three and nine months ended September 30, 2005 include the reversal of $98 million in both periods of profit sharing on external reinsurance accrued in 2004 and the first half of 2005. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes are reported net of the Company's reasonable assumption of expected catastrophe activity (defined as "net catastrophe reinsurance premium earned"). Catastrophe losses include the impact of reinstatement premiums.

2 Losses incurred by LIU's Reinsurance line of business related to Hurricane Rita were classified as part of normal operations in the third quarter of the prior year, but were reclassified as catastrophe losses in the fourth quarter of 2005. These losses have been classified as catastrophe losses in the current presentation.

3 Assumed catastrophe losses related to the 2005 hurricanes are reported net of related net catastrophe reinsurance premium earned of $78 million for the three and nine months ended September 30, 2005.

4 Net of earned premium attributable to prior years of ($5) million and $1 million for the three and nine months ended September 30, 2006, respectively, and $4 million and $9 million for the comparable periods of 2005.

NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2006 were $1.201 billion and $3.565 billion, respectively, an increase of $220 million and $705 million over the same periods in 2005. The major components of revenues include net premium earned, realized investments gains and losses and net investment income.

Net premium earned for the three and nine months ended September 30, 2006 was $1.081 billion and $3.204 billion, respectively, an increase of $208 million and $642 million over the same periods in 2005. The increase in both periods reflects the earned premium recognition of business growth consistent with the changes in net written premium. In addition, earned premium was lower in 2005 due to the accelerated recognition of ceded earned premium on reinsurance contracts covering losses related to the 2005 hurricanes.

Net investment income for the three and nine months ended September 30, 2006 was $107 million and $295 million, respectively, an increase of $22 million and $39 million over the same periods in 2005. The increase is driven by a higher invested asset base, due primarily to capital contributions and strong operating cash flow.

Realized investment gains for the three and nine months ended September 30, 2006 were $1 million and $25 million, respectively, a decrease of $12 million and an increase of $13 million over the same periods in 2005. The change in both periods reflects normal portfolio turnover. The increase year-to-date also includes the redemption of certain government debt securities in Venezuela.

Claims, benefits and expenses for the three and nine months ended September 30, 2006 were $1.050 billion and $3.205 billion, a decrease of $240 million and an increase of $163 million over the same periods in 2005. Losses related to the 2005 hurricanes decreased $375 million and $335 million in the quarter and year-to-date from the same periods in 2005. Losses related to the 2004 hurricanes decreased $19 million and $31 million in the quarter and year-to-date, respectively, from the same periods in 2005. Incurred losses attributable to prior years decreased $36 million and increased $21 million in the quarter and year-to-date, respectively, versus the same periods in 2005 primarily due to reserve adjustments related to loss trends on casualty business of LIU's Reinsurance segment. The remainder of the increase in the quarter and year-to-date reflects business growth in the Company's local operations and LIU's Reinsurance, First Party and Third Party businesses. Foreign exchange gains decreased $9 million and increased $25 million in the quarter and year-to-date, respectively, versus the same periods in 2005 due to fluctuation in foreign exchange rates, primarily in Venezuela and Colombia.

	Three Months Ended September 30,			**Nine Months Ended September 30,**		
INTERNATIONAL	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion						
Claims and claim adjustment expense ratio	63.9%	70.3%	(6.4)	66.2%	67.9%	(1.7)
Underwriting expense ratio	29.9	27.1	2.8	28.9	29.3	(0.4)
Dividend ratio	-	-	-	-	-	-
Subtotal	93.8	97.4	(3.6)	95.1	97.2	(2.1)
Catastrophes[1]:						
- 2005 hurricanes	3.4	47.8	(44.4)	0.9	16.4	(15.5)
- All other	-	2.1	(2.1)	0.6	1.9	(1.3)
Net incurred losses attributable to prior years:						
- Asbestos	-	-	-	-	-	-
- All other	(3.5)	(1.4)	(2.1)	0.5	(0.4)	0.9
Discount accretion	-	-	-	-	-	-
Total combined ratio	93.7%	145.9%	(52.2)	97.1%	115.1%	(18.0)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to 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.

International's combined ratio before catastrophes, net incurred losses attributable to prior years and discount accretion for the three and nine months ended September 30, 2006 was 93.8% and 95.1%, respectively, a decrease of 3.6 points and 2.1 points from the same periods in 2005. The decrease in the claims and claim adjustment expense ratio in both periods was primarily attributable to significant rate increases earned on LIU's Reinsurance business and favorable loss experience to date in LIU's Reinsurance line of business partially offset by the increase of inland marine specialty business which has a higher loss ratio than International's other lines of business. The increase in the expense ratio for the quarter reflects earned premium adjustments related to LIU Reinsurance in 2005, partially offset by the increase in the inland marine specialty business, which has a lower expense ratio than International's other lines of business, and impacted both periods.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and nine months ended September 30, 2006 was 93.7% and 97.1%, respectively, a decrease of 52.2 and 18.0 points from the same periods in 2005. Catastrophe losses decreased 46.5 points and 16.8 points in the quarter and year-to-date, respectively, from the same periods in 2005. Catastrophe losses in 2005 include losses from Hurricanes Katrina and Rita. Net incurred losses attributable to prior years decreased 2.1 points and increased 0.9 points in the quarter and year-to-date, respectively, from the same periods in 2005 primarily due to reserve adjustments on casualty business in LIU's Reinsurance segment.

PTOI for the three and nine months ended September 30, 2006 was $150 million and $335 million, respectively, an increase of $472 million and $529 million over the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $29 million and $95 million, respectively, an increase of $117 million and $119 million over the same periods in 2005. These increases are primarily driven by the tax benefit from losses incurred from the 2005 hurricanes in the prior year. Federal and foreign income taxes reflect volatility associated with the different tax structures within the countries that the International SBU operates.

Net income for the three and nine months ended September 30, 2006 was $122 million and $265 million, respectively, an increase of $343 million and $435 million over the same periods in 2005. In 2005, the Company recorded a $12 million loss, net of tax, in discontinued operations related to the disposal of certain pension business in Spain.

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 January 1, 2006, the pre-2004 Commercial assumed voluntary reinsurance business.

- 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 SBUs. 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.

- 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, 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 September 30,			Nine Months Ended September 30,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$608	$493	23.3%	$1,693	$1,259	34.5%
Pre-tax operating income before catastrophes, net incurred losses attributable to prior years and discount accretion	$55	$165	(66.7%)	$148	$202	(26.7%)
Catastrophes[1]:						
- 2005 hurricanes	(4)	(96)	(95.8)	(9)	(96)	(90.6)
- All other	-	6	(100.0)	-	-	-
Net incurred losses attributable to prior years:						
- Asbestos	(1)	(208)	(99.5)	(2)	(210)	(99.0)
- All other	(48)	(33)	45.5	(135)	(108)	25.0
Discount accretion	(2)	(3)	(33.3)	(7)	(8)	(12.5)
Pre-tax operating income (loss)	-	(169)	(100.0)	(5)	(220)	97.7
Realized investment gains, net	241	157	53.5	286	361	(20.8)
Federal and foreign income tax benefit (expense)	(65)	26	NM	(50)	227	NM
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$176	$14	NM	$231	$368	(37.2%)

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
NM = Not Meaningful

Revenues for the three and nine months ended September 30, 2006 were $608 million and $1.693 billion, respectively, an increase of $115 million and $434 million over the same periods 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 and nine months ended September 30, 2006 was $97 million and $661 million, respectively, an increase of $4 million and $455 million over the same periods in 2005. The increase year-to-date is due primarily to the sale of annuities and structured settlements.

Net investment income for the three and nine months ended September 30, 2006 was $224 million and $590 million, respectively, an increase of $39 million and $42 million over the same periods in 2005. The increase in both periods reflects higher interest income due to a larger invested asset base and continued strong cash flow from operations, as well as an increase in limited partnership and limited liability company income.

Realized investment gains for the three and nine months ended September 30, 2006 were $241 million and $286 million, respectively, an increase of $84 million and a decrease of $75 million versus the same periods in 2005. The increase in the quarter is primarily due to an increase in energy related gains partially offset by lower gains on fixed maturities. The year-to-date decrease is primarily due to lower gains on fixed maturities partially offset by an increase in energy related gains.

Fee and other revenues for the three and nine months ended September 30, 2006 were $46 million and $156 million, respectively, a decrease of $12 million and an increase $12 million versus the same periods in 2005. The change in both periods reflects a decrease in revenues from the sale and production of oil and gas from the subsidiary operations of Liberty Energy, partially offset by lease income earned from a commercial office building acquired in January 2006.

Claims, benefits and expenses for the three and nine months ended September 30, 2006 were $367 million and $1.412 billion, respectively, a decrease of $138 million and an increase of $294 million versus the same periods in 2005. The decrease in the quarter is primarily due to lower catastrophe losses and incurred losses attributable to prior years partially offset by an increase in insurance operating costs and expenses primarily related to an increase in variable incentive compensation, other benefit costs and interest expense related to the Company's August 2006 debt issuance. The year-to-date increase is primarily due to an increase in policyholder benefits related to immediate annuity and structured settlement business growth and insurance operating costs and expenses primarily related to variable incentive compensation, other benefit costs and interest expense related to the Company's March 2005 and August 2006 debt issuances. The year-to-date increase was partially offset by lower assumed intercompany catastrophe losses in 2006 versus 2005 and a decrease in incurred losses attributable to prior years.

Pre-tax operating income (loss) for the three and nine months ended September 30, 2006 was zero and ($5) million, respectively, an increase of $169 million and $215 million over the same periods in 2005.

Federal and foreign income tax expense for the three and nine months ended September 30, 2006 was $65 million and $50 million, respectively, an increase of $91 million and $277 million from the comparable periods in 2005. See the Consolidated Section for a discussion of taxes.

Net income for the three and nine months ended September 30, 2006 was $176 million and $231 million, respectively, an increase of $162 million and a decrease of $137 million versus the same periods 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 as of September 30, 2006 and December 31, 2005:

$ in Millions	**As of September 30, 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	$40,159	88.0%	$37,391	89.3%
Equity securities, available for sale, at fair value	2,440	5.4	1,908	4.6
Trading securities, at fair value	22	-	20	-
Limited partnerships and limited liability companies	1,547	3.4	1,040	2.5
Short-term investments	1,373	3.0	1,430	3.4
Other investments	88	0.2	84	0.2
Total invested assets	$45,629	100.0%	$41,873	100.0%

Total invested assets as of September 30, 2006 were $45.629 billion, a $3.756 billion or 9.0% increase over December 31, 2005. The increase reflects strong cash flow from operations, the investment of proceeds from the Company's August 2006 debt offering, and an increase in commitments to purchase securities, partially offset by a decline in unrealized capital gains.

Fixed maturities as of September 30, 2006 were $40.159 billion, an increase of $2.768 billion or 7.4% over December 31, 2005. The increase reflects the aforementioned change in the amount of cash available to invest, partially offset by a decrease in net unrealized gains in the portfolio due to higher market interest rates. As of September 30, 2006, net unrealized gains were $133 million, a decrease of $296 million from December 21, 2005.

Equity securities available for sale as of September 30, 2006 were $2.440 billion, a $532 million or 27.9% increase over December 31, 2005. The increase reflects a $333 million increase in preferred stock due to new investments in this asset class, and a $199 million increase in common stock due to new investments and market appreciation.

Limited partnerships and limited liability companies as of September 30, 2006 were $1.547 billion, a $507 million or 48.8% increase over December 31, 2005. The increase reflects in part, the tactical allocation to commercial mortgages and real estate financing, along with continued investment in private equity partnerships and market appreciation. The Company's investments in private equity limited partnerships are long-term in nature and highly illiquid. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

As of September 30, 2006, the Company had unfunded private equity, energy and commercial mortgage commitments of $925 million, $165 million and $103 million, respectively. As of September 30, 2006, the Company had commitments to purchase various residential mortgage-backed securities at a cost of $204 million (fair market value of $205 million) and various corporate and municipal securities at a cost and a fair market value of $95 million.

As of September 30, 2006, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1% of invested assets.

The following tables summarize the Company's fixed income portfolio by security type, credit quality and maturity as of September 30, 2006 and December 31, 2005:

$ in Millions	**As of September 30, 2006**		**As of December 31, 2005**	
Fixed Maturities by Security Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
U.S. Government and agency securities	$4,697	11.7%	$4,570	12.2%
Mortgage and asset-backed securities	12,633	31.4	12,542	33.6
U.S. state and municipal	5,333	13.3	4,005	10.7
Corporate and other	15,263	38.0	14,400	38.5
Foreign government securities	2,233	5.6	1,874	5.0
Total fixed maturities	$40,159	100.0%	$37,391	100.0%

Through the third 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 and municipal, and foreign government securities resulting in market value increases of $1.328 billion and $359 million, respectively, in these asset classes as of September 30, 2006.

$ in Millions	As of September 30, 2006		As of December 31, 2005	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$21,816	54.3%	$20,285	54.3%
AA+, AA, AA-	4,650	11.6	3,903	10.4
A+, A, A-	6,662	16.6	6,786	18.1
BBB+, BBB, BBB-	4,207	10.5	3,824	10.2
BB+, BB, BB-	1,644	4.1	1,325	3.6
B+, B, B-	1,120	2.8	1,238	3.3
CCC or lower	60	0.1	30	0.1
Total fixed maturities	$40,159	100.0%	$37,391	100.0%

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

The Company maintained its allocation in investment grade bonds at 93% since December 31, 2005.

The remaining 7.0% of the Company's investments in fixed maturity securities are non-investment grade. The change in the allocation of single B / double B securities 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) an actively managed 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 September 30, 2006		As of December 31, 2005	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,304	3.2%	$1,080	2.9%
Over 1 yr through 5 yrs	8,198	20.4	6,898	18.4
Over 5 yrs through 10 yrs	7,773	19.4	7,615	20.4
Over ten years	10,251	25.5	9,256	24.8
Mortgage and asset-backed securities	12,633	31.5	12,542	33.5
Total fixed maturities	$40,159	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 for the three and nine months ended September 30, 2006 and 2005:

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Net Investment Income	**2006**	**2005**	**2006**	**2005**
Taxable interest income	$538	$514	$1,546	$1,514
Tax-exempt interest income	53	21	140	41
Dividends	19	8	43	62
Limited partnerships and limited liability companies	82	72	211	189
Other investment income	(1)	(2)	4	5
Gross investment income	691	613	1,944	1,811
Investment expenses	(27)	(23)	(86)	(73)
Net investment income	$664	$590	$1,858	$1,738

Net investment income for the three and nine months ended September 30, 2006 was $664 million and $1.858 billion, respectively, an increase of $74 million and $120 million over the same periods in 2005. The increase in net investment income in both periods reflects higher interest income due to a larger invested asset base and continued strong cash flow from operations, as well as an increase in limited partnership and limited liability company income of $10 million and $22 million in the quarter and year-to-date, respectively, related to private equity investments. The increases in both periods were partially offset by higher investment expenses due primarily to an increase in staffing and fees for outside services. Another factor constraining net investment income growth in both periods was the lower yield on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities beginning in the second half of 2005 and continuing into 2006. In addition, dividend income in the quarter increased over the same period in 2005 due to an increase in investments in preferred stock and a significant dividend received on an equity investment. Year-to-date dividend income, however, decreased due to the termination of an equity investment program in the second quarter of 2005.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and nine months ended September 30, 2006 and 2005:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended September 30, 2006:				
Fixed maturities	($3)	($6)	$ -	($9)
Common and preferred stock	19	(6)	-	13
Other	238	-	-	238
Total	$254	($12)	$ -	$242
Three Months Ended September 30, 2005:				
Fixed maturities	$ 75	$ -	$ -	$ 75
Common and preferred stock	23	(1)	4	26
Other	72	-	-	72
Total	$170	($1)	$4	$173
Nine Months Ended September 30, 2006:				
Fixed maturities	$15	($36)	$ -	($21)
Common and preferred stock	88	(8)	-	80
Other	252	-	-	252
Total	$355	($44)	$ -	$311
Nine Months Ended September 30, 2005:				
Fixed maturities	$167	$ -	$ -	$167
Common and preferred stock	82	(9)	(3)	70
Other	142	-	-	142
Total	$391	($9)	($3)	$379

$ in Millions	Three Months Ended September 30,		Nine Months Ended September 30,	
Components of Net Realized Investment Gains (Losses)	**2006**	**2005**	**2006**	**2005**
Fixed maturities:				
Gross realized gains	$9	$ 84	$55	$222
Gross realized losses	(18)	(9)	(76)	(55)
Equities:				
Gross realized gains	22	28	97	110
Gross realized losses	(9)	(2)	(17)	(40)
Other:				
Gross realized gains	239	73	254	144
Gross realized losses	(1)	(1)	(2)	(2)
Total net realized investment gains (losses)	$242	$173	$311	$379

Net realized investment gains for the three and nine months ended September 30, 2006 were $242 million and $311 million, respectively, an increase of $69 million and a decrease of $68 million versus the same periods in 2005. The increase in net realized investment gains for the quarter was driven by a $235 million gain on the sale of a restricted equity holding. This was partially offset by an $84 million decrease in fixed maturity gains. The decrease in year-to-date net realized investment gains reflects fixed maturity gains in the prior year associated with the sale of targeted taxable securities as part of a strategic realignment that did not recur in 2006. These results were also impacted by an $11 million and $35 million increase in impairment losses for the three months and nine months ended September 30, 2006, respectively.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment as of September 30, 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. Government and agency securities	($9)	$540	($61)	$2,355
Mortgage and asset-backed securities	(40)	3,818	(178)	5,209
U.S. state and municipal	(3)	262	(12)	673
Corporate and other	(66)	3,794	(196)	4,468
Foreign government securities	(12)	779	(2)	129
Equities	(20)	251	(7)	54
Total	($150)	$9,444	($456)	$12,888

Unrealized losses increased from $509 million as of December 31, 2005 to $606 million as of September 30, 2006 primarily due to an increase in interest rates. Approximately 95% of the unrealized losses ($572 million) exist on holdings where the fair value as of September 30, 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 September 30, 2006 are temporary.

The gross unrealized losses recorded on common equity securities and other investments at September 30, 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 catastrophe losses 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 September 30, 2006 totaled $45.629 billion.

Short-term debt outstanding as of September 30, 2006 and December 31, 2005 was as follows:

$ in Millions	**As of September 30, 2006**	**As of December 31, 2005**
Commercial paper	$ -	$100
Revolving credit facilities	40	35
Current maturities of long-term debt	121	10
Total short-term debt	$161	$145

Long-term debt outstanding as of September 30, 2006 and December 31, 2005 was as follows:

$ in Millions	**As of September 30, 2006**	**As of December 31, 2005**
8.20% Surplus notes, due 2007	$ -	$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
6.70% Senior notes, due 2016	250	-
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
7.50% Senior notes, due 2036	500	-
7.697% Surplus notes, due 2097	500	500
7.10% – 7.86%, Medium term notes, with various maturities	27	27
Subtotal	3,209	2,580
Unamortized discount	(35)	(25)
Total long-term debt excluding current maturities	$3,174	$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 Corporate Capital Limited entered into a new $100 million / €85 million / £65 million 364-day revolving credit agreement, which became effective July 31, 2006. The facility is available to provide working capital to the Company's Lloyd's Syndicate business. The 364-day credit agreement is guaranteed by LMIC. To date, no funds have been borrowed under the facility. Effective July 20, 2006, Liberty International Iberia S.L., S.C.S. terminated its €85 million / $100 million 364-day revolving credit agreement.

Liberty Mutual Insurance Europe Limited entered into a $20 million revolving loan agreement, which became effective June 9, 2006. The facility is available to provide working capital to the Company's international operations. The revolving loan 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 September 30, 2006, total short-term loans and borrowings under the Venezuelan credit facility were approximately $40 million.

The $16 million increase in short-term debt outstanding is primarily due to $121 million of 8.2% Surplus Notes due May 4, 2007 and a $5 million increase in outstanding borrowing under the Venezuelan credit facility, partially offset by a redemption of $10 million of 5% Notes due 2008 to Prudential Financial Inc. issued in connection with the PruPac acquisition and a decrease of $100 million of commercial paper.

The $619 million increase in long-term debt outstanding is primarily the result of the August 15, 2006 offering by LMGI of $750 million of senior notes, partially offset by the reclass of the 2007 debt from surplus notes to short-term debt. The proceeds were contributed to its wholly owned subsidiary, LMIC.

Consolidated interest expense for the three and nine months ended September 30, 2006 was $54 million and $151 million, respectively, representing increases of $7 million and $15 million over the same periods 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 September 30, 2006, the Company, through its downstream subsidiary LMGI, had $2.264 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 Liberty Mutual Fire Insurance Company ("LMFIC") and Employers Insurance Company of

Wausau ("EICOW"), an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC and EICOW could negatively affect LMGI's ability to pay principal and interest on 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 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[3]	**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.
[3] Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group.

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. For the three and nine months ended September 30, 2006, the services companies recorded $77 million and $160 million, respectively, 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 $11.508 billion and $9.869 billion at September 30, 2006, and December 31, 2005, respectively. The increase in surplus reflects $593 million of net income, capital contribution from parent of $741 million, affiliated unrealized gains of $179 million, and unaffiliated unrealized gains of $123 million.

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, associated uncollectible reserves;
- 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 $38.592 billion and $38.045 billion at September 30, 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 net of reinsurance and including an allowance for uncollectible accounts were $1.446 billion and $1.628 billion at September 30, 2006 and December 31, 2005, respectively.

The Company's asbestos reserves as of September 30, 2006 and December 31, 2005 were as follows:

$ in Millions	**As of September 30, 2006**	**As of December 31, 2005**
Gross reserves[1]	$1,269	$1,421
Ceded reserves[1]	343	355
Net reserves	$926	$1,066
Allowance for reinsurance on unpaid losses	109	110
Total asbestos reserves	**$1,035**	**$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 $15.937 billion and $16.302 billion as of September 30, 2006 and December 31, 2005, respectively, net of allowance for uncollectible accounts of $344 million and $324 million, respectively. The decrease is primarily due to the ongoing settlement of claims related to Nationwide Indemnity Company and offsetting direct/ceded reductions in reinsurance recoverables related to state mandated involuntary pools and associations.

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 net underwriting risk by ceding 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 93% 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 September 30, 2006. Collateral held against outstanding gross reinsurance recoverable balances was $4.321 billion and $4.106 billion at September 30, 2006 and December 31, 2005, respectively.

The remaining 7% 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 September 30, 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 September 30, 2006 and December 31, 2005) that are amortized into income using the effective interest method over the estimated settlement periods. At September 30, 2006 and December 31, 2005, deferred gains related to these reinsurance arrangements were $839 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 and nine months ended September 30, 2006 was $27 million and $80 million, respectively, as compared to $26 million and $87 million, for the three months and nine months ended September 30, 2005, respectively. Amortization of the deferred gain for the three months and nine months ended September 30, 2006 was $15 million and $45 million, respectively, as compared to $13 million and $71 million for the three months and nine months ended September 30, 2005, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2.189 billion and $2.211 billion as of September 30, 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. Moreover, approximately $38 million and $31 million of additional losses were ceded to these retroactive and prospective contracts for the nine months ended September 30, 2005, with additional premium of $24 million and $22 million, respectively.

On June 21, 2006, LMIC entered into a multi-year property catastrophe reinsurance agreement with Mystic Re Ltd. (“Mystic Re”), a Cayman Islands domiciled reinsurer, to provide $200 million of additional reinsurance coverage for LMIC and its affiliates in the event of a Northeast hurricane. The reinsurance agreement is fully collateralized by proceeds received by Mystic Re from the issuance of catastrophe bonds, and provides coverage for hurricane related losses from Washington D.C. to Maine for the 2006-2008 hurricane seasons. The reinsurance limit is proportionally available, based on industry insured losses between $30 billion and $40 billion in the covered area, as reported by Property Claim Services ("PCS"), and is exhausted with the full $200 million available, in the event of PCS-reported industry insured losses exceeding $40 billion.

Impairment Losses on Investments

The total impairment losses on investments for the three and nine months ended September 30, 2006 were $12 million and $44 million, an increase of $11 million and $35 million over the same period in 2005. 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.

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 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 September 30, 2006. In addition, the Company has investments in six VIEs for which it is not the primary beneficiary at September 30, 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 September 30, 2006. The Company's maximum exposure to losses from VIEs is $116 million as of September 30, 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 September 30, 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 September 30, 2006, the value of these instruments was immaterial. The Company recognized approximately $4.1 million in net realized investment gains through September 30, 2006 driven by changes in fair value of derivative instruments, primarily warrants.

Deferred Policy Acquisition Costs

Total deferred policy acquisition costs were $1.653 billion and $1.476 billion as of September 30, 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 $873 million and $810 million at September 30, 2006 and December 31, 2005, respectively.

Deferred Income Taxes

The net deferred income tax asset was $1.641 billion and $1.627 billion as of September 30, 2006 and December 31, 2005, respectively, net of a valuation allowance of $96 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 2005 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, $69.966 billion in consolidated liabilities, 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 SBUs: 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.