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

Year Ended December 31, 2006

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

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three and twelve months ended December 31, 2006 and 2005. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's Annual Report, 2006 Audited Consolidated Financial Statements, Fourth Quarter 2006 Financial Supplement and the First, Second, and Third Quarter 2006 MD&As, located on the Company's Investor Relations website 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 ((i) and (ii) together "A&E"), 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), as well as its results of operations, financial condition and liquidity, to the extent impacted by the sufficiency of the Company's A&E and toxic tort reserves, are subject to a number of potential adverse developments including adverse developments involving A&E and toxic tort 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, toxic tort and other claims, the legal, economic, regulatory, and legislative environments, and their impact on the future development of A&E and toxic tort 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 audited financial statements.

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

- Revenues for the three months ended December 31, 2006 were $6.008 billion, an increase of $494 million or 9.0% over the same period in 2005.

- Pre-tax income for the three months ended December 31, 2006 was $577 million, an increase of $292 million or 102.5% over the same period in 2005. Results in the quarter include a $427 million decrease in catastrophe losses[1] from the same period in 2005, as prior year results included the impact of the 2005 hurricanes. Results in the period also reflect a decrease in realized capital gains of $112 million.

- Net income for the three months ended December 31, 2006 was $455 million, an increase of $202 million over the same period in 2005.

- Cash flow from operations for the three months ended December 31, 2006 was $1.037 billion, an increase of $485 million or 87.9% from the same period in 2005.

- The combined ratio before catastrophes, net incurred losses attributable to prior years[2] and the re-estimation of current accident year losses[3] for the three months ended December 31, 2006 was 95.6%, an increase of 2.3 points over the same period in 2005. Including the impact of catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the Company's combined ratio for the three months ended December 31, 2006 decreased 7.5 points to 98.1%.

Twelve Months Ended December 31, 2006 - Consolidated Results of Operations

- Revenues for the twelve months ended December 31, 2006 were $23.520 billion, an increase of $2.359 billion or 11.1% over the same period in 2005.

- Pre-tax income for the twelve months ended December 31, 2006 was $2.258 billion, an increase of $1.128 billion or 99.8% over the same period in 2005. Pre-tax income reflects a $1.095 billion decrease in catastrophe losses from the same period in 2005. Results in the period also reflect a decrease in realized capital gains of $180 million.

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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 external 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"). In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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. 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.

[3] Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

- Net income for the twelve months ended December 31, 2006 was $1.626 billion, an increase of $599 million or 58.3% over the same period in 2005.

- Cash flow from operations for the twelve months ended December 31, 2006 was $3.895 billion, an increase of $189 million or 5.1% from the same period in 2005.

- The combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the twelve months ended December 31, 2006 was 95.0%, an increase of 0.2 points over the same period in 2005. Including the impact of catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the Company's combined ratio for the twelve months ended December 31, 2006 decreased 6.4 points to 99.3%.

Financial Condition as of December 31, 2006

- Total assets were $85.498 billion as of December 31, 2006, an increase of $6.674 billion or 8.5% over December 31, 2005.

- Policyholders' equity was $10.895 billion as of December 31, 2006, an increase of $2.037 billion or 23.0% 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 $12.131 billion as of December 31, 2006, an increase of $2.262 billion or 22.9% over December 31, 2005.

- The consolidated debt-to-capital ratio including accumulated other comprehensive income ("AOCI") as of December 31, 2006 was 23.5%, an increase of 0.1 points over December 31, 2005. Excluding AOCI, the consolidated debt-to-capital ratio was 24.9%, an increase of 0.7 points over December 31, 2005.

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 December 31,			**Twelve Months Ended December 31,**		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Private passenger automobile	$1,361	$1,258	8.2%	$5,630	$5,433	3.6%
Workers compensation	976	1,000	(2.4)	4,585	4,093	12.0
Homeowners	460	398	15.6	1,784	1,579	13.0
Commercial multiple peril / Fire	408	367	11.2	1,593	1,448	10.0
International local businesses [1]	337	267	26.2	1,164	970	20.0
Commercial automobile	301	260	15.8	1,154	1,102	4.7
LIU[2] reinsurance	175	122	43.4	1,021	757	34.9
General liability	196	176	11.4	838	688	21.8
LIU first party[3]	102	120	(15.0)	510	292	74.7
LIU third party[3]	94	113	(16.8)	432	417	3.6
Group disability	103	86	19.8	400	343	16.6
Surety	62	48	29.2	250	195	28.2
Assumed voluntary reinsurance	27	10	170.0	115	82	40.2
Other	213	227	(6.2)	1,152	677	70.2
Total net written premium	$4,815	$4,452	8.2%	$20,628	$18,076	14.1%

1 Local international businesses, selling small commercial and other personal lines products locally; excluding private passenger automobile.
2 Liberty International Underwriters (LIU).
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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Personal Markets	$1,279	$1,188	7.7%	$5,365	$5,133	4.5%
Commercial Markets	1,024	906	13.0	4,149	3,550	16.9
Agency Markets	1,337	1,221	9.5	5,853	5,423	7.9
International	1,125	955	17.8	4,652	3,740	24.4
Corporate and Other[1]	50	182	(72.5)	609	230	164.8
Total net written premium	$4,815	$4,452	8.2%	$20,628	$18,076	14.1%

1 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 twelve months ended December 31, 2006 was $4.815 billion and $20.628 billion, respectively, an increase of $363 million and $2.552 billion over the same periods in 2005. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $103 million and $197 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 businesses operations, primarily in Brazil, Spain and Venezuela. The change in the quarter also reflects an increase in Personal Markets voluntary policies in force over the same period in 2005 due to strong customer retention. In addition, the year-to-date increase was partially offset by a decrease in Agency Markets net written premium, due primarily to a decrease in policies in force.
- Workers compensation net written premium decreased $24 million and increased $492 million in the quarter and year-to-date, respectively. The decrease in the quarter reflects an adjustment of $119 million to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium. The change in both periods also reflects an increase in new business growth, strong retention rates, an increase in payroll exposure and the non-renewal of a ceded reinsurance contract (resulted in approximately $36 million and $150 million of additional net written premium in the quarter and year-to-date, respectively). 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 $62 million and $205 million in the quarter and year-to-date, respectively. The increase in both periods primarily reflects rate increases and a 3.5% increase in Personal Markets policies in force, primarily in non-coastal areas, for the twelve months ended December 31, 2006 driven by strong customer retention and new business growth.
- Commercial multiple peril / fire net written premium increased $41 million and $145 million in the quarter and year-to-date, respectively. The increase in both periods is primarily due to significant rate increases and lower ceded reinstatement premium in 2006 versus 2005 in Commercial Markets and strong retention in Agency Markets.
- International local businesses net written premium (excluding private passenger automobile net written premium) increased $70 million and $194 million in the quarter and year-to-date, respectively. The increase in both periods primarily reflects organic growth in Latin America.
- LIU reinsurance increased $53 million and $264 million in the quarter and year-to-date, respectively. The increase in both periods is primarily due to rate increases on property business. The year-to-date increase is also due to higher ceded premium in 2005 due to experience based premium adjustments and reinstatement premiums related to ceded reinsurance contracts covering 2005 hurricane losses.
- General liability net written premium increased $20 million and $150 million in the quarter and year-to-date, respectively. The increase in both periods primarily reflects higher retention, new

business growth and reduced reinsurance cessions in Agency Markets and the addition of several new National Market accounts in Commercial Markets.

- LIU first party net written premium decreased $18 million and increased $218 million in the quarter and year-to-date, respectively. The decrease in the quarter is due to an adjustment to the timing of recording ceded written premium for certain excess of loss contracts. The year-to-date increase is 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 $475 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 segment.

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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$6,008	$5,514	9.0%	$23,520	$21,161	11.1%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$667	$679	(1.8%)	$2,714	$2,445	11.0%
Catastrophes[1]:						
- 2005 hurricanes[2]	(32)	(541)	(94.1)	(113)	(1,460)	(92.3)
- All other	(92)	(10)	NM	(428)	(176)	143.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental[3]	(20)	(3)	NM	(22)	(215)	(89.8)
- All other[4]	(100)	16	NM	(236)	13	NM
Current accident year re-estimation[5]	122	-	NM	-	-	-
Pre-tax operating income	545	141	NM	1,915	607	NM
Realized investment gains, net	32	144	(77.8)	343	523	(34.4)
Federal and foreign income tax (expense)	(122)	(32)	NM	(632)	(91)	NM
Discontinued operations, net of tax	-	-	-	-	(12)	(100.0)
Net income	$455	$253	79.8%	$1,626	$1,027	58.3%
Cash flow from operations	$1,037	$552	87.9%	$3,895	$3,706	5.1%

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 external 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 twelve months ended December 31, 2006 include the reversal of ($14) million and $15 million, respectively, and the three and twelve months ended December 31, 2005 include the reversal of $12 million and $110 million, respectively, of profit sharing on external reinsurance. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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 $55 million and $146 million for the three and twelve months ended December 31, 2005.

3 Net of allowance for doubtful accounts of $11 million and $12 million for the three and twelve months ended December 31, 2006, respectively, and $17 million for both of the comparable periods of 2005.

4 Net of earned premium attributable to prior years of ($44) million and ($28) million for the three and twelve months ended December 31, 2006, respectively, and $46 million and $86 million for the comparable periods of 2005. Net of amortization of deferred gains on retroactive reinsurance of $51 million and $97 million for the three and twelve months ended December 31, 2006, respectively, and $18 million and $97 million for the comparable periods of 2005.

5 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2006 were $6.008 billion and $23.520 billion, respectively, an increase of $494 million and $2.359 billion 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 twelve months ended December 31, 2006 was $5.100 billion and $19.867 billion, respectively, an increase of $434 million and $2.236 billion over the same periods in 2005. The increase in both periods reflects the earned premium associated with the changes in net written premium. In addition, the year-to-date change also reflects higher ceded premium in 2005 as a result of ceded reinstatement and experience rated premiums triggered by the 2005 hurricanes.

Net investment income for the three and twelve months ended December 31, 2006 was $690 million and $2.548 billion, respectively, an increase of $181 million and $301 million over the same periods in 2005.

The increase in net investment income in both periods reflects higher income primarily due to an increase in limited partnership and limited liability company income of $62 million and $77 million in the quarter and year-to-date, respectively, a larger invested asset base driven by continued strong cash flow from operations and proceeds received from the Company's August 2006 debt offering, and lower investment expenses. The decrease in investment expenses in both periods primarily reflects the impact of short-term and long-term variable compensation in 2005, which did not recur in 2006. One factor constraining growth in net investment income was lower yields on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities.

Net realized investment gains for the three and twelve months ended December 31, 2006 were $32 million and $343 million, respectively, a decrease of $112 million and $180 million from the same periods in 2005. The decrease in the quarter primarily reflects a gain of $106 million recognized on the sale of a private equity investment in the fourth quarter of 2005, which did not recur in 2006. The year-to-date decrease primarily reflects lower fixed maturity gains versus the same period in 2005, reflecting the sale of targeted taxable securities as part of a strategic realignment in 2005 that did not recur in 2006.

Fee and other revenues for the three and twelve months ended December 31, 2006 were $186 million and $762 million, respectively, a decrease of $9 million and an increase of $2 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 revenue 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 continued to decline. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative duties for all participating involuntary pool members.

Claims, benefits and expenses for the three and twelve months ended December 31, 2006 were $5.431 billion and $21.262 billion, respectively, an increase of $202 million and $1.231 billion over the same periods in 2005. The increase in both periods is primarily due to business growth and general cost increases in each of the Company's SBUs, partially offset by lower catastrophe losses, as prior year results included the impact of the 2005 hurricanes. The change in both periods also reflects an increase in Personal Markets' sales and service personnel costs and advertising costs, an increase in variable incentive compensation and other benefit costs and interest expense related to the Company's August 2006 debt issuance. In the quarter, the Company completed an actuarial reserve study, which increased environmental reserves by $20 million. The year-to-date change was also impacted by higher profit share expenses related to operations acquired from Prudential Financial, Inc. ("PruPac"), an increase in policyholder benefits related to immediate annuity and structured settlement business growth, and a decrease in incurred losses attributable to prior years[1]. In 2005, the Company recorded $203 million of asbestos reserves, which did not recur in 2006.

[1] Incurred losses attributable to prior years is defined as net incurred losses attributable to prior years gross of earned premium attributable to prior years and including amortization of retroactive reinsurance gain.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
CONSOLIDATED	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio[1]	66.6%	68.3%	(1.7)	67.4%	69.2%	(1.8)
Underwriting expense ratio [1]	28.6	24.7	3.9	27.3	25.4	1.9
Dividend ratio	0.4	0.3	0.1	0.3	0.2	0.1
Subtotal	95.6	93.3	2.3	95.0	94.8	0.2
Catastrophes[2]:						
- 2005 hurricanes	0.6	12.3	(11.7)	0.6	8.7	(8.1)
- All other	1.9	0.2	1.7	2.3	1.0	1.3
Net incurred losses attributable to prior years:						
- Asbestos & environmental	0.5	0.1	0.4	0.1	1.3	(1.2)
- All other	2.0	(0.3)	2.3	1.3	(0.1)	1.4
Current accident year re-estimation[3]	(2.5)	-	(2.5)	-	-	-
Total combined ratio[4]	98.1%	105.6%	(7.5)	99.3%	105.7%	(6.4)

1 In the fourth quarter of 2006, Personal Markets reclassified certain underwriting expenses to claim adjustment expenses. Results for 2005 reflect this reclassification.

2 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external 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. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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.

3 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

4 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 unless related to an asbestos & environmental commutation.

The consolidated combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the three and twelve months ended December 31, 2006 was 95.6% and 95.0%, respectively, an increase of 2.3 and 0.2 points over the comparable periods in 2005. The increase in the quarter is 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 primarily reflects an increase in variable incentive compensation and other benefit costs and an increase in Personal Markets' acquisition expenses primarily related to an increase in sales and service personnel costs and an increase in advertising costs. In addition, the year-to-date underwriting expense ratio reflects higher profit share expenses related to operations acquired from PruPac. The decrease in the claims and claim adjustment expense ratio in both periods is primarily due to improved Commercial Markets' underwriting results, primarily in workers compensation, and improved Agency Markets' underwriting results in personal lines and Summit. The year-to-date claims and claim adjustment expense ratio also reflects lower claims frequency trends (excluding catastrophes) in the auto and homeowners lines of business, improved surety results and improved loss ratios in LIU's reinsurance business (excluding catastrophe losses).

Including the impact of catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the total combined ratio was 98.1% for the quarter and 99.3% year-to-date, a decrease of 7.5 and 6.4 points, respectively, from the same periods in 2005. The decrease in both periods reflects lower catastrophe losses of 10.0 points and 6.8 points in the quarter and year-to-date, respectively, as prior year results included the impact of the 2005 hurricanes, partially offset by a higher frequency of 2006 non-hurricane catastrophe activity, primarily in the Midwest. The decrease in the quarter also reflects the re-estimation of current accident year losses. Net incurred losses attributable to prior years increased 2.7 and 0.2 points in the quarter and year-to-date, respectively. The increase in net incurred losses attributable to prior years in the quarter is due to favorable reserve development related to International's Local Business segment in 2005, which did not recur in 2006, workers compensation prior year loss development in the Company's Commercial Markets and Agency Markets business units and an increase in environmental reserves related to the Company's actuarial reserve study completed in the fourth quarter of 2006.

PTOI for the three and twelve months ended December 31, 2006 was $545 million and $1.915 billion, respectively, an increase of $404 million and $1.308 billion over the same periods in 2005.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2006 was $122 million and $632 million, respectively, an increase of $90 million and $541 million over the same periods in 2005. The Company's effective tax rates for the three and twelve months ended December 31, 2006 were 21% and 28%, respectively, compared to 11% and 8% for the same periods for 2005. The fourth quarter of each year reflects revisions to prior estimates. In addition, 2005 reflects the impact of reducing the remaining domestic valuation allowance for deferred tax assets which were established in 2001. The Company's effective tax rate for the three and twelve months ended December 31, 2006 was below the statutory tax rate of 35% primarily due to tax preferenced investment income and revisions to estimates made in prior years.

Net income for the three and twelve months ended December 31, 2006 was $455 million and $1.626 billion, respectively, an increase of $202 million and $599 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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Private passenger automobile	$846	$835	1.3%	$3,699	$3,706	(0.2%)
Homeowners and other	433	353	22.7	1,666	1,427	16.7
Total net written premium	$1,279	$1,188	7.7%	$5,365	$5,133	4.5%

Net written premium for the three and twelve months ended December 31, 2006 was $1.279 billion and $5.365 billion, respectively, an increase of $91 million and $232 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 twelve months ended December 31, 2006 was $846 million and $3.699 billion, respectively, an increase of $11 million and a decrease of $7 million from the same periods in 2005. The change in both periods reflects an increase in voluntary policies in force over the same period in 2005 due to strong customer retention, partially offset by a reduction in involuntary market policies. Voluntary policies in force for the twelve months ended December 31, 2006 increased 2.5%. The decrease year-to-date also reflects lower average written premium per policy due to a shift in state mix.

Homeowners and other net written premium for the three and twelve months ended December 31, 2006 was $433 million and $1.666 billion, respectively, an increase of $80 million and $239 million over the same periods in 2005. The increase in both periods reflects rate increases and a 3.6% increase in policies in force, primarily in non-coastal areas, for the twelve months ended December 31, 2006 due to strong customer retention and new business growth.

Results of Operations – Personal Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,442	$1,378	4.6%	$5,602	$5,435	3.1%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$208	$224	(7.1%)	$844	$897	(5.9%)
Catastrophes[1]:						
- 2005 hurricanes	-	(122)	(100.0)	(10)	(386)	(97.4)
- All other	(41)	(5)	NM	(208)	(81)	156.8
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	50	-	NM	70	99	(29.3)
Current accident year re-estimation[3]	-	-	-	-	-	-
Pre-tax operating income	217	97	123.7	696	529	31.6
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax (expense)	(75)	(34)	120.6	(243)	(185)	31.4
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$142	$63	125.4%	$453	$344	31.7%

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 twelve months ended December 31, 2006, and zero and ($4) million for the comparable periods of 2005.
3 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.
NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2006 were $1.442 billion and $5.602 billion, respectively, an increase of $64 million and $167 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 twelve months ended December 31, 2006 was $1.350 billion and $5.248 billion, respectively, an increase of $56 million and $140 million over the same periods in 2005. The increase in both periods reflects the earned premium associated with the changes in net written premium.

Net investment income for the three and twelve months ended December 31, 2006 was $78 million and $298 million, respectively, an increase of $9 million and $29 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 twelve months ended December 31, 2006 were $1.225 billion and $4.906 billion, respectively, a decrease of $56 million and unchanged compared to the same periods in 2005. The decrease in the quarter reflects lower catastrophe losses and an increase in the amount of favorable incurred losses attributable to prior years related to the auto line of business, partially offset by an increase in acquisition expenses related to higher sales and service personnel costs and advertising costs. On a year-to-date basis, the lower catastrophe losses were offset by higher profit share expense related to the PruPac business, as well as an increase in acquisition expenses due to an increase in sales and service personnel costs and an increase in advertising costs.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
			Change			Change
PERSONAL MARKETS	**2006**	**2005**	**(Points)**	**2006**	**2005**	**(Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio[1]	63.6%	63.2%	0.4	64.0%	65.1%	(1.1)
Underwriting expense ratio[1]	26.4	24.4	2.0	25.2	22.4	2.8
Dividend ratio	-	-	-	-	-	-
Subtotal	90.0	87.6	2.4	89.2	87.5	1.7
Catastrophes[2]:						
- 2005 hurricanes	-	9.4	(9.4)	0.2	7.5	(7.3)
- All other	3.1	0.4	2.7	4.0	1.6	2.4
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.7)	-	(3.7)	(1.3)	(1.9)	0.6
Current accident year re-estimation[3]	-	-	-	-	-	-
Total combined ratio	89.4%	97.4%	(8.0)	92.1%	94.7%	(2.6)

1 In the fourth quarter of 2006, the Company reclassified certain underwriting expenses to claim adjustment expenses. Results for 2005 reflect this reclassification.
2 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums
3 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

Personal Markets' combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the three and twelve months ended December 31, 2006 was 90.0% and 89.2%, respectively, an increase of 2.4 and 1.7 points over the same periods in 2005. The increase in both periods reflects a higher underwriting expense ratio due to an increase in acquisition expenses primarily related to an increase in sales and service personnel costs and an increase in advertising costs. The year-to-date underwriting expense ratio was further impacted by higher profit share expenses related to operations acquired from PruPac, 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, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the total combined ratio for the three and twelve months ended December 31, 2006 was 89.4% and 92.1%, respectively, a decrease of 8.0 and 2.6 points from the same periods in 2005. The decrease in both periods reflects lower catastrophe losses, as prior year results included the impact of the 2005 hurricanes, partially offset by a higher frequency of 2006 non-hurricane storm activity (i.e. wind and hail), primarily in the Midwest. The decrease in the quarter also reflects favorable incurred losses attributable to prior years related to the auto line of business.

PTOI for the three and twelve months ended December 31, 2006 was $217 million and $696 million, respectively, an increase of $120 million and $167 million over the same periods in 2005.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2006 was $75 million and $243 million, respectively, an increase of $41 million and $58 million over the same periods in 2005.

Net income for the three and twelve months ended December 31, 2006 was $142 million and $453 million, respectively, an increase of $79 million and $109 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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Business Market	$396	$366	8.2%	$1,643	$1,513	8.6%
National Market [1]	340	301	13.0	1,365	1,186	15.1
Group Market	103	86	19.8	400	343	16.6
Liberty Mutual Property	84	62	35.5	319	218	46.3
Other Markets [1]	101	91	11.0	422	290	45.5
Total net written premium	$1,024	$906	13.0%	$4,149	$3,550	16.9%

1 Effective in the fourth quarter of 2006, National Market has been reorganized to include Liberty Mutual Alternative Markets, previously included in Other Markets. Results for all periods have been restated for the reorganization.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Workers compensation	$527	$503	4.8%	$2,232	$ 1,972	13.2%
Commercial automobile	133	96	38.5	450	412	9.2
General liability	113	100	13.0	489	389	25.7
Group disability and life	103	86	19.8	400	343	16.6
Commercial multiple peril / Fire	72	54	33.3	273	188	45.2
Assumed voluntary reinsurance	17	10	70.0	105	82	28.0
Other	59	57	3.5	200	164	22.0
Total net written premium	$1,024	$906	13.0%	$4,149	$3,550	16.9%

Net written premium for the three and twelve months ending December 31, 2006 was $1.024 billion and $4.149 billion respectively, an increase of $118 million and $599 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 business segments and lines of business. 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 rate increases on property coverages in the commercial multiple peril/fire line. Results in both periods also reflect an increase in workers compensation premium growth due to the non-renewal of an involuntary market reinsurance contract in the Other Markets segment (resulted in approximately $29 million and $116 million of additional net written premium in the quarter and year-to-date, respectively), an increase in the payroll exposure base on existing accounts in the Business Market and National Market segments, and higher retention. In addition, commercial auto premium increased in both periods due to higher retrospectively rated policy premiums booked on loss sensitive business. The year-to-date increase in general liability premiums also reflects the addition of several National Market accounts. These increases in both periods were partially offset by modest rate decrease in most non-property lines.

Results of Operations – Commercial Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,234	$1,183	4.3%	$4,733	$4,391	7.8%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$146	$120	21.7%	$518	$380	36.3%
Catastrophes[1]:						
- 2005 hurricanes[2]	-	(28)	(100.0)	(30)	(135)	(77.8)
- All other	(10)	11	NM	(45)	(7)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other [3]	(120)	(33)	NM	(180)	(93)	93.5
Current accident year re-estimation[4]	63	-	NM	-	-	-
Pre-tax operating income	79	70	12.9	263	145	81.4
Realized investment gains, net	-	-	-	-	-	-
Federal and foreign income tax (expense)	(29)	(24)	20.8	(94)	(50)	88.0
Discontinued operations, net of tax	-	-	-	-	-	-
Net income [5]	$50	$46	8.7%	$169	$95	77.9%

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. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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 $3 million and $16 million for the three and twelve months ended December 31, 2005.

3 Net of earned premium attributable to prior years of ($35) million and ($57) million for the three and twelve months December 31, 2006, respectively, and $59 million and $80 million for the comparable periods in 2005. Net of amortization of deferred gains on retroactive reinsurance of $36 million and $58 million for the three and twelve months ended December 31, 2006, respectively, and $9 million and $48 million for the comparable periods in 2005.

4 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

5 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.

NM = Not Meaningful.

Revenues for the three and twelve months ended December 31, 2006 were $1.234 billion and $4.733 billion, respectively, an increase of $51 million and $342 million over the same periods in 2005. The major components of revenues include net premium earned, net investment income, and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2006 was $999 million and $3.813 billion, respectively, an increase of $48 million and $344 million over the same periods in 2005. The increase in both periods reflects the earned premium associated with the changes in net written premium.

Net investment income for the three and twelve months ended December 31, 2006 was $145 million and $562 million, respectively, an increase of $8 million and $16 million over the same periods in 2005. The increases reflect a higher invested asset base and cash flow from operations, partially offset by lower investment yields.

Fee and other revenues for the three and twelve months ended December 31, 2006 were $90 million and $358 million, respectively, a decrease of $5 million and $18 million versus the same periods in 2005. The decrease in both periods primarily reflects lower fee revenues associated with the Company's involuntary market servicing carrier operations as serviced premium continued to decline. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative duties for all participating involuntary pool members.

Claims, benefits and expenses for the three and twelve months ended December 31, 2006 were $1.155 billion and $4.470 billion, respectively, an increase of $42 million and $224 million over the same periods in 2005. The increase in both periods is primarily driven by business growth and the non-renewal of a ceded reinsurance contract, partially offset by lower catastrophe losses.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
COMMERCIAL MARKETS	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	75.3%	80.9%	(5.6)	78.1%	82.9%	(4.8)
Underwriting expense ratio	19.7	18.9	0.8	19.7	19.0	0.7
Dividend ratio	0.1	-	0.1	0.2	(0.6)	0.8
Subtotal	95.1	99.8	(4.7)	98.0	101.3	(3.3)
Catastrophes[1]:						
- 2005 hurricanes	-	3.4	(3.4)	0.9	4.4	(3.5)
- All other	1.1	(1.3)	2.4	1.3	0.2	1.1
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	13.0	3.7	9.3	5.2	2.8	2.4
Current accident year re-estimation[2]	(6.8)	-	(6.8)	-	-	-
Total combined ratio	102.4%	105.6%	(3.2)	105.4%	108.7%	(3.3)

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. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

The Commercial Markets combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the three and twelve months ended December 31, 2006 was 95.1% and 98.0%, respectively, a decrease of 4.7 and 3.3 points versus the same periods in 2005. The improvement in the claims and claim adjustment expense ratio for the three and twelve months ended December 31, 2006 is due to improved underwriting results, primarily in workers compensation. Partially offsetting this improvement in both periods was a higher underwriting expense ratio due to a reduction in the expense reimbursement received from the Company's servicing carrier operations and lower ceding commissions as a result of the non-renewal of a ceded reinsurance contract. The increase of 0.8 points 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 the re-estimation of current accident year losses, the total combined ratio for the three and twelve months ended December 31, 2006 was 102.4% and 105.4%, respectively, a decrease of 3.2 and 3.3 points over the same periods in

2005. The decrease in the quarter reflects the re-estimation of current accident year losses in workers compensation, offset by higher net incurred losses attributable to prior years. In addition, catastrophe losses in the quarter and year-to-date decreased 1.0 and 2.4 points, respectively, from the same periods in 2005, as prior year results included the impact of the 2005 hurricanes. The increase in net incurred losses attributable to prior years in both periods is related to the workers compensation line of business.

PTOI for the three and twelve months ended December 31, 2006 was $79 million and $263 million, respectively, an increase of $9 million and $118 million over the same periods in 2005.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2006 was $29 million and $94 million, respectively, an increase of $5 million and $44 million over the same periods in 2005.

Net income for the three and twelve months ended December 31, 2006 was $50 million and $169 million, respectively, an increase of $4 million and $74 million over 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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Regional Companies	$816	$777	5.0%	$3,394	$3,295	3.0%
Wausau	315	265	18.9	1,280	1,122	14.1
Summit	119	120	(0.8)	826	772	7.0
Surety	59	48	22.9	242	195	24.1
Other	28	11	154.5	111	39	184.6
Total net written premium	$1,337	$1,221	9.5%	$5,853	$5,423	7.9%

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Commercial Lines						
Workers compensation total:	$505	$440	14.8%	$2,490	$2,202	13.1%
- Wausau	220	179	22.9	972	835	16.4
- Summit	119	120	(0.8)	826	772	7.0
- All other	166	141	17.7	692	595	16.3
Commercial multiple peril	311	294	5.8	1,217	1,174	3.7
Commercial automobile	167	164	1.8	702	690	1.7
General liability	64	58	10.3	273	228	19.7
Surety	62	48	29.2	250	195	28.2
Other	46	43	7.0	189	167	13.2
Subtotal	$1,155	$1,047	10.3%	$5,121	$4,656	10.0%
Personal Lines						
Private passenger automobile	$107	$102	4.9%	$434	$467	(7.1%)
Homeowners	66	64	3.1	262	268	(2.2)
Other	9	8	12.5	36	32	12.5
Subtotal	$182	$174	4.6%	$732	$767	(4.6%)
Total net written premium	$1,337	$1,221	9.5%	$5,853	$5,423	7.9%

Net written premium for the three and twelve months ended December 31, 2006 was $1.337 billion and $5.853 billion, respectively, an increase of $116 million and $430 million over the same periods in 2005. The growth in both periods reflects an increase in workers compensation premium driven by new business growth and higher retention. The increase in year-to-date workers compensation premium also reflects increased payroll exposure (including higher audit and retrospective premiums) on existing accounts at Summit, growth in California (approximately $70 million), and the non-renewal of a workers compensation reinsurance program that ceded involuntary assumed business (approximately $34 million). These increases were partially offset by modest rate decreases in most states, mandated rate decreases in Florida and a decrease in California rates due to workers compensation reform. The remainder of the growth in both periods reflects higher retention rates and new business growth and reduced reinsurance cessions in commercial lines, partially offset by modest rate decreases in all lines except surety and homeowners. The surety growth is a result of the Company's strategic expansion in this line. Further, the personal lines net written premium change in the quarter is due to an increase in policies in force, homeowners' rate increases and higher customer retention. The year-to-date decrease in personal lines net written premium was due primarily to a decrease in policies in force.

(2) Results of Operations – Agency Markets

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,588	$1,513	5.0%	$6,183	$5,776	7.0%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$146	$130	12.3%	$645	$522	23.6%
Catastrophes[1]:						
- 2005 hurricanes	3	(30)	NM	(1)	(80)	(98.8)
- All other	(34)	(10)	NM	(150)	(33)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	18	47	(61.7)	75	101	(25.7)
Current accident year re-estimation[3]	59	-	NM	-	-	-
Pre-tax operating income	192	137	40.1	569	510	11.6
Realized investment gains, net	-	3	(100.0)	-	9	(100.0)
Federal and foreign income tax (expense)	(67)	(49)	36.7	(199)	(182)	9.3
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$125	$91	37.4%	$370	$337	9.8%

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 $31 million for the three and twelve months ended December 31, 2006, respectively, and $4 million and $18 million for the comparable periods of 2005. Net of amortization of deferred gains on retroactive reinsurance of $6 million and $14 million for the three and twelve months ended December 31, 2006, respectively, and $3 million and $16 million for the comparable periods of 2005.
3 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.
NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2006 were $1.588 billion and $6.183 billion, respectively, an increase of $75 million and $407 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 twelve months ended December 31, 2006 was $1.445 billion and $5.635 billion, respectively, an increase of $75 million and $400 million over the same periods in 2005. The increase in both periods reflects the earned premium associated with the changes in net written premium.

Net investment income for the three and twelve months ended December 31, 2006 was $120 million and $456 million, respectively, an increase of $3 million and $14 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.

Claims, benefits and expenses for the three and twelve months ended December 31, 2006 were $1.396 billion and $5.614 billion, respectively, an increase of $23 million and $357 million over the same periods in 2005. The increase in both periods is primarily due to business growth and general cost increases.

Results in the quarter also reflect a decrease in the amount of favorable incurred losses attributable to prior periods. These changes were partially offset by lower catastrophe losses and commission expenses in the quarter. The quarter also included $59 million of favorable development from the re-estimation of current accident year workers compensation losses as of the nine months ended September 30, 2006. Year-to-date results also reflect a reduction in the amount of favorable incurred losses attributable to prior years related to favorable surety results in 2005 that did not recur in 2006 and higher catastrophe losses, primarily due to 2006 storm activity in the Midwest.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
AGENCY MARKETS	**2006**	**2005**	**Change (Points)**	**2006**	**2005**	**Change (Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	66.1%	67.1%	(1.0)	65.0%	65.7%	(0.7)
Underwriting expense ratio	30.4	30.8	(0.4)	30.5	31.4	(0.9)
Dividend ratio	1.2	1.1	0.1	1.0	0.9	0.1
Subtotal	97.7	99.0	(1.3)	96.5	98.0	(1.5)
Catastrophes[1]:						
- 2005 hurricanes	(0.2)	2.2	(2.4)	-	1.5	(1.5)
- All other	2.3	0.7	1.6	2.7	0.6	2.1
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(1.2)	(3.4)	2.2	(1.4)	(1.8)	0.4
Current accident year re-estimation[2]	(4.1)	-	(4.1)	-	-	-
Total combined ratio	94.5%	98.5%	(4.0)	97.8%	98.3%	(0.5)

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

Agency Markets' combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the three and twelve months ended December 31, 2006 was 97.7% and 96.5%, respectively, a decrease of 1.3 points and 1.5 points from the same periods in 2005. The decrease in the claims and claim adjustment expense ratio in both periods is due to improved underwriting results in personal lines and Summit, partially offset by higher commercial property losses. Year-to-date results also reflect improved surety results. The decrease in the underwriting expense ratio in both periods was driven by strong premium growth and lower net commission rates at the Regional Companies and Summit.

Including the impact of catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the total combined ratio for the three and twelve months ended December 31, 2006 was 94.5% and 97.8%, respectively, a decrease of 4.0 and 0.5 points from the same periods in 2005. The decrease in the quarter reflects the re-estimation of current accident year workers compensation losses and higher catastrophe losses in 2005 versus 2006 due to the 2005 hurricanes, partially offset by a reduction in the amount of favorable incurred loss development attributable to prior years related to workers compensation losses. Results year-to-date also reflect increased catastrophe losses driven by 2006 non-hurricane storm activity in the Midwest and a reduction in the amount of favorable incurred loss development attributable to prior years related to favorable surety results in 2005 that did not recur in 2006.

PTOI for the three and twelve months ended December 31, 2006 was $192 million and $569 million, respectively, an increase of $55 million and $59 million over the same periods in 2005.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2006 was $67 million and $199 million, respectively, an increase of $18 million and $17 million over the same periods in 2005.

Net income for the three and twelve months ended December 31, 2006 was $125 million and $370 million, respectively, an increase of $34 million and $33 million over the same periods in 2005.

INTERNATIONAL

(1) Overview – International

International net written premium by market segment was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
International Local Businesses	$744	$595	25.0%	$2,659	$2,247	18.3%
Liberty International Underwriters	381	360	5.8	1,993	1,493	33.5
Total net written premium	$1,125	$955	17.8%	$4,652	$3,740	24.4%

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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Local businesses – private passenger auto	$407	$328	24.1%	$1,495	$1,277	17.1%
Local businesses – all other	337	267	26.2	1,164	970	20.0
LIU reinsurance	175	122	43.4	1,021	757	34.9
LIU first party[1]	102	120	(15.0)	510	292	74.7
LIU third party[1]	94	113	(16.8)	432	417	3.6
LIU other	10	5	100.0	30	27	11.1
Total net written premium	$1,125	$955	17.8%	$4,652	$3,740	24.4%

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 twelve months ended December 31, 2006 was $1.125 billion and $4.652 billion, respectively, an increase of $170 million and $912 million over the same periods in 2005. The increase in private passenger auto net written premium in both periods reflects organic growth, primarily in Brazil, Spain and Venezuela, while the increase in other local business operations reflects organic growth in Latin America. In addition, the increase in LIU's reinsurance line of business primarily reflects rate increases on property business in both periods as well as higher year-to-date ceded premium in 2005 due to experience based premium adjustments and reinstatement premiums related to ceded reinsurance contracts covering 2005 hurricane losses. The year-to-date increase in LIU's first party line of business 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 line of business also increased year-to-date primarily due to organic growth. The decreases in LIU's first party and third party lines of business in the quarter reflects an adjustment to the timing of recording ceded written premium for certain excess of loss contracts.

(2) Results of Operations – International

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$1,325	$1,043	27.0%	$4,890	$3,903	25.3%
PTOI before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$143	$202	(29.2%)	$543	$449	20.9%
Catastrophes[1]:						
- 2005 hurricanes[2]	(16)	(304)	(94.7)	(44)	(706)	(93.8)
- All other	-	-	-	(18)	(49)	(63.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[3]	(5)	47	NM	(24)	57	NM
Current accident year re-estimation[4]	-	-	-	-	-	-
Pre-tax operating income (loss)	122	(55)	NM	457	(249)	NM
Realized investment (losses) gains, net	(2)	17	NM	23	29	(20.7)
Federal and foreign income tax (expense) benefit	(7)	47	NM	(102)	71	NM
Discontinued operations, net of tax	-	-	-	-	(12)	(100.0)
Net income (loss)	$113	$9	NM	$378	($161)	NM

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to external 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 twelve months ended December 31, 2006 include the reversal of ($14) million and $15 million, respectively, and the three and twelve months ended December 31, 2005 include the reversal of $12 million and $110 million, respectively, 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 for assumed external reinsurance 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 Assumed catastrophe losses related to the 2005 hurricanes are reported net of related net catastrophe reinsurance premium earned of $52 million and $130 million for the three and twelve months ended December 31, 2005, respectively.

3 Net of earned premium attributable to prior years of ($3) million and ($2) million for the three and twelve months ended December 31, 2006, respectively, and ($17) million and ($8) million for the comparable periods of 2005.

4 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2006 were $1.325 billion and $4.890 billion, respectively, an increase of $282 million and $987 million over the same periods in 2005. The major components of revenues include net premium earned, net investment income and net realized investment gains and losses.

Net premium earned for the three and twelve months ended December 31, 2006 was $1.194 billion and $4.398 billion, respectively, an increase of $276 million and $918 million over the same periods in 2005. The increase in both periods reflects the earned premium associated with the changes in net written premium. In addition, the year-to-date change also reflects higher ceded premium in 2005 as a result of ceded reinstatement and experience rated premiums triggered by the 2005 hurricanes.

Net investment income for the three and twelve months ended December 31, 2006 was $118 million and $413 million, respectively, an increase of $20 million and $59 million over the same periods in 2005. The increase in both periods reflects a higher invested asset base, primarily due to capital contributions and strong cash flow from operations.

Realized investment (losses) gains for the three and twelve months ended December 31, 2006 were ($2) million and $23 million, respectively, a decrease of $19 million and $6 million over the same periods in 2005. The decrease in both periods reflects normal portfolio turnover as gains recorded in 2005 did not recur in 2006. The decrease year-to-date was partially offset by the redemption of certain Government debt securities in Venezuela.

Claims, benefits and expenses for the three and twelve months ended December 31, 2006 were $1.205 billion and $4.410 billion, an increase of $124 million and $287 million over the same periods in 2005. Losses related to the 2005 hurricanes decreased $285 million and $620 million in the quarter and year-to-date, respectively, from the same periods in 2005. Incurred losses attributable to prior years increased $66 million and $87 million in the quarter and year-to-date, respectively, versus the same periods in 2005 primarily due to favorable Local Business reserve development in 2005 that did not recur in 2006. The remainder of the increase in both periods reflects growth across the businesses. Foreign exchange gains decreased $49 million and $24 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.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
			Change			Change
INTERNATIONAL	**2006**	**2005**	**(Points)**	**2006**	**2005**	**(Points)**
Combined ratio before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	66.3%	64.1%	2.2	66.3%	66.9%	(0.6)
Underwriting expense ratio	29.4	28.9	0.5	29.0	29.2	(0.2)
Dividend ratio	-	-	-	-	-	-
Subtotal	95.7	93.0	2.7	95.3	96.1	(0.8)
Catastrophes[1]:						
- 2005 hurricanes	1.4	33.8	(32.4)	1.0	20.9	(19.9)
- All other	-	-	-	0.4	1.4	(1.0)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	0.4	(4.7)	5.1	0.5	(1.4)	1.9
Current accident year re-estimation[2]	-	-	-	-	-	-
Total combined ratio	97.5%	122.1%	(24.6)	97.2%	117.0%	(19.8)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to external 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. In addition, losses related to the 2005 hurricanes and the 2004 hurricanes for assumed external reinsurance 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 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.

International's combined ratio before catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses for the three and twelve months ended December 31, 2006 was 95.7% and 95.3%, respectively, an increase of 2.7 points in the quarter and a decrease of 0.8 points year-to-date versus the same periods in 2005. The decrease in the claims and claim adjustment expense ratio year-to-date reflects improved underwriting results (excluding catastrophes) in LIU's reinsurance business offset by an increase in inland marine specialty business, which has a higher loss ratio than International's other lines of business. The increase in the claims and claim adjustment expense ratio in the quarter reflects a reduction in frequency and severity of losses, primarily in Spain, in 2005, which did not recur in

2006, coupled with a more competitive auto market in Spain in 2006. In addition, the increase in the underwriting expense ratio in the quarter is primarily due to an increase in taxes and other fees.

Including the impact of catastrophes, net incurred losses attributable to prior years and the re-estimation of current accident year losses, the total combined ratio for the three and twelve months ended December 31, 2006 was 97.5% and 97.2%, respectively, a decrease of 24.6 and 19.8 points from the same periods in 2005. Catastrophe losses decreased 32.4 and 20.9 points in the quarter and year-to-date, respectively, from the same periods in 2005, as prior year results included the impact of 2005 and 2004 hurricanes. The increase in net incurred losses attributable to prior years reflects favorable reserve development in the Local Business segment in 2005, which did not recur in 2006.

PTOI for the three and twelve months ended December 31, 2006 was $122 million and $457 million, respectively, an increase of $177 million and $706 million versus the same periods in 2005.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2006 was $7 million and $102 million, respectively, an increase of $54 million and $173 million versus the same periods in 2005. The increase in tax is primarily due to the hurricane losses and the resulting tax benefit for these losses reported in 2005. The effective tax rates for the three and twelve months ended December 31, 2006 were 6% and 21%, respectively, compared to (124%) and (32%) for the same periods in 2005. The difference between these rates and the statutory rate of 35% is primarily due to revisions to estimates made in prior years, and reported in the fourth quarter of 2005 and 2006, and volatility associated with the different tax regimes within the countries that the International SBU operates.

Net income for the three and twelve months ended December 31, 2006 was $113 million and $378 million, respectively, an increase of $104 million and $539 million versus 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"), certain distribution channels related to PruPac's 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 December 31,			Twelve Months Ended December 31,		
$ in Millions	**2006**	**2005**	**Change**	**2006**	**2005**	**Change**
Revenues	$419	$397	5.5%	$2,112	$1,656	27.5%
Pre-tax operating income before catastrophes, net incurred losses attributable to prior years and current accident year re-estimation	$24	$3	NM	$164	$197	(16.8)
Catastrophes[1]:						
- 2005 hurricanes	(19)	(57)	(66.7)	(28)	(153)	(81.7)
- All other	(7)	(6)	16.7	(7)	(6)	16.7
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(20)	(3)	NM	(22)	(215)	(89.8)
- All other	(43)	(45)	(4.4)	(177)	(151)	17.2
Current accident year re-estimation[3]	-	-	-	-	-	-
Pre-tax operating (loss)	(65)	(108)	(39.8)	(70)	(328)	(78.7)
Realized investment gains, net	34	124	(72.6)	320	485	(34.0)
Federal and foreign income tax benefit	56	28	100.0	6	255	(97.6)
Discontinued operations, net of tax	-	-	-	-	-	-
Net income	$25	$44	(43.2%)	$256	$412	(37.9%)

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Net of allowance for doubtful accounts of $11 million and $12 million for the three and twelve months ended December 31, 2006, respectively, and $17 million for both of the comparable periods of 2005.
3 Re-estimation of the current accident year loss reserves as of the nine months ended September 30, 2006.
NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2006 were $419 million and $2.112 billion, respectively, an increase of $22 million and $456 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 twelve months ended December 31, 2006 was $112 million and $773 million, respectively, a decrease of $21 million and an increase of $434 million versus the same periods in 2005. The change in both periods primarily reflects variability in sales of annuities and structured settlements.

Net investment income for the three and twelve months ended December 31, 2006 was $229 million and $819 million, respectively, an increase of $141 million and $183 million over the same periods in 2005. The increase in both periods reflects higher income primarily due to an increase in limited partnership and limited liability company income, a larger invested asset base driven by continued strong cash flow from operations and proceeds received from the Company's August 2006 debt offering and lower investment expenses. The decrease in investment expenses in both periods primarily reflects the impact of short-term and long-term variable compensation in 2005, which did not recur in 2006. One factor constraining growth in net investment income was lower yields on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities.

Net realized investment gains for the three and twelve months ended December 31, 2006 were $34 million and $320 million, respectively, decreases of $90 million and $165 million from the same periods in 2005. The decrease in the quarter primarily reflects a gain recognized on the sale of a private equity investment in the fourth quarter of 2005, which did not recur in 2006. The year-to-date decrease primarily reflects lower fixed maturity gains versus the same period in 2005, reflecting the sale of targeted taxable securities as part of a strategic realignment in 2005 that did not recur in 2006.

Fee and other revenues for the three and twelve months ended December 31, 2006 were $44 million and $200 million, respectively, a decrease of $8 million and an increase of $4 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 a subsidiary operation, 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 twelve months ended December 31, 2006 were $450 million and $1.862 billion, respectively, an increase of $69 million and $363 million over the same periods in 2005. The increase in both periods is primarily due to 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 increase in the quarter was partially offset by a reduction in general unallocated loss expense reserves. The year-to-date increase also reflects an increase in policyholder benefits related to immediate annuity and structured settlement business growth and interest expense related to the Company's March 2005 debt issuance, partially offset by decreases in assumed catastrophes losses through internal catastrophe reinsurance programs and incurred losses attributable to prior years. In addition, the Company completed an actuarial reserve study in the fourth quarter of 2006, which increased environmental reserves by $20 million. In 2005, the Company recorded $203 million of asbestos reserves which did not recur in 2006.

Pre-tax operating loss for the three and twelve months ended December 31, 2006 was $65 million and $70 million, respectively, an improvement of $43 million and $258 million over the same periods in 2005.

Federal and foreign income tax benefit for the three and twelve months ended December 31, 2006 was $56 million and $6 million, respectively, an increase of $28 million and a decrease of $249 million versus the same periods in 2005. See the Consolidated Section for a discussion of taxes.

Net income for the three and twelve months ended December 31, 2006 was $25 million and $256 million, respectively, a decrease of $19 million and $156 million comparable to 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, including 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 December 31, 2006 and December 31, 2005:

$ in Millions	**As of December 31, 2006**		**As of December 31, 2005**	
Invested Assets by Type	**Market Value**	**% of Total**	**Market Value**	**% of Total**
Fixed maturities, available for sale, at fair value	$41,102	87.0%	$37,391	89.3%
Equity securities, available for sale, at fair value	2,619	5.6	1,812	4.4
Trading securities, at fair value	22	-	20	-
Limited partnerships and limited liability companies	1,435	3.0	1,081	2.6
Commercial mortgage loans	322	0.7	-	-
Short-term investments	1,550	3.3	1,430	3.4
Other investments	211	0.4	139	0.3
Total invested assets	$47,261	100.0%	$41,873	100.0%

Total invested assets as of December 31, 2006 were $47.261 billion, a $5.388 billion or 12.9% 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.

Fixed maturities as of December 31, 2006 were $41.102 billion, an increase of $3.711 billion or 9.9% over December 31, 2005. The increase reflects the aforementioned change in the amount of cash available to invest, partially offset by a decrease in unrealized gains in the portfolio due to higher market interest rates. As of December 31, 2006, net unrealized gains were $121 million, a decrease of $308 million from December 31, 2005.

Equity securities available for sale as of December 31, 2006 were $2.619 billion, an $807 million or 44.5% increase over December 31, 2005. The increase reflects a $406 million increase in preferred stock holdings due to new investments in this asset class, and a $401 million increase in common stock due to new investments of $189 million and market appreciation of $212 million.

Limited partnerships and limited liability companies as of December 31, 2006 were $1.435 billion, a $354 million or 32.7% increase over December 31, 2005. The increase reflects in part, the tactical allocation to real estate financing, along with continued investment in private equity partnerships and market appreciation. These increases were partially offset by the distribution of commercial mortgage loan assets from a limited liability company investment to the Company at the end of December 2006. The Company's investments in private equity limited partnerships and limited liability companies 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.

Commercial mortgage loans as of December 31, 2006 were $322 million. The Company began investing in commercial mortgage loans as part of its diversification strategy in 2005 through its investment in a limited liability company. At December 31, 2005, the Company owned $116 million of commercial mortgage loans as part of this limited liability company investment and continued to grow this asset class in 2006. As mentioned above, the Company acquired participation certificates in commercial mortgage loans in exchange for a limited liability company investment in December 2006.

As of December 31, 2006, the Company had unfunded private equity, commercial mortgage loan and energy commitments of $1.106 billion, $335 million and $232 million, respectively. As of December 31, 2006, the Company had commitments to purchase various residential mortgage-backed securities at a cost and market value of $60 million and various corporate and municipal securities at a cost of $394 million (fair market value of $390 million).

As of December 31, 2006, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.1% of invested assets.

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

$ in Millions	**As of December 31, 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	$4,658	11.3%	$4,570	12.2%
Mortgage and asset-backed securities	12,267	29.8	12,542	33.6
U.S. state and municipal	6,612	16.1	4,005	10.7
Corporate and other	15,354	37.4	14,400	38.5
Foreign government securities	2,211	5.4	1,874	5.0
Total fixed maturities	$41,102	100.0%	$37,391	100.0%

During 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 $2.607 billion and $337 million, respectively, in these asset classes as of December 31, 2006.

$ in Millions	As of December 31, 2006		As of December 31, 2005	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$21,954	53.4%	$20,285	54.3%
AA+, AA, AA-	5,706	13.9	3,903	10.4
A+, A, A-	6,631	16.1	6,786	18.1
BBB+, BBB, BBB-	3,995	9.7	3,824	10.2
BB+, BB, BB-	1,699	4.1	1,325	3.6
B+, B, B-	1,047	2.6	1,238	3.3
CCC or lower	70	0.2	30	0.1
Total fixed maturities	$41,102	100.0%	$37,391	100.0%

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

The Company's allocation in investment grade bonds remained constant from December 31, 2005.

The Company had 6.9% of its fixed maturity securities invested in non-investment grade securities at December 31, 2006. 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 and loans 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 December 31, 2006		As of December 31, 2005	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,946	4.7%	$1,080	2.9%
Over 1 yr through 5 yrs	7,679	18.7	6,898	18.4
Over 5 yrs through 10 yrs	7,937	19.3	7,615	20.4
Over ten years	11,273	27.4	9,256	24.8
Mortgage and asset-backed securities	12,267	29.9	12,542	33.5
Total fixed maturities	$41,102	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 twelve months ended December 31, 2006 and 2005:

$ in Millions	Three Months Ended December 31,		Twelve Months Ended December 31,	
Net Investment Income	**2006**	**2005**	**2006**	**2005**
Taxable interest income	$543	$514	$2,089	$2,028
Tax-exempt interest income	60	34	200	75
Dividends	10	6	52	53
Limited partnerships and limited liability companies	93	31	304	227
Other investment income	15	3	20	16
Gross investment income	721	588	2,665	2,399
Investment expenses	(31)	(79)	(117)	(152)
Net investment income	$690	$509	$2,548	$2,247

Net investment income for the three and twelve months ended December 31, 2006 was $690 million and $2.548 billion, respectively, an increase of $181 million and $301 million over the same periods in 2005. The increase in net investment income in both periods reflects higher income primarily due to an increase in limited partnership and limited liability company income of $62 million and $77 million in the quarter and year-to-date, respectively, a larger invested asset base driven by continued strong cash flow from operations and proceeds received from the Company's August 2006 debt offering, and lower investment expenses. The decrease in investment expenses in both periods primarily reflects the impact of short-term and long-term variable compensation in 2005, which did not recur in 2006. One factor constraining growth in net investment income was lower yields on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and twelve months ended December 31, 2006 and 2005:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended December 31, 2006:				
Fixed maturities	$19	($3)	$-	$16
Common and preferred stock	30	(1)	-	29
Other	(11)	(2)	-	(13)
Total	$38	($6)	$-	$32
Three Months Ended December 31, 2005:				
Fixed maturities	$8	($4)	$-	$4
Common and preferred stock	16	(5)	-	11
Other	129	-	-	129
Total	$153	($9)	$-	$144
Twelve Months Ended December 31, 2006:				
Fixed maturities	$34	($39)	$-	($5)
Common and preferred stock	98	(5)	-	93
Other	261	(6)	-	255
Total	$393	($50)	$-	$343
Twelve Months Ended December 31, 2005:				
Fixed maturities	$175	($4)	$-	$171
Common and preferred stock	72	(7)	(3)	62
Other	297	(7)	-	290
Total	$544	($18)	($3)	$523

$ in Millions	Three Months Ended December 31,		Twelve Months Ended December 31,	
Components of Net Realized Investment Gains (Losses)	**2006**	**2005**	**2006**	**2005**
Fixed maturities:				
Gross realized gains	$50	$41	$105	$263
Gross realized losses	(34)	(37)	(110)	(92)
Equities:				
Gross realized gains	35	17	112	101
Gross realized losses	(6)	(6)	(19)	(39)
Other:				
Gross realized gains	1	131	273	301
Gross realized losses	(14)	(2)	(18)	(11)
Total net realized investment gains (losses)	$32	$144	$343	$523

Net realized investment gains for the three and twelve months ended December 31, 2006 were $32 million and $343 million, respectively, a decrease of $112 million and $180 million from the same periods in 2005. The decrease in the quarter primarily reflects a gain of $106 million recognized on the sale of a private equity investment in the fourth quarter of 2005, which did not recur in 2006. The year-to-date decrease primarily reflects lower fixed maturity gains versus the same period in 2005, reflecting the sale of targeted taxable securities as part of a strategic realignment in 2005 that did not recur in 2006.

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 December 31, 2006:

$ in Millions	Less Than 12 Months		Greater Than 12 Months	
Unrealized Losses & Fair Value by Security Type	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**	**Unrealized Losses**	**Fair Value of Investments with Unrealized Losses**
U.S. Government and agency securities	($10)	$1,416	($70)	$2,233
Mortgage and asset-backed securities	(21)	2,633	(203)	6,118
U.S. state and municipal	(16)	1,657	(15)	179
Corporate and other	(55)	3,599	(213)	4,852
Foreign government securities	(8)	635	(5)	268
Equities	(16)	281	(4)	38
Total	($126)	$10,221	($510)	$13,688

Unrealized losses increased from $507 million as of December 31, 2005 to $636 million as of December 31, 2006 primarily due to an increase in interest rates. Approximately 95% of the unrealized losses ($600 million) exist on holdings where the fair value as of December 31, 2006 was less than 10% below amortized cost. The Company monitors the difference between the amortized cost and estimated fair value of investments to ascertain whether declines in value are temporary in nature. The Company employs a systematic methodology utilizing a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss in shareholders' equity. If the decline is believed to be "other-than-temporary," the carrying value of the investment is written down to fair value 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 December 31, 2006 are temporary.

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

LIQUIDITY AND CAPITAL RESOURCES

General

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

Net cash flows are generally invested in marketable securities. The Company invests its net cash flows in fixed income securities and equities while keeping a certain amount in cash and short-term investments to meet unpredictable cash obligations. For ongoing business, the Company monitors the duration of these investments, and purchases and sales are executed with the objective of having adequate cash available to satisfy its maturing liabilities. As the Company's investment strategy focuses on overall asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. The Company's invested assets as of December 31, 2006 totaled $47.261 billion.

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

$ in Millions	**As of December 31, 2006**	**As of December 31, 2005**
Commercial paper	$ -	$100
Revolving credit facilities	50	35
Current maturities of long-term debt	121	10
Total short-term debt	$171	$145

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

$ in Millions	**As of December 31, 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	(34)	(25)
Total long-term debt excluding current maturities	$3,175	$2,555

The Company issues commercial paper from Liberty Mutual Group Inc. ("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 $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. As of December 31, 2006, no borrowings were outstanding 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 December 31, 2006, total short-term loans and borrowings under the Venezuelan credit facility were approximately $50 million.

The $26 million increase in short-term debt outstanding is primarily due to $121 million of 8.2% Surplus Notes due May 4, 2007 and a $15 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 $620 million increase in long-term debt outstanding is primarily the result of the August 15, 2006 offering whereby LMGI issued $750 million of senior notes, partially offset by the reclassification of $121 million of current maturities to short-term debt.

Consolidated interest expense for the three and twelve months ended December 31, 2006 was $61 million and $212 million, respectively, representing increases of $13 million and $28 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 December 31, 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 a Keep Well Agreement with the Massachusetts Commissioner of Insurance, LMFIC and certain other affiliates which effectively limit LMFIC from paying any dividends to the Company when the "total adjusted capital" of LMFIC is below 300% of the "authorized control level," as such terms are defined in the Massachusetts risk-based capital regulations as of September 13, 2001. The Keep Well Agreement will terminate automatically upon the earlier of (i) the date that is five years from the effective date of the reorganization (March 19, 2007), or (ii) the date upon which the Company, LMFIC or LMHC Massachusetts Holdings Inc. becomes subject to the public reporting requirements of the Securities and Exchange Commission. Accordingly, the Keep Well Agreement between LMFIC and the Massachusetts Commissioner of Insurance will terminate on March 19, 2007.

As of December 31, 2006, the authorized control level risk-based capital and 2007 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	**2006**	**2005**	**Change**	**2007**
LMIC [3]	554%	495%	59 points	$1,007
LMFIC	579%	596%	(17 points)	$69
EICOW[3]	395%	370%	25 points	$121

[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.
[3] Any reallocation of surplus between insurance subsidiaries could change the dividend capacity of individual companies within the group. Effective January 1, 2007, the EICOW pooling percentage decreased from 16.0% to 10.0% and LMIC's pooling percentage increased accordingly.

LMGI also has access to funds at Liberty Corporate Services LLC ("Corporate Services"). Through its subsidiaries, Corporate Services collects fees and other revenues, primarily for claims administration and agency services rendered for affiliated and non-affiliated entities. For the three and twelve months ended December 31, 2006, Corporate Services recorded $44 million and $205 million, respectively, in pre-tax income. The service operations, based on existing fee based businesses, coupled with the transfer of other service operations in late 2006 and early 2007, are expected to generate approximately $270 million of pre-tax income in 2007, which would be available to service the obligations of LMGI.

Statutory Surplus

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $12.131 billion and $9.869 billion at December 31, 2006, and December 31, 2005, respectively. The increase in surplus reflects net income of $867 million (the sum of earnings from the Company's 43 domestic insurance companies and dividends from subsidiaries), a capital contribution from the parent, LMGI, of $881 million, affiliated unrealized gains of $295 million, and unaffiliated unrealized gains of $263 million. The balance of the change in statutory surplus primarily reflects changes in the provision for reinsurance, deferred taxes, foreign exchange, and non-admitted assets.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

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

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years;
- reinsurance recoverables and associated uncollectible reserves;
- impairments to the fair value of the investment portfolio;
- variable interest entities;
- deferred acquisition costs;
- 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.

Accounting Pronouncements Not Yet Adopted

In September 2006, the FASB issued SFAS No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*" ("SFAS 158"). This statement requires an entity to: (a) recognize an asset for the funded status of defined benefit plans that are over-funded and a liability for plans that are under-funded, measured as of the employer's fiscal year end; and (b) recognize changes in the funded status of defined benefit plans, other than for the net periodic benefit cost included in net income, in accumulated other comprehensive income. For pension plans the funded status must be based on the projected benefit obligation, which includes an assumption for future salary increases. For postretirement plans the funded status is based on the accumulated postretirement benefit obligation. The Company is required to adopt SFAS 158 effective December 31, 2007. The actual effect to the Company will depend on the discount rate, other valuation assumptions, and the actual value of plan assets as of December 31, 2007 and is expected to be less than 5% of equity.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $38.606 billion and $38.067 billion at December 31, 2006 and December 31, 2005, respectively. The increase was primarily due to business growth less the on-going settlement of claims.

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

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

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

Asbestos and Environmental

The Company’s asbestos and environmental (A&E) reserves for unpaid claims and claim adjustment expenses net of reinsurance and including an allowance for uncollectible accounts were $1.386 billion and $1.628 billion at December 31, 2006 and December 31, 2005, respectively. The decline in reserves is primarily due to the ongoing settlement of asbestos and environmental claims, partially offset by an increase in environmental reserves following the Company’s completion of an actuarial study in the fourth quarter of 2006.

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

$ in Millions	**As of December 31, 2006**	**As of December 31, 2005**
Gross reserves[1]	$1,203	$1,421
Ceded reserves[1]	331	355
Net reserves	$872	$1,066
Allowance for reinsurance on unpaid losses	100	110
Total asbestos reserves	**$972**	**$1,176**

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

The Company’s environmental reserves as of December 31, 2006 and December 31, 2005 were as follows:

$ in Millions	**As of December 31, 2006**	**As of December 31, 2005**
Gross reserves[1]	$441	$481
Ceded reserves[1]	27	29
Total environmental reserves	**$414**	**$452**

[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 $190 million and $130 million of gross and net A&E reserves, respectively. Any increase in A&E reserves related to PruPac is reinsured by Vantage Casualty

Insurance Company and guaranteed by Prudential Financial Inc. The company had paid losses associated with these reserves of $61 million and $2 million in 2006 and 2005, respectively.

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 $15.564 billion and $16.302 billion at December 31, 2006 and December 31, 2005, respectively, net of allowance for doubtful accounts of $315 million and $324 million, respectively**.** The decrease is primarily due to the ongoing settlement of 2005 hurricane claims and the re-estimation of ceded liabilities.

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

As part of its reinsurance security oversight, the Company has established a Standing Reinsurance Credit Committee 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 committee is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company's purchase and use of reinsurance.

Approximately 95% 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 December 31, 2006. Collateral held against outstanding gross reinsurance recoverable balances was $4.802 billion and $4.106 billion at December 31, 2006 and December 31, 2005, respectively.

The remaining 5% 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 December 31, 2006.

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 December 31, 2006 and 2005) that are amortized into income using the effective interest method over the estimated settlement periods. At December 31, 2006 and 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 years ended December 31, 2006 and 2005 was $125 million and $113 million, respectively. Deferred gain amortization was $95 million and $89 million for the years ended December 31, 2006 and 2005, respectively. The Company performed a re-estimation of the amount of deferred gains and amortization related to these reinsurance agreements in 2005. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $2,258 million and $2,211 million as of December 31, 2006 and 2005, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets and the Wausau market segment 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. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph. Approximately $45 million and $32 million of additional losses and $29 million and $23 million of additional premium were ceded to these retroactive and prospective contracts, respectively, for the twelve months ended December 31, 2006. Approximately $38 million and $31 million of additional losses and $24 million and $22 million of additional premium were ceded to these retroactive and prospective contracts, respectively, for the twelve months ended December 31, 2005. The income statement impact of ceding the additional losses and premium on the fourth quarter 2000 through fourth quarter 2001 covered accident-year periods was deferred for GAAP purposes and is amortized into income using the effective interest method over the estimated settlement period.

In 2006, LMIC entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 million of additional reinsurance coverage for LMIC and its affiliates in the event of a Northeast hurricane. The reinsurance agreements are fully collateralized by proceeds received by Mystic Re from the issuance of catastrophe bonds and provide coverage for hurricane-related losses from Washington, D.C. to Maine based on industry insured losses as reported by Property Claim Services. The reinsurance covers the 2007-2008 hurricane seasons, and $200 million was in force for the 2006 hurricane season. The Company has not recorded any recoveries under this program. Mystic Re has no other reinsurance in force.

Impairment Losses on Investments

The total impairment losses on investments for the three and twelve months ended December 31, 2006 were $6 million and $50 million, a decrease of $3 million and an increase of $32 million over the same periods 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 assets positions of the Company.

Effective January 1, 2006, the Company adopted FASB Statement of Position No. FAS 115-1 and FAS 124-1, Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments ("FSP FAS 115-1 and FAS 124-1"), which provides guidance on determining whether investment impairment is other-than-temporary regardless of the intent to sell and when a security is impaired due to fluctuations in interest rates.

In February 2006 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 ("SFAS No. 155"). SFAS No. 155 was issued to clarify the accounting treatment of non-traditional derivative instruments, referred to as hybrid instruments, and extend derivative accounting to investments in asset-backed securities. In January 2007, the FASB approved a scope exception to exclude from the application of SFAS No. 155 assets that contain an embedded derivative that is tied to the prepayment risk of pre-payable financial assets, and the investor does not control the right to accelerate the settlement. The Company's asset-backed security portfolio consists primarily of government-backed mortgages that do not provide for acceleration of payment therefore, we do not believe adoption of SFAS No. 155 will have a material impact on the Company.

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), relate primarily to investments in energy and private equity limited partnerships that are accounted for under the equity method. Two VIEs in the energy investment sector have been consolidated in the Company's 2006 and 2005 financial statements as the Company has been deemed to be the primary beneficiary. In addition, the Company has investments in 31 VIEs for which it is not the primary beneficiary at December 31, 2006. The Company's investments in VIEs were $208 million and $151 million at December 31, 2006 and 2005, respectively. The Company's maximum exposure to losses from VIEs is $481 million and $292 million as of December 31, 2006 and 2005, respectively, 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, which has been approved by the Investment Committee and state insurance regulatory authorities. Pursuant to the policy, the Company may enter into derivative transactions. As of December 31, 2006, the Company had several embedded derivative instruments in its portfolio, warrants and two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of December 31, 2006, the value of these instruments was immaterial. The

Company recognized approximately $2.1 million in net realized investment gains through December 31, 2006 driven by changes in fair value of derivative instruments, primarily warrants.

Deferred Policy Acquisition Costs

Total deferred policy acquisition costs were $1.662 billion and $1.476 billion as of December 31, 2006 and December 31, 2005, respectively. Deferred policy acquisition costs are costs that vary with, and are primarily related to, the acquisition of new and renewal insurance and investment contracts that are deferred and amortized over the respective policy terms. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration insurance contracts, acquisition costs include commissions, underwriting expenses, and premium taxes and assessments. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses.

Goodwill and Intangibles

Goodwill and intangible assets were $907 million and $810 million at December 31, 2006 and December 31, 2005, respectively.

Deferred Income Taxes

The net deferred income tax asset was $1.490 billion and $1.627 billion as of December 31, 2006 and December 31, 2005, respectively, net of a valuation allowance of $101 million and $99 million, respectively. The decrease in the Company's deferred income tax asset is primarily due to the reduction of the Company's minimum pension liability. 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.

In June 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*" ("FIN 48"). The interpretation requires companies to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The amount recognized would be the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability would be recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty (if applicable) on the excess. FIN 48 will require a tabular reconciliation of the change in the aggregate unrecognized tax benefits claimed, or expected to be claimed, in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Discussion will also be required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next 12 months. The Company is required to adopt FIN 48 effective January 1, 2007. Adoption of FIN 48 is not expected to have a material impact on the Company's 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, 2006, LMG had $85.498 billion in consolidated assets, $74.603 billion in consolidated liabilities, and $23.520 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 Inc.

Functionally, the Company conducts its business through four SBUs: Personal Markets, Commercial Markets, Agency Markets 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.