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

# Quarter Ended March 31, 2007

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

The following discussion highlights significant factors influencing results of operations and changes in financial position of Liberty Mutual Holding Company Inc., the parent corporation of the Liberty Mutual Group of companies (the "Company" or "LMG"), for the three months ended March 31, 2007 and 2006. This Management's Discussion & Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's 2006 Annual Report, First Quarter 2007 Consolidated Financial Statements (unaudited) and First Quarter 2007 Financial Supplement 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 unaudited financial statements.*

**Three Months Ended March 31, 2007 - Consolidated Results of Operations**

- Revenues for the three months ended March 31, 2007 were \$6.143 billion, an increase of \$695 million or 12.8% over the same period in 2006.

- Pre-tax income for the three months ended March 31, 2007 was \$500 million, an increase of \$96 million or 23.8% over the same period in 2006. Results in the period reflect an increase in realized capital gains of \$55 million.

- Net income for the three months ended March 31, 2007 was \$350 million, an increase of \$58 million or 19.9% over the same period in 2006.

- Cash flow from operations for the three months ended March 31, 2007 was \$1.009 billion, an increase of \$511 million or 102.6% over the same period in 2006.

- The combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2007 was 99.1%, an increase of 2.4 points over the same period in 2006. Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the three months ended March 31, 2007 increased 1.0 point to 101.1%.

**Financial Condition as of March 31, 2007**

- Total assets were \$88.124 billion as of March 31, 2007, an increase of \$2.626 billion or 3.1% over December 31, 2006.

- Policyholders' equity was \$11.318 billion as of March 31, 2007, an increase of \$423 million or 3.9% over December 31, 2006.

- Statutory surplus as regards policyholders for the combined operations of Liberty Mutual Insurance Company ("LMIC") and its U.S. affiliates was \$13.284 billion as of March 31, 2007, an increase of \$1.153 billion or 9.5% over December 31, 2006.

**Other 2007 1st Quarter Highlights**

***Rating Actions***

- On February 26, 2007, Moody's Investors Service placed the long-term ratings of Liberty Mutual Group under review for possible upgrade and affirmed the A2 (Good) financial strength rating of LMIC and its related property/casualty companies. The outlook for the financial strength rating remains stable.

- On February 28, 2007, A.M. Best Co. affirmed the A (Excellent) financial strength rating of LMIC and its related property/casualty companies. The outlook for this rating remains stable.

***Debt Transactions***

- On March 7, 2007, Liberty Mutual Group Inc. ("LMGI") issued \$700 million of 7.8% series A junior subordinated notes having a final maturity of 2087 and a final fixed rate interest payment date of 2037, and \$300 million of 7.0% series B junior subordinated notes having a final maturity of 2067 and a final fixed rate interest payment date of 2017. These securities receive various levels of equity treatment by the rating agencies. The majority of the proceeds of the offering were contributed to LMGI's wholly owned insurance subsidiary, LMIC.

## 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 pre-tax income excluding net realized gains (losses), 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.

***Overview – Consolidated***

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

| | **Three Months Ended March 31,** | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Workers compensation | $1,485 | $1,440 | 3.1% |
| Private passenger automobile | 1,446 | 1,317 | 9.8 |
| Homeowners | 394 | 352 | 11.9 |
| Commercial multiple peril / Fire | 392 | 392 | - |
| International local businesses [1] | 353 | 285 | 23.9 |
| LIU[2] reinsurance | 291 | 384 | (24.2) |
| Commercial automobile | 288 | 285 | 1.1 |
| General liability | 256 | 196 | 30.6 |
| LIU inland marine program[3] | 131 | 62 | 111.3 |
| LIU third party | 125 | 110 | 13.6 |
| Group disability and life | 116 | 98 | 18.4 |
| LIU first party[3] | 71 | 63 | 12.7 |
| Surety | 66 | 58 | 13.8 |
| Assumed voluntary reinsurance | 31 | 19 | 63.2 |
| Other[4] | 242 | 249 | (2.8) |
| Total net written premium | $5,687 | $5,310 | 7.1% |

1 Local international businesses, selling small commercial and other personal lines products locally, excluding private passenger automobile.
2 Liberty International Underwriters (LIU).
3 Effective in the first quarter of 2007, the LIU inland marine program has been reported separately from LIU first party. The prior period has been restated to reflect this change.
4 Includes premium assumed from International operations through internal reinsurance programs, primarily LIU Reinsurance and LIU first party.

Consolidated net written premium by SBU was as follows:

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Personal Markets | $1,255 | $1,195 | 5.0% |
| Commercial Markets | 1,280 | 1,177 | 8.8 |
| Agency Markets | 1,654 | 1,602 | 3.2 |
| International | 1,423 | 1,274 | 11.7 |
| Corporate and Other[1] | 75 | 62 | 21.0 |
| Total net written premium | $5,687 | $5,310 | 7.1% |

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 months ended March 31, 2007 was $5.687 billion, an increase of $377 million over the same period in 2006. Significant changes by major line of business include:

- Workers compensation net written premium increased $45 million over the same period in 2006. The increase primarily reflects new business, increased audit and retrospective premium, and an increase in Regional Companies' retention. Partially offsetting these increases was a decrease in Summit's premium due to mandated rate decreases in Florida and a significant decline in California rates due to increased competition.
- Private passenger automobile net written premium increased $129 million over the same period in 2006. The increase primarily reflects organic growth in Latin America and Europe, the acquisition of Seker Sigorta A.S., a property and casualty insurer located in Turkey, and the strengthening of foreign currencies versus the U.S. dollar in International's local businesses operations. The increase also reflects strong customer retention and new business in both Personal Markets and Agency Markets.
- Homeowners net written premium increased $42 million over the same period in 2006. The increase reflects rate increases and a 3.7% increase in Personal Markets policies in force driven by strong customer retention and new business, primarily in non-coastal areas. The increase also reflects improved customer retention and new business in Agency Markets.
- International local businesses net written premium (excluding private passenger automobile) increased $68 million over the same period in 2006. The increase reflects organic growth in Latin America and Europe and the strengthening of foreign currencies versus the U.S. dollar.
- LIU reinsurance net written premium decreased $93 million from the same period in 2006. The decrease reflects management's decision to significantly reduce its Lloyd's catastrophe exposure in the U.S. and Europe in 2007, partially offset by lower ceded premium.
- General liability net written premium increased $60 million over the same period in 2006. The increase primarily reflects new business and higher audit and retrospective premium in Commercial Markets' National Market segment.
- LIU inland marine program net written premium increased $69 million over the same period in 2006. The increase reflects the continued expansion of LIU's inland marine program business, which provides replacement coverage for lost or damaged cell phones.
- LIU third party net written premium increased $15 million over the same period in 2006 due primarily to reduced utilization of reinsurance.
- Group disability and life net written premium increased $18 million over the same period in 2006 due primarily to new business growth driven by an expanded sales force and broader market penetration.
- Assumed voluntary reinsurance net written premium increased $12 million over the same period in 2006 due primarily to new business growth.

- Other net written premium decreased $7 million from the same period in 2006 due to the decline in immediate annuity sales, partially offset by an increase in internal reinsurance.

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 March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Revenues | $6,143 | $5,448 | 12.8% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $514 | $526 | (2.3%) |
| Catastrophes[1] | (59) | (99) | (40.4) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental[2] | - | (2) | (100.0) |
| - All other[3] | (35) | (46) | (23.9) |
| Pre-tax operating income | 420 | 379 | 10.8 |
| Realized investment gains, net | 80 | 25 | NM |
| Federal and foreign income tax expense | (150) | (112) | 33.9 |
| Net income | $350 | $292 | 19.9% |
| Cash flow from operations | $1,009 | $498 | 102.6% |

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. 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 Net of allowance for uncollectible reinsurance reduction of $3 million and zero for the three months ended March 31, 2007 and 2006, respectively.

3 Net of earned premium attributable to prior years of $19 million and $16 million for the three months ended March 31, 2007 and 2006, respectively. Net of amortization of deferred gains on retroactive reinsurance of $16 million and $16 million for the three months ended March 31, 2007 and 2006, respectively.

NM = Not Meaningful

Revenues for the three months ended March 31, 2007 were $6.143 billion, an increase of $695 million over the same period in 2006. The major components of revenues are net premium earned, net investment income, net realized investment gains and losses, and other revenues.

Net premium earned for the three months ended March 31, 2007 was $5.211 billion, an increase of $545 million over the same period in 2006. The increase in the period primarily reflects the earned premium associated with the changes in net written premium in 2006 and the current period.

Net investment income for the three months ended March 31, 2007 was $673 million, an increase of $113 million over the same period in 2006. The increase in net investment income reflects an increase in interest income of $79 million due primarily to a larger invested asset base driven by strong cash flow from operations and the proceeds received from the Company's August 2006 debt offering. In addition, limited partnership and limited liability company income increased $23 million over the same period in 2006. Growth in net investment income was constrained by lower yields on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities.

Net realized investment gains for the three months ended March 31, 2007 were $80 million, an increase of $55 million over the same period in 2006. The increase in net realized investment gains for the quarter was primarily driven by a $37 million increase in net gains on equities primarily from the sales of foreign equities and lower impairment losses.

Fee and other revenues for the three months ended March 31, 2007 were $179 million, a decrease of $18 million from the same period in 2006. The decrease reflects lower revenues from the sale and production of oil and gas from the subsidiary operations of Liberty Energy Holdings, LLC ("Liberty Energy") and lower fee revenues associated with the Company's involuntary market servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three months ended March 31, 2007 were $5.643 billion, an increase of $599 million over the same period in 2006. The increase is primarily due to business growth and general cost increases in each of the Company's SBU's and higher interest expense and advertising costs, partially offset by a decrease in policyholder benefits due to the decline in immediate annuity sales. Lower catastrophe losses were offset by non-catastrophe property losses, including losses from the European storm Kyrill.

| | **Three Months Ended March 31,** | | |
|---|---|---|---|
| **CONSOLIDATED** | **2007** | **2006** | **Change (Points)** |
| **Combined ratio before catastrophes and net incurred losses attributable to prior years** | | | |
| Claims and claim adjustment expense ratio | 70.6% | 69.9% | 0.7 |
| Underwriting expense ratio | 28.2 | 26.4 | 1.8 |
| Dividend ratio | 0.3 | 0.4 | (0.1) |
| Subtotal | 99.1 | 96.7 | 2.4 |
| Catastrophes[1] | 1.2 | 2.4 | (1.2) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | 0.1 | - | 0.1 |
| - All other | 0.7 | 1.0 | (0.3) |
| Total combined ratio[2] | 101.1% | 100.1% | 1.0 |

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

2 The combined claim and expense ratio, expressed as a percentage, is a measure of underwriting profitability. This measure should only be used in conjunction with, and not in lieu of, underwriting income and may not be comparable to other performance measures used by the Company's competitors. The combined claim and expense ratio is computed as the sum of the following property and casualty ratios: the ratio of claims and claim adjustment expense to earned premium; the ratio to earned premium of insurance operating costs plus amortization of deferred policy acquisition costs less fee income (primarily related to the Company's involuntary market servicing carrier operations and managed care income) 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 and net incurred losses attributable to prior years for the three months ended March 31, 2007 was 99.1%, an increase of 2.4 points over the same period in 2006. The increase reflects a higher underwriting expense ratio due to an increase in variable incentive compensation and other Corporate expenses, higher commission expense due to a reduction in the utilization of reinsurance on LIU's third party business which resulted in a lower amount of ceding commission received, and an increase in Personal Markets' advertising costs. The increase also reflects a higher claims and claim adjustment expense ratio due primarily to an increase in non-catastrophe related property losses, losses from the European storm Kyrill and a more competitive rate environment, partially offset by higher earned premium primarily associated with internal property catastrophe reinsurance which had no corresponding losses. In addition, the current accident year loss ratio in Personal Markets was booked at a level higher than 2006, reflective of the uncertainty associated with the continuation of favorable auto liability loss trends and lower premium rates.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 101.1%, an increase of 1.0 point over the same period in 2006. Results in the quarter reflect lower catastrophe losses of 1.2 points and a decrease in net incurred losses attributable to prior years of 0.2 points.

PTOI for the three months ended March 31, 2007 was $420 million, an increase of $41 million over the same period in 2006.

Federal and foreign income tax expense for the three months ended March 31, 2007 was $150 million, an increase of $38 million over the same period in 2006. The Company's effective tax rate for the three months ended March 31, 2007 was 30%, compared to 28% for the same period in 2006. The Company's effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three months ended March 31, 2007 was $350 million, an increase of $58 million over the same period in 2006.

## PERSONAL MARKETS

***Overview – Personal Markets***

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Private passenger automobile | $900 | $865 | 4.0% |
| Homeowners and other | 355 | 330 | 7.6 |
| Total net written premium | $1,255 | $1,195 | 5.0% |

Net written premium for the three months ended March 31, 2007 was $1.255 billion, an increase of $60 million over the same period in 2006.

Private passenger automobile net written premium for the three months ended March 31, 2007 was $900 million, an increase of $35 million over the same period in 2006. The increase in the quarter reflects a 2.5% increase in voluntary policies in force over the same period in 2006 due to strong customer retention and new business growth.

Homeowners and other net written premium for the three months ended March 31, 2007 was $355 million, an increase of $25 million over the same period in 2006. The increase in the quarter is due to rate increases and a 3.8% increase in policies in force over the same period in 2006 due to strong customer retention and new business growth, primarily in non-coastal areas.

***Results of Operations – Personal Markets***

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Revenues | $1,411 | $1,362 | 3.6% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $156 | $176 | (11.4%) |
| Catastrophes | (36) | (59) | (39.0) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other[1] | 40 | - | NM |
| Pre-tax operating income | 160 | 117 | 36.8 |
| Realized investment gains, net | - | - | - |
| Federal and foreign income tax expense | (48) | (41) | 17.1 |
| Net income | $112 | $76 | 47.4% |

1 Net of earned premium attributable to prior years of zero for the three months ended March 31, 2007 and 2006, respectively.
NM = Not Meaningful

Revenues for the three months ended March 31, 2007 were $1.411 billion, an increase of $49 million over the same period in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2007 was $1.316 billion, an increase of $40 million over the same period in 2006. The increase in the quarter reflects the earned premium associated with growth in net written premium for both the voluntary auto and homeowners lines of business in 2006 and the current period, partially offset by a reduction in involuntary market policies.

Net investment income for the three months ended March 31, 2007 was $81 million, an increase of $10 million over the same period in 2006. The increase primarily reflects a higher invested asset base.

Claims, benefits and expenses for the three months ended March 31, 2007 were $1.251 billion, an increase of $6 million over the same period in 2006. The increase in the quarter reflects business growth and higher acquisition expenses mainly due to an increase in advertising costs as compared to the same period in 2006. These items are partially offset by lower catastrophe losses.

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **PERSONAL MARKETS** | **2007** | **2006** | **Change (Points)** |
| **Combined ratio before catastrophes and net incurred losses attributable to prior years** | | | |
| Claims and claim adjustment expense ratio | 68.5% | 67.2% | 1.3 |
| Underwriting expense ratio | 25.5 | 24.2 | 1.3 |
| Dividend ratio | - | - | - |
| Subtotal | 94.0 | 91.4 | 2.6 |
| Catastrophes | 2.7 | 4.6 | (1.9) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other | (3.0) | - | (3.0) |
| Total combined ratio | 93.7% | 96.0% | (2.3) |

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 93.7%, a decrease of 2.3 points from the same period in 2006. The decrease reflects lower catastrophe losses in addition to favorable net incurred losses attributable to prior years related to the auto line of business. Prior year auto liability loss and loss adjustment expense reserves continued to develop favorably, resulting in 3.0 points of favorable development in the quarter. The current accident year has been recorded at a loss ratio reflective of the uncertainty associated with the continuation of favorable auto liability loss trends and lower premium rates. The higher underwriting expense ratio is primarily due to an increase in advertising costs.

PTOI for the three months ended March 31, 2007 was $160 million, an increase of $43 million over the same period in 2006.

Federal and foreign income tax expense for the three months ended March 31, 2007 was $48 million, an increase of $7 million over the same period in 2006, as a result of higher pre-tax income offset by a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three months ended March 31, 2007 was $112 million, an increase of $36 million over the same period in 2006.

## COMMERCIAL MARKETS

***Overview – Commercial Markets***

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Business Market | $548 | $537 | 2.0% |
| National Market | 437 | 375 | 16.5 |
| Group Market | 116 | 98 | 18.4 |
| Liberty Mutual Property | 80 | 85 | (5.9) |
| Other Markets[1] | 99 | 82 | 20.7 |
| Total net written premium | $1,280 | $1,177 | 8.8% |

1 Effective January 1, 2007 net written premium associated with the involuntary pools for Wausau, previously included in Commercial Markets, is included in Agency Markets. The prior period has been restated to reflect this change.

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Workers compensation | $ 738 | $722 | 2.2% |
| Commercial automobile | 113 | 113 | - |
| General liability | 167 | 109 | 53.2 |
| Group disability and life | 116 | 98 | 18.4 |
| Commercial multiple peril / Fire | 70 | 77 | (9.1) |
| Assumed voluntary reinsurance | 30 | 19 | 57.9 |
| Other | 46 | 39 | 17.9 |
| Total net written premium | $1,280 | $1,177 | 8.8% |

Net written premium for the three months ended March 31, 2007 was $1.280 billion, an increase of $103 million over the same period in 2006. The increase in the quarter primarily reflects new business growth across all market segments and lines of business and a $50 million increase in audit and retrospective premium, of which $25 million relates to the general liability line within the National Market segment. Group disability and life reflects the impact of an expanded sales force and broader market penetration. Partially offsetting these increases are modest rate declines and lower retention in most lines of business reflective of competitive market conditions. In addition, an increase in ceded premiums on an internal reinsurance program impacted the commercial multiple peril/fire line within Liberty Mutual Property.

***Results of Operations – Commercial Markets***

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006[3]** | **Change** |
| Revenues | $1,255 | $1,090 | 15.1% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $96 | $85 | 12.9% |
| Catastrophes[1] | (5) | (12) | (58.3) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other[2] | (9) | (21) | (57.1) |
| Pre-tax operating income | 82 | 52 | 57.7 |
| Realized investment gains, net | - | - | - |
| Federal and foreign income tax expense | (25) | (17) | 47.1 |
| Net income | $57 | $35 | 62.9% |

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 Net of earned premium attributable to prior years of $5 million and ($6) million for the three months ended March 31, 2007 and 2006, respectively. Net of amortization of deferred gains on retroactive reinsurance of $10 million and $7 million for the three months ended March 31, 2007 and 2006, respectively.

3 Effective January 1, 2007, the results associated with the involuntary pool for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

NM = Not Meaningful.

Revenues for the three months ended March 31, 2007 were $1.255 billion, an increase of $165 million over the same period in 2006. The major components of revenues are net premium earned, net investment income, and other revenues.

Net premium earned for the three months ended March 31, 2007 was $1.026 billion, an increase of $158 million over the same period in 2006. The increase reflects the earned premium associated with the changes in net written premium in 2006 and the current period.

Net investment income for the three months ended March 31, 2007 was $148 million, an increase of $16 million over the same period in 2006. The increase primarily reflects a higher invested asset base due to strong cash flow from operations.

Fee and other revenues for the three months ended March 31, 2007 were $81 million, a decrease of $9 million from the same period in 2006. The decrease primarily reflects lower fee revenues associated with the Company's involuntary market servicing carrier operations due to lower involuntary market premium volume. As a servicing carrier, the Company receives fee income for performing certain underwriting, claims and administrative services for all participating involuntary pool members.

Claims, benefits and expenses for the three months ended March 31, 2007 were $1.173 billion, an increase of $135 million over the same period in 2006. The increase is primarily driven by business growth, general cost increases and higher non-catastrophe related property losses. These increases were partially offset by lower catastrophes.

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **COMMERCIAL MARKETS** | **2007** | **2006[2]** | **Change (Points)** |
| **Combined ratio before catastrophes and net incurred losses attributable to prior years** | | | |
| Claims and claim adjustment expense ratio | 83.4% | 82.7% | 0.7 |
| Underwriting expense ratio | 18.4 | 20.0 | (1.6) |
| Dividend ratio | 0.4 | 0.1 | 0.3 |
| Subtotal | 102.2 | 102.8 | (0.6) |
| Catastrophes[1] | 0.6 | 1.6 | (1.0) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other | 1.0 | 2.8 | (1.8) |
| Total combined ratio | 103.8% | 107.2% | (3.4) |

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 hurricanes and the 2005 hurricanes. 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 Effective January 1, 2007, the results associated with the involuntary pool for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

The Commercial Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2007 was 102.2%, a decrease of 0.6 points from the same period in 2006. The increase in the claims and claim adjustment expense ratio reflects higher non-catastrophe related property losses compared to the same period in 2006 as well as a more competitive rate environment. The decrease in the underwriting expense ratio is a result of earned premium growth greater than the rate of expense growth, partially offset by the lower expense reimbursement received from the Company's servicing carrier operations.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 103.8%, a decrease of 3.4 points from the same period in 2006. The decrease in the quarter was driven by lower catastrophes and net incurred losses attributable to prior year and higher earned premium compared to the same period in 2006.

PTOI for the three months ended March 31, 2007 was $82 million, an increase of $30 million over the same period in 2006.

Federal and foreign income tax expense for the three months ended March 31, 2007 was $25 million, an increase of $8 million over the same periods in 2006, as a result of higher pre-tax income offset by a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three months ended March 31, 2007 was $57 million, an increase of $22 million over the same period in 2006.

## AGENCY MARKETS

***Overview – Agency Markets***

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006[1]** | **Change** |
| Regional Companies[2] | $855 | $811 | 5.4% |
| Wausau | 433 | 425 | 1.9 |
| Summit | 280 | 291 | (3.8) |
| Surety | 66 | 57 | 15.8 |
| Other[2] | 20 | 18 | 11.1 |
| Total net written premium | $1,654 | $1,602 | 3.2% |

[1] Effective January 1, 2007 net written premium associated with the involuntary pools for Wausau, previously included in Commercial Markets, is included in Agency Markets. The prior period has been restated to reflect this change.
[2] Effective January 1, 2007, the results associated with the NCCI involuntary business, which were previously included in Other, are included in Regional Companies. Reclassifications have been made to the prior period to reflect this change, with no overall impact to Agency Markets.

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006[1]** | **Change** |
| **Commercial Lines** | | | |
| Workers compensation total: | $826 | $813 | 1.6% |
| - Wausau | 358 | 347 | 3.2 |
| - Summit | 280 | 291 | (3.8) |
| - All other | 188 | 175 | 7.4 |
| Commercial multiple peril | 295 | 285 | 3.5 |
| Commercial automobile | 173 | 172 | 0.6 |
| General liability | 68 | 70 | (2.9) |
| Surety | 66 | 58 | 13.8 |
| Other | 52 | 45 | 15.6 |
| Subtotal | $1,480 | $1,443 | 2.6% |
| **Personal Lines** | | | |
| Private passenger automobile | $107 | $97 | 10.3% |
| Homeowners | 58 | 53 | 9.4 |
| Other | 9 | 9 | - |
| Subtotal | $174 | $159 | 9.4% |
| Total net written premium | $1,654 | $1,602 | 3.2% |

Net written premium for the three months ended March 31, 2007 was $1.654 billion, an increase of $52 million over the same period in 2006. The growth in the quarter reflects higher retention and new business growth in personal lines, increased audit and retrospective workers compensation premium at Wausau, higher Regional Company commercial lines retention, and an increase in surety net written premium due to lower ceded reinsurance premium and growth. These increases were partially offset by a decrease in Summit's workers compensation premium due to mandated rate decreases in Florida, a significant decline in California workers compensation rates due to increased competition, and modest rate decreases in most other lines.

***Results of Operations – Agency Markets***

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006[3]** | **Change** |
| Revenues | $1,616 | $1,493 | 8.2% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $125 | $124 | 0.8% |
| Catastrophes[1] | (18) | (22) | (18.2) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other[2] | 21 | 26 | (19.2) |
| Pre-tax operating income | 128 | 128 | - |
| Realized investment gains, net | - | - | - |
| Federal and foreign income tax expense | (38) | (45) | (15.6) |
| Net income | $90 | $83 | 8.4% |

1 Catastrophe losses include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.
2 Net of earned premium attributable to prior years of $13 million and $17 million for the three months ended March 31, 2007 and 2006, respectively. Net of amortization of deferred gains on retroactive reinsurance of $1 million and $3 million for the three months ended March 31, 2007 and 2006, respectively.
3 Effective January 1, 2007, the results associated with the involuntary pool for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.
NM = Not Meaningful

Revenues for the three months ended March 31, 2007 were $1.616 billion, an increase of $123 million over the same period in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three months ended March 31, 2007 was $1.462 billion, an increase of $103 million over the same period in 2006. The increase reflects the earned premium recognition of business growth consistent with the changes in net written premium in 2006 and the current period.

Net investment income for the three months ended March 31, 2007 was $132 million, an increase of $20 million over the same period in 2006. The increase primarily reflects a higher invested asset base due to strong cash flow from operations.

Claims, benefits and expenses for the three months ended March 31, 2007 were $1.488 billion, an increase of $123 million over the same period in 2006. The increase is primarily due to an increase in variable expenses driven by business growth general cost increases and an increase in non-catastrophe related property losses.

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **AGENCY MARKETS** | **2007** | **2006[2]** | **Change (Points)** |
| **Combined ratio before catastrophes and net incurred losses attributable to prior years** | | | |
| Claims and claim adjustment expense ratio | 69.2% | 66.2% | 3.0 |
| Underwriting expense ratio | 30.4 | 31.0 | (0.6) |
| Dividend ratio | 0.9 | 1.2 | (0.3) |
| Subtotal | 100.5 | 98.4 | 2.1 |
| Catastrophes[1] | 1.2 | 1.6 | (0.4) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other | (1.4) | (1.8) | 0.4 |
| Total combined ratio | 100.3% | 98.2% | 2.1 |

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

2 Effective January 1, 2007, the results associated with the involuntary pool for Wausau, previously included in Commercial Markets, are included in Agency Markets. In 2006, the net result was allocated to Agency Markets. The prior period has been restated to reflect this change.

The Agency Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2007 was 100.5%, an increase of 2.1 points over the same period in 2006. The increase in the claims and claim adjustment expense ratio is due to higher non-catastrophe related property losses and an increase in the current accident year loss ratio for workers compensation due to exposure growth and a more competitive rate environment. The decrease in the underwriting expense ratio is driven by earned premium growth greater than the rate of expense growth. The decrease in the dividend ratio is due to lower dividends at Summit.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 100.3%, an increase of 2.1 points over the same period in 2006. The increase reflects a decrease in the amount of favorable incurred loss development attributable to prior years related to property lines, offset by favorable development in liability lines and lower catastrophe losses due to lower winter storm activity compared to the same period last year.

PTOI for the three months ended March 31, 2007 was $128 million, unchanged from the same period in 2006.

Federal and foreign income tax expense for the three months ended March 31, 2007 was $38 million, a decrease of $7 million from the same periods in 2006, as a result of a lower effective tax rate in 2007. The effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three months ended March 31, 2007 was $90 million, an increase of $7 million over the same period in 2006.

## INTERNATIONAL

***Overview – International***

International net written premium by market segment was as follows:

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| International Local Businesses | $792 | $640 | 23.8% |
| Liberty International Underwriters | 631 | 634 | (0.5) |
| Total net written premium | $1,423 | $1,274 | 11.7% |

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 six 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 inland marine program: cell phone replacement coverage for lost or damaged devices;
(4) LIU third party: includes casualty, excess casualty, D&O, E&O, professional liability and other;
(5) LIU first party: includes marine, energy, engineering, aviation, and property; and
(6) LIU other: includes workers compensation, commercial auto, and residual value.

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

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Local businesses – private passenger auto | $439 | $355 | 23.7% |
| Local businesses – all other | 353 | 285 | 23.9 |
| LIU reinsurance | 291 | 384 | (24.2) |
| LIU inland marine program[1] | 131 | 62 | 111.3 |
| LIU third party | 125 | 110 | 13.6 |
| LIU first party[1] | 71 | 63 | 12.7 |
| LIU other | 13 | 15 | (13.3) |
| Total net written premium | $1,423 | $1,274 | 11.7% |

1 Effective in the first quarter of 2007, LIU inland marine program has been reported separately from LIU first party. The prior period has been restated to reflect this change.

Net written premium for the three months ended March 31, 2007 was $1.423 billion, an increase of $149 million over the same period in 2006. The increase in International's local businesses reflects organic growth in both Latin America and Europe, the acquisition of Seker Sigorta A.S., a property and casualty insurer located in Turkey, and the strengthening of foreign currencies versus the U.S. dollar. Growth in the quarter also reflects the continued expansion of LIU's inland marine program business, which provides replacement coverage for lost or damaged cell phones. In addition, LIU first party net written premium increased due to a change in the timing of recording ceded written premium for certain excess of loss contracts while LIU's third party business increased due to a reduction in the utilization of reinsurance.

The decrease in LIU's reinsurance business reflects management's decision to significantly reduce its Lloyd's catastrophe exposure in the U.S. and Europe in 2007, partially offset by lower ceded premium.

***Results of Operations – International***

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Revenues | $1,433 | $1,115 | 28.5% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $135 | $114 | 18.4% |
| Catastrophes[1] | - | - | - |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other[2] | 9 | (18) | NM |
| Pre-tax operating income | 144 | 96 | 50.0 |
| Realized investment gains, net | 12 | 15 | (20.0) |
| Federal and foreign income tax expense | (44) | (34) | 29.4 |
| Net income | $112 | $77 | 45.5% |

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 Net of earned premium attributable to prior years of $1 million and $5 million for the three months ended March 31, 2007 and 2006, respectively.

NM = Not Meaningful

Revenues for the three months ended March 31, 2007 were $1.433 billion, an increase of $318 million over the same period in 2006. The major components of revenues are net premium earned, net investment income and net realized investment gains and losses.

Net premium earned for the three months ended March 31, 2007 was $1.283 billion, an increase of $284 million over the same period in 2006. The increase reflects the earned premium associated with the changes in net written premium of the local businesses and LIU's inland marine program and third party lines of business in 2006 and the current period. Despite the reduction in net written premium in 2007, earned premium for LIU's reinsurance business increased in the quarter due to a higher level of written premium in 2006 due to rate increases.

Net investment income for the three months ended March 31, 2007 was $123 million, an increase of $34 million over the same period in 2006. The increase is driven by a higher invested asset base due to strong cash flows from operations, capital contributions and the impact of foreign exchange partially offset by a decline in yields.

Net realized investment gains for the three months ended March 31, 2007 were $12 million, a decrease of $3 million from the same period in 2006.

Claims, benefits and expenses for the three months ended March 31, 2007 were $1.277 billion, an increase of $273 million over the same period in 2006. The increase in the quarter is primarily due to growth in the business, losses from European storm Kyrill and higher commission expense. The increase in commission expense is due to a reduction in ceding commission in LIU's third party business and inland marine program as well as higher acquisition costs in the local companies, primarily in Europe. Partially offsetting these increases is a decrease in net incurred losses attributable to prior years reflecting favorable loss development in local business operations, primarily Europe, in 2007 versus unfavorable development in 2006 and the reversal of a value-added tax accrual in Spain.

| | **Three Months Ended March 31,** | | |
|---|---|---|---|
| **INTERNATIONAL** | **2007** | **2006** | **Change (Points)** |
| **Combined ratio before catastrophes and net incurred losses attributable to prior years** | | | |
| Claims and claim adjustment expense ratio | 67.6% | 66.1% | 1.5 |
| Underwriting expense ratio | 30.9 | 29.3 | 1.6 |
| Dividend ratio | - | - | - |
| Subtotal | 98.5 | 95.4 | 3.1 |
| Catastrophes[1] | - | - | - |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental | - | - | - |
| - All other | (0.7) | 1.9 | (2.6) |
| Total combined ratio | 97.8% | 97.3% | 0.5 |

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.

The International combined ratio before catastrophes and net incurred losses attributable to prior years for the three months ended March 31, 2007 was 98.5%, an increase of 3.1 points over the same period in 2006. The increase in the quarter reflects a higher underwriting expense ratio due to a reduction in the utilization of reinsurance on LIU’s third party business which resulted in a lower amount of ceding commission received, a change in terms of the inland marine program which resulted in a lower expense recovery and more favorable loss ratio, and higher acquisition costs in Europe. In addition, the claims and claim adjustment expense ratio increased in the quarter due to a higher loss ratio incurred on LIU’s reinsurance business due to European storm Kyrill and a higher loss ratio on auto business in Latin America. This increase in the loss ratio was partially offset by the previously mentioned change in the terms of LIU’s inland marine program, which reduced the loss ratio and increased the underwriting expense ratio in the quarter.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio was 97.8%, an increase of 0.5 points over the same period in 2006. The decrease in net incurred losses attributable to prior years reflects favorable loss development in local business operations, primarily Europe, in 2007 versus unfavorable development in 2006.

PTOI for the three months ended March 31, 2007 was $144 million, an increase of $48 million over the same period in 2006.

Federal and foreign income tax expense for the three months ended March 31, 2007 was $44 million, an increase of $10 million over the same periods in 2006, as a result of higher pre-tax income offset by a lower effective tax rate in 2007. The effective tax rate for the three months ended March 31, 2007 was 28%, compared to 31% for the same period in 2006. Federal and foreign income taxes reflect volatility associated with different tax structures within countries that International operates.

Net income for the three months ended March 31, 2007 was $112 million, an increase of $35 million over the same period in 2006.

## CORPORATE and OTHER

***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 internal discontinued operations, composed of: asbestos, environmental, toxic tort exposures, the run-off of the California workers compensation business of Golden Eagle Insurance Corporation ("Golden Eagle"), and certain distribution channels related to PruPac's business.

- Interest expense on the Company's outstanding domestic debt.

- Internal reinsurance programs, primarily catastrophe treaties where the businesses choose to purchase more reinsurance coverage than the Company purchases for the consolidated group and effective in 2007 loss development associated with Commercial Market's pre-2005 fully insured workers compensation business.

- 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, and Agency Markets and International business units. In 2007, the Company changed its allocation methodology to allocate federal taxes at the expected effective tax rate (30%). In 2006, domestic operations included in the business units reflect income tax at the 35% marginal U.S. Federal tax rate, while International reflects the actual tax expense of each country including changes in the international valuation allowance.

- Income (loss) related to limited partnership and limited liability company investments.

- 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.

***Results of Operations – Corporate and Other***

| | Three Months Ended March 31, | | |
|---|---|---|---|
| **$ in Millions** | **2007** | **2006** | **Change** |
| Revenues | $428 | $388 | 10.3% |
| PTOI before catastrophes and net incurred losses attributable to prior years | $2 | $27 | (92.6%) |
| Catastrophes[1] | - | (6) | (100.0) |
| Net incurred losses attributable to prior years: | | | |
| - Asbestos & environmental[2] | - | (2) | (100.0) |
| - All other | (96) | (33) | 190.9 |
| Pre-tax operating loss | (94) | (14) | NM |
| Realized investment gains, net | 68 | 10 | NM |
| Federal and foreign income tax benefit | 5 | 25 | (80.0) |
| Net (loss) income | $(21) | $21 | NM |

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

2 Net of allowance for uncollectible reinsurance reduction of $3 million and zero for the three months ended March 31, 2007 and 2006, respectively.

NM = Not Meaningful

Revenues for the three months ended March 31, 2007 were $428 million, an increase of $40 million over the same period in 2006. The major components of revenues include net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three months ended March 31, 2007 was $124 million, a decrease of $40 million from the same period in 2006. The decrease primarily reflects the decline in immediate annuity sales partially offset by an increase in internal reinsurance earned premium.

Net investment income for the three months ended March 31, 2007 was $189 million, an increase of $33 million over the same period in 2006. The increase reflects an increase in interest income due primarily to a larger invested asset base driven by strong cash flow from operations and the proceeds received from the Company’s August 2006 debt offering. In addition, the increase reflects higher limited partnership and limited liability company income. Growth in net investment income was constrained by lower yields on the fixed maturity portfolio, due primarily to the increased investment in tax-exempt securities.

Net realized investment gains for the three months ended March 31, 2007 were $68 million, an increase of $58 million over the same period in 2006. The increase was primarily driven by gains on equities primarily from the sales of foreign equities and lower impairment losses.

Fee and other revenues for the three months ended March 31, 2007 were $47 million, a decrease of $11 million from the same period in 2006. The decrease reflects lower revenues from the sale and production of oil and gas from the Liberty Energy subsidiary operation.

Claims, benefits and expenses for the three months ended March 31, 2007 were $454 million, an increase of $62 million over the same period in 2006. The increase is due to an increase in variable incentive compensation and other Corporate expenses, incurred losses attributable to prior years primarily related to workers compensation and general liability reserves, and higher interest expense related to the Company’s March 2007 and August 2006 debt offerings. These increases were partially offset by a decrease in policyholder benefits due to the decline in immediate annuity sales.

Pre-tax operating loss for the three months ended March 31, 2007 was $94 million, an increase of $80 million over the same period in 2006.

Federal and foreign income tax benefit for the three months ended March 31, 2007 was $5 million, a decrease of $20 million from the same periods in 2006. See the Consolidated section for a discussion of taxes.

Net loss for the three months ended March 31, 2007 was $21 million, an increase of $42 million over the same period in 2006.

## 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 energy 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 March 31, 2007 and December 31, 2006:

| **$ in Millions** | **As of March 31, 2007** | | **As of December 31, 2006** | |
|---|---|---|---|---|
| **Invested Assets by Type** | **Carrying Value** | **% of Total** | **Carrying Value** | **% of Total** |
| Fixed maturities, available for sale, at fair value | $42,361 | 87.3% | $41,102 | 87.0% |
| Equity securities, available for sale, at fair value | 2,837 | 5.8 | 2,619 | 5.6 |
| Trading securities, at fair value | 23 | - | 22 | - |
| Limited partnerships and limited liability companies | 1,531 | 3.2 | 1,435 | 3.0 |
| Commercial mortgage loans | 382 | 0.8 | 322 | 0.7 |
| Short-term investments | 1,161 | 2.4 | 1,550 | 3.3 |
| Other investments | 252 | 0.5 | 211 | 0.4 |
| Total invested assets | $48,547 | 100.0% | $47,261 | 100.0% |

Total invested assets as of March 31, 2007 were $48.547 billion, an increase of $1.286 billion or 2.7% over December 31, 2006. The increase reflects strong cash flow from operations, continued growth in investment income, and a portion of the proceeds received from the Company's March 2007 junior subordinated notes offering.

Fixed maturities as of March 31, 2007 were $42.361 billion, an increase of $1.259 billion or 3.1% over December 31, 2006. The increase reflects the aforementioned change in the amount of cash available to invest.

Equity securities, available for sale, as of March 31, 2007 were $2.837 billion, an increase of $218 million or 8.3% over December 31, 2006. The increase reflects $180 million of new investments in common and preferred stock, the reinvestment of gains, and changes in market value.

Limited partnerships and limited liability companies as of March 31, 2007 were $1.531 billion, an increase of $96 million or 6.7% over December 31, 2006. These investments consist of traditional private equity partnerships of $1.064 billion, real estate partnerships of $210 million, and $257 million in other partnerships (primarily energy). The increase over December 31, 2006 was driven primarily by investments in real estate limited partnerships as the Company continues to diversify its private equity strategy. 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 March 31, 2007 were $382 million, an increase of $60 million or 18.6% over December 31, 2006. The Company began investing in commercial mortgage loans as part of its diversification strategy in 2005.

As of March 31, 2007, the Company had unfunded commitments in traditional private equity partnerships, real estate partnerships, energy, and commercial mortgage loans of $777 million, $300 million, $301 million, and $272 million, respectively. As of March 31, 2007, the Company had commitments to purchase various residential mortgage-backed securities at a cost of $155 million (fair market value of $156 million) and various corporate and municipal securities at a cost of $235 million (fair market value of $234 million).

As of March 31, 2007, no single issuer, excluding U.S. Treasuries, agency securities and mortgage-backed securities, accounted for more than 1.0% of invested assets.

The following tables summarize the Company's fixed maturity portfolio by security type, credit quality and maturity as of March 31, 2007 and December 31, 2006:

| **$ in Millions** | **As of March 31, 2007** | | **As of December 31, 2006** | |
|---|---|---|---|---|
| **Fixed Maturities by Security Type** | **Market Value** | **% of Total** | **Market Value** | **% of Total** |
| U.S. Government and agency securities | $4,544 | 10.7% | $4,658 | 11.3% |
| Mortgage and asset-backed securities | 12,419 | 29.3 | 12,267 | 29.8 |
| U.S. state and municipal | 7,510 | 17.7 | 6,612 | 16.1 |
| Corporate and other | 15,653 | 37.0 | 15,354 | 37.4 |
| Foreign government securities | 2,235 | 5.3 | 2,211 | 5.4 |
| Total fixed maturities | $42,361 | 100.0% | $41,102 | 100.0% |

During the first quarter of 2007, the Company, after consideration of investment opportunities, its tax status, and the current and prospective business environment, continued to increase its tactical allocation to U.S. state and municipal securities. As of March 31, 2007, U.S. state and municipal securities were $7.510 billion, an increase of $898 million or 13.6% over December 31, 2006. This was partially offset by U.S. Government and agency securities, which totaled $4.544 billion as of March 31, 2007, a decrease of $114 million or 2.4% from December 31, 2006.

| $ in Millions | As of March 31, 2007 | | As of December 31, 2006 | |
|---|---|---|---|---|
| **Fixed Maturities by Credit Quality*** | **Market Value** | **% of Total** | **Market Value** | **% of Total** |
| AAA | $22,584 | 53.3% | $21,954 | 53.4% |
| AA+, AA, AA- | 6,605 | 15.6 | 5,706 | 13.9 |
| A+, A, A- | 6,233 | 14.7 | 6,631 | 16.1 |
| BBB+, BBB, BBB- | 4,031 | 9.5 | 3,995 | 9.7 |
| BB+, BB, BB- | 1,721 | 4.1 | 1,699 | 4.1 |
| B+, B, B- | 1,113 | 2.6 | 1,047 | 2.6 |
| CCC or lower | 74 | 0.2 | 70 | 0.2 |
| Total fixed maturities | $42,361 | 100.0% | $41,102 | 100.0% |

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

The Company's allocation in investment grade securities remained constant from December 31, 2006.

The Company had 6.9% of its fixed maturity securities invested in non-investment grade securities at March 31, 2007. The Company's holdings of below investment grade securities primarily consist of: (1) an actively managed diversified portfolio of high yield securities 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 March 31, 2007 | | As of December 31, 2006 | |
|---|---|---|---|---|
| **Fixed Maturities by Maturity Date** | **Market Value** | **% of Total** | **Market Value** | **% of Total** |
| 1 yr or less | $1,995 | 4.7% | $1,946 | 4.7% |
| Over 1 yr through 5 yrs | 7,750 | 18.3 | 7,679 | 18.7 |
| Over 5 yrs through 10 yrs | 8,070 | 19.1 | 7,937 | 19.3 |
| Over 10 years | 12,127 | 28.6 | 11,273 | 27.5 |
| Mortgage and asset-backed securities | 12,419 | 29.3 | 12,267 | 29.8 |
| Total fixed maturities | $42,361 | 100.0% | $41,102 | 100.0% |

During the first quarter of 2007, 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 investment portfolio.

**Net Investment Income**

The following table summarizes the Company's net investment income for the three months ended March 31, 2007 and 2006:

| $ in Millions | Three Months Ended March 31, | |
|---|---|---|
| **Net Investment Income** | **2007** | **2006** |
| Taxable interest income | $546 | $498 |
| Tax-exempt interest income | 72 | 41 |
| Dividends | 17 | 7 |
| Limited partnerships and limited liability companies[1] | 65 | 42 |
| Commercial mortgage loans[1] | 5 | - |
| Other investment income | 1 | 3 |
| Gross investment income | 706 | 591 |
| Investment expenses | (33) | (31) |
| Net investment income | $673 | $560 |

1. *Commercial loan income previously reported as limited liability income in 2006.*

Net investment income for the three months ended March 31, 2007 was $673 million, an increase of $113 million over the same period in 2006. The increase in net investment income reflects an increase in interest income of $79 million due primarily to a larger invested asset base driven by strong cash flow from operations and the proceeds received from the Company's August 2006 debt offering. In addition, limited partnership and limited liability company income increased $23 million over the same period in 2006. Growth in net investment income was constrained by 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 months ended March 31, 2007 and 2006:

| $ in Millions<br>**Net Realized Investment Gains (Losses)** | **Sales & Dispositions** | **Impairments** | **Change in Trading Security Unrealized** | **Total** |
|---|---|---|---|---|
| Three Months Ended March 31, 2007: | | | | |
| Fixed maturities | $15 | $- | $- | $15 |
| Common and preferred stock | 59 | (2) | - | 57 |
| Other | 13 | (5) | - | 8 |
| Total | $87 | ($7) | $- | $80 |
| | | | | |
| Three Months Ended March 31, 2006: | | | | |
| Fixed maturities | $10 | ($13) | $- | ($3) |
| Common and preferred stock | 22 | (2) | - | 20 |
| Other | 8 | - | - | 8 |
| Total | $40 | ($15) | $- | $25 |

| $ in Millions | Three Months Ended March 31, | |
|---|---|---|
| **Components of Net Realized Investment Gains (Losses)** | **2007** | **2006** |
| Fixed maturities: | | |
| Gross realized gains | $32 | $28 |
| Gross realized losses | (17) | (31) |
| Equities: | | |
| Gross realized gains | 61 | 26 |
| Gross realized losses | (4) | (6) |
| Other: | | |
| Gross realized gains | 14 | 9 |
| Gross realized losses | (6) | (1) |
| Total net realized investment gains (losses) | $80 | $25 |

Net realized investment gains for the three months ended March 31, 2007 were $80 million, an increase of $55 million from the same period in 2006. The increase in net realized investment gains for the quarter was primarily driven by a $37 million increase in net gains on equities primarily from the sales of foreign equities and lower impairment losses.

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 March 31, 2007:

| $ 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 | ($4) | $1,020 | ($59) | $2,277 |
| Mortgage and asset-backed securities | (9) | 1,919 | (176) | 6,060 |
| U.S. state and municipal | (21) | 2,236 | (15) | 193 |
| Corporate and other | (46) | 3,247 | (218) | 5,329 |
| Foreign government securities | (9) | 636 | (11) | 495 |
| Equities | (15) | 302 | (6) | 44 |
| Total | ($104) | $9,360 | ($485) | $14,398 |

Unrealized losses decreased from $636 million as of December 31, 2006 to $589 million as of March 31, 2007 primarily due to a decrease in interest rates. Approximately 93.5% of the unrealized losses ($551 million) exist on holdings where the fair value as of March 31, 2007 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 March 31, 2007 are temporary.

The gross unrealized losses recorded on common equity securities and other investments at March 31, 2007 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 March 31, 2007 totaled $48.547 billion.

Short-term debt outstanding at March 31, 2007 and December 31, 2006 was as follows:

| $ in Millions | As of March 31, 2007 | As of December 31, 2006 |
|---|---|---|
| Commercial paper | $ - | $ - |
| Revolving credit facilities | 72 | 50 |
| Current maturities of long-term debt | 121 | 121 |
| Total short-term debt | $193 | $171 |

Long-term debt outstanding at March 31, 2007 and December 31, 2006 was as follows:

| $ in Millions | As of March 31, 2007 | As of December 31, 2006 |
|---|---|---|
| 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 | 250 |
| 7.00% Junior subordinated notes, due 2017 | 300 | - |
| 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 | 500 |
| 7.80% Junior subordinated notes, due 2037 | 700 | - |
| 7.697% Surplus notes, due 2097 | 500 | 500 |
| 7.10% – 7.86% Medium term notes, with various maturities | 27 | 27 |
| Subtotal | 4,209 | 3,209 |
| Unamortized discount | (36) | (34) |
| Total long-term debt excluding current maturities | $4,173 | $3,175 |

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

Liberty Mutual Insurance Europe Limited entered into a $20 million revolving loan facility, which became effective June 9, 2006. The facility is available to provide working capital to the Company's international operations. The revolving loan facility is guaranteed by LMIC. As of March 31, 2007, no borrowings were outstanding under the facility.

The Company also has a Venezuelan subsidiary, Inversora Segucar, C.A., which has entered into a $90 million revolving credit facility to provide liquidity for working capital purposes. Inversora Segucar also has short-term loans outstanding. As of March 31, 2007, total short-term loans and borrowings under the Venezuelan credit facility were approximately $72 million.

The $22 million increase in short-term debt outstanding is due to an increase of $22 million in outstanding borrowings under the Venezuelan credit facility.

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1 billion, consisting of $700 million Series A junior subordinated notes (the "Series A Notes") and $300 million Series B junior subordinated notes (the "Series B Notes"). The Notes are scheduled for redemption on March 15, 2037; the final maturity of the Series A Notes is March 7, 2087; and the final maturity of the Series B Notes is March 7, 2067. LMGI may redeem (a) the Series B Notes in whole or in part, on March 15, 2017 and on each interest payment date thereafter at their principal amount plus accrued and unpaid interest to the date of redemption, or (b) prior to March 15, 2037 for the Series A Notes or March 15, 2017 for the Series B Notes, (i) in whole or in part at any time at their principal amount or, if greater, a make-whole price, or (ii) in certain circumstances, in whole at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, a special event make-whole price. Interest is payable semi-annually at a fixed rate of 7.800% for the Series A Notes and 7.000% for the Series B Notes up to, but excluding, the final fixed rate interest payment date. In the event the Notes are not redeemed on or before the final fixed rate interest payment date, interest will accrue at an annual rate of three-month LIBOR plus 3.576% for the Series A Notes and three-month LIBOR plus 2.905% for the Series B Notes, payable quarterly in arrears. LMGI has the right to defer interest payments on the Notes for a period up to ten years. Interest compounds during periods of deferral. In connection with the issuance of the Notes, LMGI entered into a replacement capital covenant ("RCC"). As part of the RCC, LMGI agreed that it will not repay, redeem, defease or purchase the Notes on or before the relevant RCC termination date unless, subject to certain limitations, it has received proceeds from the sale of specified capital securities. The RCC will terminate upon the occurrence of certain events, including an acceleration of the Notes, and may not be enforced by the holders of the Series A Notes or the Series B Notes. The RCC is for the benefit of holders of the specified series of LMGI's indebtedness (initially LMGI's 7.50% senior notes due 2036). The $998 million increase in long-term debt outstanding is primarily the result of this offering.

Consolidated interest expense for the three months ended March 31, 2007 was $66 million, representing an increase of $18 million over the same period in 2006.

***Holding Company Liquidity and Capital Resources***

The Company conducts substantially all of its operations through its wholly owned insurance and service company subsidiaries, and therefore is primarily dependent on dividends, distributions, loans or other payments of funds from these entities to meet its current and future obligations. However, the subsidiaries are separate and distinct legal entities and have no obligation to make funds available to the Company, whether in the form of loans, dividends or other distributions. As of March 31, 2007, the Company, through its downstream subsidiary LMGI, had $3.291 billion of debt outstanding.

The insurance subsidiaries' ability to pay dividends is restricted under applicable insurance laws 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.

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 months ended March 31, 2007, Corporate Services recorded $70 million in pre-tax income.

***Statutory Surplus***

Statutory surplus as regards policyholders for the combined operations of LMIC and its U.S. affiliates including international branches was $13.284 billion and $12.131 billion at March 31, 2007, and December 31, 2006, respectively. The increase in surplus reflects net income of $167 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 $836 million, affiliated unrealized gains of $138 million, and unaffiliated unrealized gains of $32 million. The balance of the change in statutory surplus primarily reflects changes in deferred taxes, foreign exchange, and non-admitted assets.

## CRITICAL ACCOUNTING POLICIES

**Critical Accounting Estimates**

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

- unpaid claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and 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 2006 tables to conform to the 2007 tables.

**Adoption of New Accounting Standards**

In June 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*" ("FIN 48"). FIN 48 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 is the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability is 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 requires 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 is also 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 adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption, the Company recognized a decrease of approximately $11 million in the liability for unrecognized tax benefits, which was accounted for as an increase to retained earnings.

As of the date of adoption of FIN 48, the total amount of unrecognized tax benefits was approximately $107 million, including approximately $85 million related to tax positions that would impact the annual effective rate. The Company recognizes interest and penalties related to unrecognized tax benefits in Federal and foreign income tax expense and had approximately $39 million accrued as of January 1, 2007. The Company does not expect any material changes to the unrecognized benefits within 12 months of the reporting date.

The IRS is currently reviewing the Company's federal tax returns for the 1999 through 2003 tax years. Any adjustments that may result from the IRS examination of these income tax returns are not expected to have a material impact on the financial position, liquidity or results of operations of the Company.

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AcSEC") issued Statement of Position No. 05-1, *"Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts"* ("SOP 05-1"). This SOP provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB Statement No. 97, *"Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments"* ("FAS 97"). As defined by the SOP, an internal replacement is a modification in product benefits, features, rights, or coverage that occurs by exchange of a contract for a new contract, or by amendment, endorsement, rider, or by election of a feature or coverage within an existing contract. The Company adopted SOP 05-1 on January 1, 2007. The adoption of SOP 05-1 did not have a material impact the Company's consolidated financial statements.

In February 2006, the FASB released Statement of Financial Accounting Standards No. 155, "*Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140*" ("SFAS 155"). SFAS 155 nullifies the guidance in the FASB's Derivatives Implementation Group Issue D1 "*Application of Statement 133 to Beneficial Interests in Securitized Assets*," which had deferred the bifurcation requirements of Statement of Financial Accounting Standards No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" ("SFAS 133"), for certain beneficial interests in securitized financial assets. SFAS 155 requires beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or hybrid instruments that contain an embedded derivative requiring bifurcation. SFAS 155 is effective for all financial instruments acquired, issued or subject to a re-measurement (new basis) event occurring after the beginning of an entity's fiscal year that begins after September 15, 2006. The Company is required to adopt SFAS 155 effective January 1, 2007. In January 2007, the FASB issued Derivative Implementation Group Issue No. B40, *"Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets"* ("DIG B40"). DIG B40 provided limited exemption from bifurcation of embedded derivatives as required by paragraph 13(b) of SFAS 133. The Company adopted SFAS 155 on January 1, 2007. Management has concluded the exemption applies for the Company's investment in its mortgage backed securities and as a result, adoption of SFAS 155 did not have a material impact to the Company's consolidated financial statements.

**Future Adoption of New Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"). This statement defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 provides guidance on how to measure fair value when required under existing accounting standards. The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels ("Level 1, 2 and 3"). Level 1 inputs are observable inputs that reflect quoted prices for identical assets or liabilities in active markets the Company has the ability to access at the measurement date. Level 2 inputs are observable inputs, other than quoted prices included in Level 1, for the asset or liability. Level 3 inputs are unobservable inputs reflecting the reporting entity's estimates of the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Quantitative and qualitative disclosures will focus on the inputs used to measure fair value for both recurring and non-recurring fair value measurements and the effects of the measurements in the financial statements. The Company is required to adopt SFAS 157 effective January 1, 2008. The Company is in the process of evaluating the impact of adoption.

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 impact to the Company will depend on the discount rate, other valuation assumptions, and the actual value of plan assets as of December 31, 2007. The impact is expected to be less than 5% of equity.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS 115*" ("SFAS 159"). SFAS 159 permits all entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option"). An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date eliminating complex hedge accounting provisions. The decision about whether to elect the fair value option is applied on an instrument by instrument basis and is irrevocable unless a new election date occurs and is applied only to an entire instrument. SFAS 159 also provides guidance on disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company January 1, 2008. The Company is in the process of evaluating the impact of adoption.

In September 2006, the Emerging Issues Task Force (EITF) released, issue No. 06-4, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"* ("EITF 06-4"). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Opinion 12. EITF 06-4 is effective for the Company for fiscal years beginning after December 15, 2007. The Company is in the process of evaluating the impact of adoption but it is not expected to be material.

**Unpaid Claims and Claim Adjustment Expenses**

Reserves for property-casualty unpaid claims and claim adjustment expenses were $39.045 billion and $38.606 billion at March 31, 2007 and December 31, 2006, 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 $1.333 billion and $1.386 billion at March 31, 2007 and December 31, 2006, respectively. The decline in reserves is primarily due to the ongoing settlement of asbestos and environmental claims.

The Company's asbestos reserves as of March 31, 2007 and December 31, 2006 were as follows:

| **$ in Millions** | **As of March 31, 2007** | **As of December 31, 2006** |
|---|---:|---:|
| Gross reserves[1] | $1,151 | $1,203 |
| Ceded reserves[1] | 320 | 331 |
| Net reserves | $831 | $872 |
| Allowance for reinsurance on unpaid losses | 99 | 100 |
| **Total asbestos reserves** | **$930** | **$972** |

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

The Company's environmental reserves as of March 31, 2007 and December 31, 2006 were as follows:

| **$ in Millions** | **As of March 31, 2007** | **As of December 31, 2006** |
|---|---:|---:|
| Gross reserves[1] | $430 | $441 |
| Ceded reserves[1] | 27 | 27 |
| **Total environmental reserves** | **$403** | **$414** |

[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 $24 million for the three months ended March 31, 2007 and $61 million for the year ended December 31, 2006.

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 $15.308 billion and $15.564 billion at March 31, 2007 and December 31, 2006, respectively, net of allowance for doubtful accounts of $309 million and $315 million, respectively**.** The decrease is primarily due to the ongoing settlement of 2005 hurricane claims.

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 (RCC) 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 RCC 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 March 31, 2007. Collateral held against outstanding gross reinsurance recoverable balances was $4.787 billion and $4.802 billion at March 31, 2007 and December 31, 2006, 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.

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

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million as of March 31, 2007 and December 31, 2006) that are amortized into income using the effective interest method over the estimated settlement periods. At March 31, 2007 and December 31, 2006, deferred gains related to these reinsurance arrangements were $829 million and $839 million, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the three months ended March 31, 2007 and 2006 was $28 million and $26 million, respectively. Deferred gain amortization was $16 million for the three months ended March 31, 2007 and 2006, respectively. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $2,257 million and $2,258 million as of March 31, 2007 and December 31, 2006, 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.

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 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 months ended March 31, 2007 were $7 million, a decrease of $8 million from the same period in 2006. 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.

**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"). The Company's exposure to investment structures subject to analysis under FIN 46(R), relate primarily to investments in energy, private equity, and real estate limited partnerships that are accounted for under the equity method. The Company consolidates 2 VIEs in the energy investment sector in its 2007 and 2006 financial statements; the Company has been deemed to be the primary beneficiary. In addition, the Company has investments in 32 VIEs for which it is not the primary beneficiary at March 31, 2007. The Company's investments in VIEs were $243 million and $208 million at March 31, 2007 and December 31, 2006, respectively. The Company's maximum exposure to losses from VIEs is $485 million and $481 million as of March 31, 2007 and December 31, 2006, 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. Pursuant to the policy, the Company may enter into derivative transactions. As of March 31, 2007, the Company had several embedded derivative instruments in its portfolio, warrants and two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of March 31, 2007, the value of these instruments was $10 million.

**Deferred Policy Acquisition Costs**

Total deferred policy acquisition costs were $1.743 billion and $1.662 billion as of March 31, 2007 and December 31, 2006, 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 $924 million and $907 million at March 31, 2007 and December 31, 2006, respectively.

**Deferred Income Taxes**

The net deferred income tax asset was $1.471 billion and $1.490 billion as of March 31, 2007 and December 31, 2006, respectively, net of a valuation allowance of $104 million and $101 million, respectively. Management believes it is more likely than not that the Company’s net deferred income tax asset will be realized based on the Company’s ability and likelihood of generating future taxable income.

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

The IRS is currently reviewing the Company’s federal tax returns for the 1999 through 2003 tax years. Any adjustments that may result from the IRS examination of these income tax returns are not expected to have a material impact on the financial position, liquidity or results of operations of the Company.

**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 95$^{th}$ on the Fortune 500 list of largest corporations in the United States based on 2006 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.