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

Year Ended December 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 and twelve months ended December 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 Annual Report, 2007 Unaudited Consolidated Financial Statements, Fourth Quarter 2007 Financial Supplement and First, Second, and Third Quarter MD&A, 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 automobile 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 Company's ability to successfully integrate operations, personnel and technology from its acquisitions, including the recent acquisition of Ohio Casualty Corporation and its subsidiaries, in accordance with its business strategy; 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 December 31, 2007 - Consolidated Results of Operations

- Revenues for the three months ended December 31, 2007 were $6.934 billion, an increase of $926 million over the same period in 2006.
- Net written premium for the three months ended December 31, 2007 was $5.579 billion, an increase of $764 million over the same period in 2006.
- Pre-tax income for the three months ended December 31, 2007 was $659 million, an increase of $82 million over the same period in 2006.
- Net income for the three months ended December 31, 2007 was $425 million, a decrease of $30 million from the same period in 2006.
- Cash flow from operations for the three months ended December 31, 2007 was $1.115 billion, an increase of $78 million over the same period in 2006.
- The combined ratio before catastrophes[1] and net incurred losses attributable to prior years[2] for the three months ended December 31, 2007 was 99.6%, an increase of 4.2 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 December 31, 2007 increased 2.9 points to 101.0%.

Twelve Months Ended December 31, 2007 - Consolidated Results of Operations

- Revenues for the twelve months ended December 31, 2007 were $25.961 billion, an increase of $2.441 billion over the same period in 2006.
- Net written premium for the twelve months ended December 31, 2007 was $22.538 billion, an increase of $1.910 billion over the same period in 2006.
- Pre-tax income for the twelve months ended December 31, 2007 was $2.198 billion, a decrease of $60 million from the same period in 2006.
- Net income for the twelve months ended December 31, 2007 was $1.518 billion, a decrease of $108 million from the same period in 2006.
- Cash flow from operations for the twelve months ended December 31, 2007 was $4.042 billion, an increase of $147 million over the same period in 2006.
- The combined ratio before catastrophes and net incurred losses attributable to prior years for the twelve months ended December 31, 2007 was 98.4%, an increase of 3.5 points over the same period in 2006.

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[1] Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

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

Including the impact of catastrophes and net incurred losses attributable to prior years, the Company's combined ratio for the twelve months ended December 31, 2007 increased 1.0 point to 100.3%.

Financial Condition as of December 31, 2007

- Total assets were $94.679 billion as of December 31, 2007, an increase of $9.181 billion over December 31, 2006.

- Policyholders' equity was $12.366 billion as of December 31, 2007, an increase of $1.471 billion 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 $14.155 billion as of December 31, 2007, an increase of $2.024 billion over December 31, 2006.

Other 2007 4th Quarter Highlights

Acquisitions

- On October 4, 2007, the Company through its Brazilian subsidiary, Liberty International Brasil Ltda., signed an agreement to purchase 100% of Indiana Seguros, S.A. Regulatory approval was granted on December 12, 2007 and the transaction was completed on January 9, 2008.

Changes in Debt / Credit Facilities

- In the third quarter of 2007, the Company borrowed $1 billion of funds under the $1.25 billion short-term revolving credit facility established on June 15, 2007 to facilitate the acquisition of Ohio Casualty. As of December 31, 2007, no borrowings were outstanding under this facility.

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 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 its 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 (NWP) by significant line of business was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Private passenger automobile[1]	$1,592	$1,361	17.0%	$6,293	$5,630	11.8%
Workers compensation	1,074	976	10.0	4,817	4,585	5.1
Homeowners	527	460	14.6	1,996	1,784	11.9
Commercial multiple peril / Fire	450	410	9.8	1,703	1,594	6.8
International local businesses	369	337	9.5	1,332	1,164	14.4
Commercial automobile	344	301	14.3	1,228	1,154	6.4
LIU[2] reinsurance	184	175	5.1	1,061	1,021	3.9
General liability	231	196	17.9	936	838	11.7
LIU inland marine program	137	75	82.7	561	274	104.7
LIU third party	145	94	54.3	557	432	28.9
Group disability and life	115	103	11.7	464	400	16.0
Surety	82	62	32.3	310	250	24.0
LIU first party	75	27	177.8	301	236	27.5
Individual life	75	82	(8.5)	280	662	(57.7)
Assumed voluntary reinsurance	30	27	11.1	113	115	(1.7)
Other	149	129	15.5	586	489	19.8
Total net written premium[3]	$5,579	$4,815	15.9%	$22,538	$20,628	9.3%

1 Includes business written through International's local businesses operations.
2 Liberty International Underwriters (LIU).
3 Net written premium associated with internal reinsurance has been re-allocated to the appropriate lines of business in the above table.

Consolidated net written premium by SBU was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Personal Markets	$1,304	$1,279	2.0%	$5,532	$5,365	3.1%
Commercial Markets[1]	1,274	1,339	(4.9)	5,616	5,429	3.4
Agency Markets[1]	1,317	1,022	28.9	5,112	4,573	11.8
International	1,465	1,125	30.2	5,714	4,652	22.8
Corporate and Other[2]	219	50	NM	564	609	(7.4)
Total net written premium (NWP)	$5,579	$4,815	15.9%	$22,538	$20,628	9.3%
Foreign exchange effect on growth			2.0			1.3
NWP growth excluding foreign exchange			13.9%			8.0%

1 Effective in the fourth quarter 2007, net written premium associated with Wausau, previously included in Agency Markets, is included in Commercial Markets. The prior periods have been restated to reflect this change.
2 Includes Individual life operations and internal reinsurance.
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2007 was $5.579 billion and $22.538 billion, respectively, increases of $764 million and $1.910 billion over the same periods in 2006. Significant changes by major line of business include:

- Private passenger automobile net written premium increased $231 million and $663 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect organic growth in all of International's local businesses, primarily in Latin America and Europe, the September 2006 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. The increases in both periods also reflect strong customer retention and new business growth in both Personal Markets and Agency Markets, including premium related to the acquisition of Ohio Casualty Corporation ("Ohio Casualty"). These increases were partially offset by lower average premium per policy in Personal Markets due primarily to mandatory rate decreases in Massachusetts, which became effective in April of 2007.
- Workers compensation net written premium increased $98 million and $232 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect strong Agency Markets retention, premium related to the Ohio Casualty acquisition and new business writings and strong retention at Wausau. The increases in both periods were partially offset by a decrease in Summit's premium due to mandated rate decreases in Florida, lower audit and retrospectively rated premium and rate decreases due to a more competitive rate environment. Both periods also include an adjustment to the Corporate and Other segment for the "booked as billed" method of accounting for net written premium.
- Homeowners net written premium, including internal reinsurance premium, increased $67 million and $212 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect strong customer retention and new business growth, primarily in non-coastal areas, in both Personal Markets and Agency Markets and includes premium related to the Ohio Casualty acquisition. The year-to-date increase also reflects the impact of rate increases from Personal Markets policies issued.
- Commercial multiple peril / fire, including internal reinsurance premium, increased $40 million and $109 million in the quarter and year-to-date, respectively. The increases in both periods reflect premium related to the Ohio Casualty acquisition, strong retention and new business writings in Agency Markets, partially offset by Commercial Markets lower customer retention rates, a more competitive rate environment and lower premium due to a large multi-year policy written in 2006, which did not recur in 2007.

- International local businesses' net written premium (excluding private passenger automobile), including internal reinsurance premium, increased $32 million and $168 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect organic growth within International's local businesses in Latin America and the strengthening of foreign currencies versus the U.S. dollar.
- Commercial automobile net written premium increased $43 million and $74 million in the quarter and year-to-date, respectively. The increases in both periods primarily reflect premium related to the Ohio Casualty acquisition, strong retention and strong new business writings in Agency Markets, partially offset by modest rate decreases in both Commercial Markets and Agency Markets and lower retention in Commercial Markets.
- LIU reinsurance net written premium, including internal reinsurance premium, increased $9 million and $40 million in the quarter and year-to-date, respectively. The increase in the quarter primarily reflects the timing of new business written as compared to the prior period. The year-to-date increase primarily reflects an increase in internal reinsurance premium and growth in non-catastrophe related exposures, partially offset by management's decision to reduce its catastrophe exposure in the U.S. and to a lesser extent Europe.
- General liability net written premium, including internal reinsurance premium, increased $35 million and $98 million in the quarter and year-to-date, respectively. The increase in both periods reflects premium related to the Ohio Casualty acquisition, strong retention and new business writings, partially offset by modest rate decreases and the non-renewal of a 2006 large multi-year policy.
- LIU inland marine program net written premium increased $62 million and $287 million in the quarter and year-to-date, respectively. The increases in both periods are primarily due to International's continued expansion in this line and a change in the terms of the program.
- LIU third party net written premium, including internal reinsurance premium, increased $51 million and $125 million in the quarter and year-to-date, respectively. The increases in both periods are primarily due to a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by a decline in rates as a result of a more competitive market.
- Group disability and life net written premium increased $12 million and $64 million in the quarter and year-to-date, respectively, due primarily to the impact of an expanded sales force and broader market penetration.
- Surety net written premium increased $20 million and $60 million in the quarter and year-to-date, respectively, reflecting premium related to the Ohio Casualty acquisition, an increase in the average size of contract bonds and the non-renewal of a 2006 reinsurance program.
- LIU first party net written premium, including internal reinsurance premium, increased $48 million and $65 million in the quarter and year-to-date, respectively. The changes reflect a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by a decline in rates as a result of more a competitive market.
- Individual life net written premium decreased $7 million and $382 million in the quarter and year-to-date, respectively, primarily due to the decline in immediate annuity sales.

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

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

Results of Operations – Consolidated

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$6,934	$6,008	15.4%	$25,961	$23,520	10.4%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$453	$667	(32.1%)	$2,171	$2,714	(20.0%)
Catastrophes[1]	(139)	(124)	12.1	(378)	(541)	(30.1)
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(62)	(19)	NM	(158)	(22)	NM
- All other[3]	92	(101)	NM	127	(236)	NM
Current accident year re-estimation[4]	23	122	(81.1)	-	-	-
Pre-tax operating income	367	545	(32.7)	1,762	1,915	(8.0)
Realized investment gains, net	292	32	NM	436	343	27.1
Federal and foreign income tax expense	(234)	(122)	91.8	(680)	(632)	7.6
Net income	$425	$455	(6.6%)	$1,518	$1,626	(6.6%)
Cash flow from operations	$1,115	$1,037	7.5%	$4,042	$3,895	3.8%

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 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance of ($14) million and ($11) million for the three and twelve months ended December 31, 2007, respectively, and $11 million and $12 million for the comparable periods of 2006.

3 Net of earned premium attributable to prior years of ($144) million and ($105) million for the three and twelve months ended December 31, 2007, respectively, and ($44) million and ($28) million for the comparable periods of 2006. Net of amortization of deferred gains on retroactive reinsurance of $15 million and $84 million for the three and twelve months ended December 31, 2007, respectively, and $51 million and $97 million for the comparable periods of 2006.

4 Re-estimation of the current accident year loss reserves as of September 30, 2006 and 2007.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2007 were $6.934 billion and $25.961 billion, respectively, increases of $926 million and $2.441 billion over the same periods in 2006. The major components of revenues are net premium earned, net investment income, net realized investment gains and losses, and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2007 was $5.724 billion and $21.887 billion, respectively, increases of $624 million and $2.020 billion over the same periods in 2006. The increases in both periods primarily reflect premium related to the Ohio Casualty acquisition and higher earned premium associated with the changes in net written premium in 2006 and 2007, partially offset by a decrease in the estimate of prior year earned premium recorded in the three months ended December 31, 2007.

Net investment income for the three and twelve months ended December 31, 2007 was $743 million and $2.885 billion, respectively, increases of $53 million and $337 million over the same periods in 2006. The increases in both periods primarily reflect higher interest income due to higher invested assets resulting from continued strong cash flows from operations and the proceeds received from the Company's August 2006 and March 2007 debt offerings. Both periods also reflect an increase in interest income related to fixed income assets from the Ohio Casualty acquisition, net of purchase price, and higher dividend income due to the Company's increased investment in equity securities. Year-to-date net investment income also increased as a result of the Company's increased investment in limited partnerships, limited liability companies and commercial mortgage loans consistent with its diversification strategy. These increases in gross investment income, however, were constrained by lower yields on the fixed maturity portfolio due primarily to the Company's increased investment in tax-exempt securities. The increase in investment expenses in both periods was primarily attributable to higher variable incentive compensation.

Net realized investment gains for the three and twelve months ended December 31, 2007 were $292 million and $436 million, respectively, increases of $260 million and $93 million from the same periods in 2006. The increase in the quarter was primarily driven by a $226 million gain on the sale of a restricted equity. A comparably sized gain was recognized in the third quarter of 2006. In addition, year-to-date gains included a $32 million gain from the sale of a company owned property.

Fee and other revenues for the three and twelve months ended December 31, 2007 were $175 million and $753 million, respectively, decreases of $11 million and $9 million from the same periods in 2006. The decreases in both periods primarily reflect lower revenues associated with the production of oil and gas from energy subsidiary operations, a decrease in Company owned property revenue due to the sale of a property 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. Partially offsetting these decreases were the reclassification of contractholder charges and assessments related to SFAS 97 business within Spain and Portugal from net written premium to fee and other revenue.

Claims, benefits and expenses for the three and twelve months ended December 31, 2007 were $6.275 billion and $23.763 billion, respectively, increases of $844 million and $2.501 billion over the same periods in 2006. The increases in both periods are primarily due to business growth including the acquisition of Ohio Casualty, general cost increases, an increase in variable annuity reserves, a higher incidence of large loss events within LIU's reinsurance business, and higher interest expense. In addition, International's net commission expense increased in both periods due to lower ceding commission recognized by LIU's third party business due to a reduction in reinsurance utilization and higher acquisition costs in the local businesses, primarily Latin America and Europe. Claims, benefits and expenses in both periods were further impacted by a decrease in policyholder benefits due to the decline in immediate annuity sales and a decrease in incurred losses attributable to prior years. The decreases in incurred losses attributable to prior years in both periods reflect favorable loss development in commercial multiple peril / fire, workers compensation, private passenger automobile and reinsurance lines, partially offset by unfavorable development in general liability lines which includes an increase in asbestos and environmental reserves related to the Company's biennial ground-up asbestos reserve study completed in the third quarter of 2007 and an increase in direct site pollution claims on new and existing accounts recorded in the fourth quarter of 2007 as a result of a comprehensive study of pollution exposure .

	Three Months Ended December 31,			Twelve Months Ended December 31,		
			Change			Change
CONSOLIDATED	**2007**	**2006**	**(Points)**	**2007**	**2006**	**(Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	69.6%	66.4%	3.2	69.7%	67.3%	2.4
Underwriting expense ratio	29.5	28.6	0.9	28.3	27.3	1.0
Dividend ratio	0.5	0.4	0.1	0.4	0.3	0.1
Subtotal	99.6	95.4	4.2	98.4	94.9	3.5
Catastrophes[1]	2.5	2.5	-	1.8	2.9	(1.1)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	0.9	0.7	0.2	0.7	0.2	0.5
- All other	(1.6)	2.0	(3.6)	(0.6)	1.3	(1.9)
Current accident year re-estimation[3]	(0.4)	(2.5)	2.1	-	-	-
Total combined ratio[2]	101.0%	98.1%	2.9	100.3%	99.3%	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 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, 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 and environmental commutation.

3 Re-estimation of the current accident year loss reserves as of September 30, 2006 and 2007.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2007 was 99.6% and 98.4%, respectively, increases of 4.2 points and 3.5 over the comparable periods in 2006. The increases in the claims and claim adjustment expense ratio in both periods reflect a higher incidence of large loss events from LIU's reinsurance business as compared to 2006, increased loss activity within certain classes of LIU's first party business, higher loss trends on European automobile business (primarily Spain, as well as new operations in Poland and Turkey), an increase in non-catastrophe property related losses, higher claims frequency trends in Personal Markets' automobile physical damage line of business and the impact of a more competitive rate environment. The increase in the underwriting expense ratio in both periods primarily reflects higher acquisition costs in International's European local businesses, lower ceding commissions in LIU's third party business, and higher general expenses in LIU's first and third party businesses related to growth initiatives. Other factors impacting the expense ratio were the one-time recognition of integration costs associated with the Ohio Casualty acquisition, higher commission expenses due to a business mix shift resulting from the Ohio Casualty acquisition and a decrease in the amount of expense reimbursement received from the Company's servicing carrier operations due to the depopulation of the pools. The year-to-date increase in the underwriting expense ratio also reflects the change in the terms of LIU's inland marine program. The increases in the claims and claim adjustment expense ratio in both periods were partially offset by higher internal property catastrophe reinsurance earned premium which had no corresponding losses.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2007 was 101.0% and 100.3%, respectively, increases of 2.9 points and 1.0 point over the comparable periods in 2006. These increases reflect the change in the combined ratio components discussed previously and a decrease in the impact of favorable loss development related to the re-estimation of current accident year losses as of the nine months ended September 30, 2007. Partially offsetting these increases were lower year-to-date catastrophe losses and an increase in the impact of favorable net incurred loss development attributable to prior years.

PTOI for the three and twelve months ended December 31, 2007 was $367 million and $1.762 billion, respectively, decreases of $178 million and $153 million from the same periods in 2006.

Federal and foreign income tax expense for the three and twelve months ended December 31, 2007 was $234 million and $680 million, respectively, increases of $112 million and $48 million over the same periods in 2006. The Company's effective tax rates for the three and twelve months ended December 31, 2007 were 36% and 31%, respectively, compared to 21% and 28% for the same periods in 2006. The current quarter reflects a cumulative adjustment to arrive at the final annual rate of 31% as compared to 29% recorded through the first nine months of 2007, primarily as a result of a higher than expected tax rate associated with international operations, higher realized investment gains taxed at the marginal rate and revisions to tax estimates made in prior years. The Company's full year effective rate differs from the Federal statutory rate of 35% principally due to tax-preferenced investment income.

Net income for the three and twelve months ended December 31, 2007 was $425 million and $1.518 billion, respectively, decreases of $30 million and $108 million from the same periods in 2006.

PERSONAL MARKETS

Overview – Personal Markets

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Private passenger automobile	$844	$846	(0.2%)	$3,749	$3,699	1.4%
Homeowners and other	460	433	6.2	1,783	1,666	7.0
Total net written premium	$1,304	$1,279	2.0%	$5,532	$5,365	3.1%

Net written premium for the three and twelve months ended December 31, 2007 was $1.304 billion and $5.532 billion, respectively, increases of $25 million and $167 million over the same periods in 2006. The increases in both periods reflect new business growth, strong customer retention in both automobile and homeowners, and rate increases on homeowners policies.

Private passenger automobile net written premium for the three and twelve months ended December 31, 2007 was $844 million and $3.749 billion, respectively, a decrease of $2 million and an increase of $50 million over the same periods in 2006. Both periods reflect a 2.9% increase in voluntary policies in force as compared to December 31, 2006 due to strong customer retention and new business growth, partially offset by lower average premium per policy. The lower average premium per policy was primarily driven by the mandatory rate decrease in Massachusetts, which became effective in April of 2007.

Homeowners and other net written premium for the three and twelve months ended December 31, 2007 was $460 million and $1.783 billion, respectively, increases of $27 million and $117 million over the same periods in 2006. The increases in both periods reflect rate increases and a 3.4% increase in policies in force as compared to December 31, 2006 due to strong customer retention and new business growth, primarily in non-coastal areas.

Results of Operations – Personal Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$1,495	$1,442	3.7%	$5,829	$5,602	4.1%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$215	$208	3.4	$867	$844	2.7
Catastrophes[1]	(125)	(41)	NM	(295)	(218)	35.3
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	54	50	8.0	172	70	145.7
Current accident year re-estimation[2]	58	-	NM	-	-	-
Pre-tax operating income	$202	$217	(6.9%)	$744	$696	6.9%

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 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured cat losses are not reported net of net catastrophe reinsurance premium earned.

2 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2007 were $1.495 billion and $5.829 billion, respectively, increases of $53 million and $227 million over the same periods in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2007 was $1.393 billion and $5.433 billion, respectively, increases of $43 million and $185 million over the same periods in 2006. The increases in both periods reflect the earned premium associated with the changes in net written premium for both the voluntary automobile and homeowners lines of business in 2006 and 2007.

Net investment income for the three and twelve months ended December 31, 2007 was $86 million and $337 million, respectively, increases of $8 million and $39 million over the same periods in 2006. The increases in both periods primarily reflect a higher invested asset base due to strong cash flow from operations.

Claims, benefits and expenses for the three and twelve months ended December 31, 2007 were $1.293 billion and $5.085 billion, respectively, increases of $68 million and $179 million over the same periods in 2006. The increases in both periods reflect business growth, higher claims frequency trends in the automobile physical damage line of business, an increase in advertising costs, and higher catastrophe losses largely driven by California wildfire losses. The quarter also included favorable development from the re-estimation of current accident year automobile liability losses for the nine months ended September 30, 2007. Additional items affecting both periods were a decrease in expenses related to the reduction of non-sales personnel staffing, lower premium taxes, a decrease in claim costs related to improved claim handling initiatives and favorable incurred loss development attributable to prior years, primarily in the automobile liability line.

PERSONAL MARKETS	Three Months Ended December 31, 2007	2006	Change (Points)	Twelve Months Ended December 31, 2007	2006	Change (Points)
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	64.8%	63.6%	1.2	64.7%	64.0%	0.7
Underwriting expense ratio	25.3	26.4	(1.1)	25.0	25.2	(0.2)
Dividend ratio	-	-	-	-	-	-
Subtotal	90.1	90.0	0.1	89.7	89.2	0.5
Catastrophes[1]	9.0	3.1	5.9	5.4	4.2	1.2
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(3.8)	(3.7)	(0.1)	(3.1)	(1.3)	(1.8)
Current accident year re-estimation[2]	(4.2)	-	(4.2)	-	-	-
Total combined ratio	91.1%	89.4%	1.7	92.0%	92.1%	(0.1)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured cat losses are not reported net of net catastrophe reinsurance premium earned.

2 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2007 was 91.1% and 92.0%, an increase of 1.7 points and a decrease of 0.1 points from the same periods in 2006. Both periods reflect higher claims frequency trends in the automobile physical damage line of business, higher catastrophe losses largely driven by California wildfire losses, favorable incurred loss development attributable to prior years related to the automobile liability line, and a decrease in claim costs related to improved claim handling initiatives. The quarter also included favorable development from the re-estimation of current accident year automobile liability losses as of the nine months ended September 30, 2007. The decreases in the underwriting expense ratio in both periods reflect the reduction in non-sales personnel staffing and lower premium taxes, partially offset by an increase in advertising costs.

PTOI for the three and twelve months ended December 31, 2007 was $202 million and $744 million, respectively, a decrease of $15 million and an increase of $48 million over the same periods in 2006.

COMMERCIAL MARKETS

Overview – Commercial Markets

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Business Market	$362	$396	(8.6%)	$1,656	$1,643	0.8%
Wausau Insurance[1]	343	325	5.5	1,402	1,322	6.1
National Market	313	340	(7.9)	1,362	1,365	(0.2)
Group Market	115	103	11.7	464	400	16.0
Liberty Mutual Property	71	84	(15.5)	342	319	7.2
Other Markets	70	91	(23.1)	390	380	2.6
Total net written premium	$1,274	$1,339	(4.9%)	$5,616	$5,429	3.4%

1 Effective in the fourth quarter 2007, net written premium associated with Wausau, previously included in Agency Markets, is included in Commercial Markets. The prior periods have been restated to reflect this change.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Workers compensation	$723	$747	(3.2%)	$3,305	$3,204	3.2%
General liability	123	129	(4.7)	594	567	4.8
Group disability and life	115	103	11.7	464	400	16.0
Commercial automobile	157	160	(1.9)	554	555	(0.2)
Commercial multiple peril / Fire	67	121	(44.6)	353	396	(10.9)
Assumed voluntary reinsurance	29	17	70.6	109	105	3.8
Other	60	62	(3.2)	237	202	17.3
Total net written premium	$1,274	$1,339	(4.9%)	$5,616	$5,429	3.4%

Net written premium for the three and twelve months ended December 31, 2007 was $1.274 billion and $5.616 billion, respectively, a decrease of $65 million and an increase of $187 million versus the same periods in 2006. The decrease in the quarter primarily reflects a decrease in workers compensation premium due to lower audit and retrospectively rated premiums recorded in the National Market segment, a decrease in the prior year premium estimates within the Other Markets segment and a decline in customer retention due to a more competitive market place. The National Market segment was also impacted by premium recognized on a large multi-year general liability policy written in 2006, which did not recur in 2007. Commercial multiple peril/fire net written premiums decreased in both periods due to lower customer retention rates and a large multi-year policy written in 2006, which did not recur in 2007. Both periods reflect new business growth across all segments and lines of business, a modest decline in retention rates and decreases in premium rates due to a more competitive market place. The Group Market segment growth was a result of an expanded sales force and broader market penetration. On a year-to-date basis, the increase in net written premium also reflects an increase in audit and retrospectively rated premiums of $78 million compared to 2006 primarily in the workers compensation and general liability lines.

Results of Operations – Commercial Markets

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007[4]**	**2006[4]**	**Change**	**2007[4]**	**2006[4]**	**Change**
Revenues	$1,530	$1,583	(3.3%)	$6,489	$6,075	6.8%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$175	$161	8.7%	$565	$630	(10.3%)
Catastrophes[1]	2	(11)	NM	(3)	(80)	(96.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	(42)	(151)	(72.2)	(90)	(215)	(58.1)
Current accident year re-estimation[3]	8	102	(92.2)	-	-	-
Pre-tax operating income	$143	$101	41.6%	$472	$335	40.9%

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 ($130) million and ($99) million for the three and twelve months ended December 31, 2007, respectively, and ($42) million and ($64) million for the comparable periods of 2006. Net of amortization of deferred gains on retroactive reinsurance of $9 million and $63 million for the three and twelve months ended December 31, 2007, respectively, and $42 million and $72 million for the comparable periods of 2006.

3 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

4 Effective in the fourth quarter 2007, results associated with Wausau, previously included in Agency Markets, are included in Commercial Markets. The prior periods have been restated to reflect this change.

NM = Not Meaningful.

Revenues for the three and twelve months ended December 31, 2007 were $1.530 billion and $6.489 billion, respectively, a decrease in the quarter of $53 million and an increase of $414 million versus the same periods in 2006. The major components of revenues are net premium earned, net investment income, and fee and other revenues.

Net premium earned for the three and twelve months ended December 31, 2007 was $1.256 billion and $5.391 billion, respectively, a decrease of $53 million and an increase of $388 million versus the same periods in 2006. The changes in both periods reflect the earned premium associated with the changes in net written premium in 2006 and 2007 as well as a decrease in the estimate of prior year earned premium on loss sensitive business recorded in the three months ended December 31, 2007.

Net investment income for the three and twelve months ended December 31, 2007 was $201 million and $774 million, respectively, increases of $23 million and $84 million over the same periods in 2006. The increases in both periods primarily reflect a higher invested asset base due to strong cash flow from operations.

Fee and other revenues for the three and twelve months ended December 31, 2007 were $73 million and $324 million, respectively, decreases of $23 million and $58 million from the same periods in 2006. The decreases in both periods primarily reflect 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 and twelve months ended December 31, 2007 were $1.387 billion and $6.017 billion, respectively, a decrease of $95 million and an increase of $277 million versus the same periods in 2006. The decrease in the quarter reflects lower catastrophes and a decline in incurred losses attributable to prior years. The increase year-to-date reflects business growth, an increase in non-catastrophe property losses and general cost increases, partially offset by lower catastrophe loss activity and a decrease in incurred losses attributable to prior years as compared to the same period in 2006.

	Three Months Ended December 31,			Twelve Months Ended December 31,		
COMMERCIAL MARKETS	**2007[3]**	**2006[3]**	**Change (Points)**	**2007[3]**	**2006[3]**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	77.0%	75.0%	2.0	79.6%	76.6%	3.0
Underwriting expense ratio	21.9	21.5	0.4	21.6	21.5	0.1
Dividend ratio	0.3	0.5	(0.2)	0.4	0.3	0.1
Subtotal	99.2	97.0	2.2	101.6	98.4	3.2
Catastrophes[1]	(0.1)	0.9	(1.0)	0.1	1.8	(1.7)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	3.5	12.2	(8.7)	1.8	4.6	(2.8)
Current accident year re-estimation[2]	(0.6)	(8.2)	7.6	-	-	-
Total combined ratio	102.0%	101.9 %	0.1	103.5%	104.8%	(1.3)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to assumed voluntary reinsurance except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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”). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

3 Effective in the fourth quarter 2007, results associated with Wausau, previously included in Agency Markets, are included in Commercial Markets. The prior periods have been restated to reflect this change.

The Commercial Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2007 was 99.2% and 101.6%, respectively, increases of 2.2 points and 3.2 points over the comparable periods in 2006. The increases in both periods reflect a higher claims and claim adjustment ratio driven by an increase in non-catastrophe property related losses and the impact of a more competitive rate environment. Both periods also reflect a higher underwriting expense ratio driven primarily by a decrease in the amount of expense reimbursement received from the Company’s servicing carrier operations due to the depopulation of the pools.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2007 was 102.0% and 103.5%, respectively, an increase of 0.1 points and a decrease of 1.3 points versus the same periods in 2006. These changes reflect the changes in the combined ratio components previously discussed, lower catastrophe losses as 2006 included additional losses attributable to the 2005 U.S. hurricanes related to assumed voluntary reinsurance lines and a decrease in net incurred losses attributable to prior years.

PTOI for the three and twelve months ended December 31, 2007 was $143 million and $472 million, respectively, increases of $42 million and $137 million over the same periods in 2006.

AGENCY MARKETS

Overview – Agency Markets

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007[3]**	**2006[1,3]**	**Change**	**2007[3]**	**2006[1,3]**	**Change**
Regional Companies[1]	$874	$821	6.5%	$3,611	$3,420	5.6%
Ohio Casualty[2]	297	-	NM	410	-	NM
Summit	49	119	(58.8)	697	826	(15.6)
Surety	69	59	16.9	292	242	20.7
Other[1]	28	23	21.7	102	85	20.0
Total net written premium	$1,317	$1,022	28.9%	$5,112	$4,573	11.8%

[1] Effective January 1, 2007, the results associated with the National Council on Compensation Insurance 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.
[2] As of August 24, 2007, the results include the acquisition of Ohio Casualty.
[3] Effective in the fourth quarter 2007, net written premium associated with Wausau, previously included in Agency Markets, is included in Commercial Markets. The prior periods have been restated to reflect this change.
NM = Not meaningful

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Commercial Lines						
Workers compensation total:	$258	$285	(9.5%)	$1,475	$1,518	(2.8%)
- Summit	49	119	(58.8)	697	826	(15.6)
- All other	209	166	25.9	778	692	12.4
Commercial multiple peril	339	262	29.4	1,233	1,094	12.7
Commercial automobile	186	140	32.9	669	597	12.1
General liability	84	48	75.0	246	195	26.2
Surety	82	62	32.3	310	250	24.0
Other	56	43	30.2	213	187	13.9
Subtotal	$1,005	$840	19.6%	$4,146	$3,841	7.9%
Personal Lines						
Private passenger automobile	$186	$107	73.8%	$575	$434	32.5%
Homeowners	107	66	62.1	339	262	29.4
Other	19	9	111.1	52	36	44.4
Subtotal	$312	$182	71.4%	$966	$732	32.0%
Total net written premium	$1,317	$1,022	28.9%	$5,112	$4,573	11.8%

Net written premiums for the three and twelve months ended December 31, 2007 were $1.317 billion and $5.112 billion, respectively, increases of $295 million and $539 million over the same periods in 2006. The increases in both periods were primarily due to the Ohio Casualty acquisition and strong retention levels and new business writings in most commercial lines of business at the Regional Companies. In addition, surety premium increased due to an increase in the average size of contract bonds and the non-renewal of a reinsurance program. Private passenger automobile premium, excluding the results of Ohio Casualty and the impact of the non-standard runoff business (GoAmerica), increased 24.7% and 21.6% in the quarter and year-to-date, respectively. The increases in both periods reflect a 27.1% increase in voluntary policies in force (excluding GoAmerica) due to strong customer retention, new business growth, increased utilization of multivariate pricing models and an increase in distribution focus and improved ease of doing business, which also had a favorable impact on homeowner's growth, primarily in non-coastal areas. These increases were partially offset by modest rate decreases in most states due to a more competitive market environment and mandated rate decreases in Florida and reduced audit and retrospectively rated premium at Summit.

Results of Operations – Agency Markets

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
$ in Millions	**2007[4,5]**	**2006[5]**	**Change**	**2007[4,5]**	**2006[5]**	**Change**
Revenues	$1,643	$1,239	32.6%	$5,569	$4,841	15.0%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$140	$132	6.1%	$436	$533	(18.2%)
Catastrophes[1]	(24)	(30)	(20.0)	(90)	(146)	(38.4)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	3	-	NM	2	-	NM
- All other[2]	199	48	NM	486	110	NM
Current accident year re-estimation[3]	(43)	20	NM	-	-	-
Pre-tax operating income	$275	$170	61.8%	$834	$497	67.8%

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 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of earned premium attributable to prior years of ($12) million and ($9) million for the three and twelve months ended December 31, 2007, respectively, and $1 million and $38 million for the comparable periods of 2006.

3 Re-estimation of the current accident year loss reserves and estimated premium for the nine months ended September 30, 2007 and 2006.

4 As of August 24, 2007, the results include the acquisition of Ohio Casualty.

5 Effective in the fourth quarter 2007, results associated with Wausau, previously included in Agency Markets, are included in Commercial Markets. The prior periods have been restated to reflect this change.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2007 were $1.643 billion and $5.569 billion, respectively, increases of $404 million and $728 million over the same periods in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2007 were $1.475 billion and $5.048 billion, respectively, increases of $340 million and $603 million over the same periods in 2006. The increases in both periods reflect the earned premium associated with the changes in net written premium in 2006 and 2007 and premium related to the Ohio Casualty acquisition.

Net investment income for the three and twelve months ended December 31, 2007 was $152 million and $457 million, respectively, increases of $65 million and $129 million over the same periods in 2006. The increases in both periods reflect higher invested assets due to strong cash flow from operations and the assets assumed from the Ohio Casualty acquisition.

Claims, benefits and expenses for the three and twelve months ended December 31, 2007 were $1.368 billion and $4.735 billion, increases of $299 million and $391 million over the same periods in 2006. The increases in both periods primarily reflect claims, benefits and expenses related to the Ohio Casualty acquisition, business growth, an increase in non-catastrophe related property losses, and general cost increases, partially offset by an increase in the amount of favorable incurred loss development attributable to prior years primarily related to workers compensation and commercial multiple peril. The increase in the quarter also reflects unfavorable development from the re-estimation of current accident year losses on liability lines for the nine months ended September 30, 2007.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
AGENCY MARKETS	**2007[3,4]**	**2006[4]**	**Change (Points)**	**2007[3,4]**	**2006[4]**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	64.6%	63.7%	0.9	66.2%	63.0%	3.2
Underwriting expense ratio	34.6	31.4	3.2	33.0	31.5	1.5
Dividend ratio	1.5	1.1	0.4	1.1	1.1	-
Subtotal	100.7	96.2	4.5	100.3	95.6	4.7
Catastrophes[1]	1.6	2.6	(1.0)	1.8	3.3	(1.5)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	(0.2)	-	(0.2)	-	-	-
- All other	(13.4)	(4.1)	(9.3)	(9.7)	(2.4)	(7.3)
Current accident year re-estimation[2]	2.9	(1.8)	4.7	-	-	-
Total combined ratio	91.6%	92.9	(1.3)	92.4%	96.5%	(4.1)

1 Catastrophes include all current and prior year catastrophe losses related to the Company's insurance lines and exclude losses related to the Company's external reinsurance assumed lines (assumed voluntary reinsurance and reinsurance assumed through Lloyd's Syndicate 4472) except for losses related to the events of September 11, 2001, the 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Re-estimation of the current accident year loss reserves and estimated premium for the nine months ended September 30, 2007 and 2006.

3 As of August 24, 2007, the results include the acquisition of Ohio Casualty.

4 Effective in the fourth quarter 2007, results associated with Wausau, previously included in Agency Markets, are included in Commercial Markets. The prior periods have been restated to reflect this change.

The Agency Markets combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2007 was 100.7% and 100.3%, respectively, increases of 4.5 points and 4.7 points over the comparable periods in 2006. The increases in both periods reflect a higher underwriting expense ratio due to the one-time recognition of integration costs associated with the Ohio Casualty acquisition, higher variable incentive compensation and other benefits and higher commission expense due to a business mix shift resulting from the Ohio Casualty acquisition and other incentive commissions. These increases were partially offset by a decrease in premium taxes. The year-to-date increase in the expense ratio also reflects a one-time write-off associated with an information technology system replacement. The increases in both periods in the claims and claim adjustment expense ratio also reflect an increase in non-catastrophe related property losses and a more competitive rate environment.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2007 was 91.6% and 92.4%, respectively, decreases of 1.3 points and 4.1 points from the same periods in 2006. The decreases in both periods primarily reflect favorable net incurred losses attributable to prior years related to workers compensation and commercial multiple peril lines and lower catastrophes. The claims and claim adjustment expense ratio in the quarter was further impacted by unfavorable development from the re-estimation of current accident year losses on liability lines and a reduction in estimated earned premium at Summit, associated with the slowdown in the Florida economy, for the nine months ended September 30, 2007.

PTOI for the three and twelve months ended December 31, 2007 was $275 million and $834 million, respectively, increases of $105 million and $337 million over the same periods in 2006.

INTERNATIONAL

Overview – International

International net written premium by market segment was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
International Local Businesses Total	$931	$744	25.1	$3,296	$2,659	24.0%
- Latin America	513	381	34.6	1,748	1,372	27.4
- Europe	374	328	14.0	1,374	1,152	19.3
- Asia Pacific	44	35	25.7	174	135	28.9
Liberty International Underwriters	534	381	40.2	2,418	1,993	21.3
Total net written premium (NWP)	$1,465	$1,125	30.2%	$5,714	$4,652	22.8%
Foreign exchange effect on growth			8.4%			5.8%
NWP growth excluding foreign exchange			21.8%			17.0%

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

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

(1) Local businesses: personal, primarily private passenger automobile, 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 automobile, and residual value.

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

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006[2]**	**Change**	**2007**	**2006[2]**	**Change**
Local businesses – private passenger automobile	$562	$407	38.1%	$1,969	$1,495	31.7%
Local businesses – all other[1]	369	337	9.5	1,327	1,164	14.0
LIU reinsurance	184	175	5.1	1,009	1,021	(1.2)
LIU inland marine program[2]	137	75	82.7	561	274	104.7
LIU third party	125	94	33.0	519	432	20.1
LIU first party[2]	77	27	185.2	291	236	23.3
LIU other	11	10	10.0	38	30	26.7
Total net written premium	$1,465	$1,125	30.2%	$5,714	$4,652	22.8%

1 Premium related to small commercial and other personal lines insurance products sold by local business operations.
2 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.
NM = Not Meaningful

Net written premium for the three and twelve months ended December 31, 2007 was $1.465 billion and $5.714 billion, respectively, increases of $340 million and $1.062 billion over the same periods in 2006. The increases in both periods reflect organic growth in all local businesses, primarily in Latin America and Europe, the acquisition of Seker Sigorta A.S., a property and casualty insurer located in Turkey, in September of 2006, and the strengthening of foreign currencies versus the U.S. dollar. Growth in both periods also reflects the continued expansion of LIU's inland marine program business as well as a change in the terms of the program. The increases in LIU's third and first party business in both periods were primarily due to a reduction in the utilization of reinsurance as compared to prior periods and a change in the timing of recording ceded written premium for certain excess of loss contracts, partially offset by a decline in rates as a result of a more competitive market. The increase in the quarter in LIU's reinsurance business was primarily due to the timing of new business written as compared to the prior period. The year-to-date decrease in LIU's reinsurance business reflects management's decision to reduce its catastrophe exposure in the U.S. and to a lesser extent Europe, partially offset by growth in non-catastrophe related exposures.

Results of Operations – International

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$1,637	$1,325	23.5	$6,148	$4,890	25.7%
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	$65	$143	(54.5%)	$403	$543	(25.8%)
Catastrophes[1]	(3)	(16)	(81.3)	(3)	(62)	(95.2)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other[2]	38	(5)	NM	78	(24)	NM
Current accident year re-estimation[3]	-	-	-	-	-	-
Pre-tax operating income	$100	$122	(18.0%)	$478	$457	4.6%

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 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned, the Company's reasonable assumption of expected catastrophe activity. Catastrophe losses, where applicable, include the impact of reinstatement premiums.

2 Net of earned premium attributable to prior years of ($2) million and $3 million for the three and twelve months ended December 31, 2007, respectively, and ($3) million and ($2) million for the comparable periods of 2006.

3 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2007 were $1.637 billion and $6.148 billion, respectively, increases of $312 million and $1.258 billion over the same periods in 2006. The major components of revenues are net premium earned and net investment income.

Net premium earned for the three and twelve months ended December 31, 2007 was $1.459 billion and $5.490 billion, respectively, increases of $265 million and $1.092 billion over the same periods in 2006. The increases in both periods reflect the impact of business growth, consistent with the increase in net written premium from local businesses, LIU's inland marine program and LIU's third and first party business. Earned premium from LIU's reinsurance business also increased primarily as a result of a higher level of written premium in the second half of 2006, primarily due to rate increases on property business.

Net investment income for the three and twelve months ended December 31, 2007 was $150 million and $535 million, respectively, increases of $32 million and $122 million over the same periods in 2006. The increases in both periods reflect a higher invested asset base due to strong cash flows from operations, higher yields and the impact of foreign exchange.

Claims, benefits and expenses for the three and twelve months ended December 31, 2007 were $1.541 billion and $5.674 billion, respectively, increases of $336 million and $1.264 billion over the same periods in 2006. The increases in both periods primarily reflect business growth across all local businesses including new operations in Poland and Turkey, the continued expansion of LIU's inland marine program business, higher net commission expense and a higher incidence of large loss events within LIU's reinsurance business. Year-to-date large loss events include losses related to the floods in the United Kingdom, Hurricane Dean, the European storm Kyrill and the Brazilian airline crash. The increase in net commission expense primarily reflects lower ceding commission recognized by LIU's third party business due to a reduction in reinsurance utilization and higher acquisition costs in the local businesses, primarily Latin America and Europe. Favorable foreign exchange movements in the quarter were driven by the weakening of the Colombian and Chilean peso versus the U.S. dollar, partially offsetting the increase in claims, benefits and expenses. However, the year-to-date decline in foreign exchange gains primarily reflects the overall strengthening of the Colombian peso versus the U.S. dollar on U.S. dollar denominated investments. The changes in both periods also reflect favorable incurred loss development attributable to prior years from the local businesses, primarily automobile business in Spain, and LIU's first party and other lines of business, partially offset by strengthening in Brazil.

	Three Months Ended December 31,			**Twelve Months Ended December 31,**		
INTERNATIONAL	**2007**	**2006**	**Change (Points)**	**2007**	**2006**	**Change (Points)**
Combined ratio before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation						
Claims and claim adjustment expense ratio	73.2%	66.3%	6.9	70.1%	66.3%	3.8
Underwriting expense ratio	30.8	29.4	1.4	31.0	29.0	2.0
Dividend ratio	-	-	-	-	-	-
Subtotal	104.0	95.7	8.3	101.1	95.3	5.8
Catastrophes[1]	0.2	1.4	(1.2)	0.1	1.4	(1.3)
Net incurred losses attributable to prior years:						
- Asbestos & environmental	-	-	-	-	-	-
- All other	(2.6)	0.4	(3.0)	(1.5)	0.5	(2.0)
Current accident year re-estimation[2]	-	-	-	-	-	-
Total combined ratio	101.6%	97.5%	4.1	99.7%	97.2%	2.5

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 U.S. hurricanes and the 2005 U.S. hurricanes. Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned, the Company's reasonable assumption of expected catastrophe activity. Catastrophe losses, where applicable, include the impact of reinstatement premiums.

2 Re-estimation of the current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

The consolidated combined ratio before catastrophes and net incurred losses attributable to prior years for the three and twelve months ended December 31, 2007 was 104.0% and 101.1%, respectively, increases of 8.3 points and 5.8 points over the comparable periods in 2006. The increases in the claims and claim adjustment expense ratio in both periods reflect a higher incidence of large loss events from LIU's reinsurance business as compared to 2006 and increased loss activity within certain classes of LIU's first party business, as well as the impact of a softening rate environment on both LIU's third and first party businesses. Higher loss trends on European automobile business, particularly Spain, as well as new operations in Poland and Turkey, were also contributors to the increases in the claims and claims adjustment expense ratio in both periods. Year-to-date large loss events in LIU's reinsurance business also include the floods in the United Kingdom, Hurricane Dean, European storm Kyrill, and the Brazilian airline crash. The increase in the combined ratio in both periods also reflects a higher underwriting expense ratio due to higher acquisition costs in Europe, lower ceding commissions in LIU's third party business, and higher general expenses in LIU’s third and first party business related to growth initiatives. Additionally, the year-to-date increase in the underwriting expense ratio reflects the change in the terms of LIU’s inland marine program.

Including the impact of catastrophes and net incurred losses attributable to prior years, the total combined ratio for the three and twelve months ended December 31, 2007 was 101.6% and 99.7%, respectively, increases of 4.1 points and 2.5 points over the same periods in 2006. These increases reflect the changes in the combined ratio components previously discussed, partially offset by lower catastrophe losses and a decrease in year-to-date net incurred losses attributable to prior years.

PTOI for the three and twelve months ended December 31, 2007 was $100 million and $478 million, respectively, a decrease of $22 million and an increase of $21 million versus the same periods 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, certain distribution channels related to PruPac, and Commercial assumed voluntary reinsurance business.

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

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

- The Company reports its written premiums on workers compensation contracts on the "booked as billed" method. Commercial Markets and Agency Markets report these same written premiums on the "booked at inception" method. Corporate and Other results reflect the difference between these two methods.

- 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 is allocated to the business units based on planned ordinary investment income returns by investment category. Investments are allocated to the business units in an amount equal to their respective liabilities net of insurance assets (reinsurance, premiums receivable, etc.) plus allocated statutory policyholders' surplus. The difference between allocated net investment income and actual net investment income is included in Corporate and Other.

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

- 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.

Corporate and Other net written premium by line of business was as follows:

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Internal reinsurance	$58	$19	NM	$273	$96	184.4%
Individual life	75	82	(8.5%)	280	662	(57.7)
Workers compensation[1]	86	(62)	NM	7	(164)	NM
Other	-	11	(100.0)	4	15	(73.3)
Total net written premium	$219	$50	NM	$564	$609	(7.4%)

1 Booked as billed adjustment.

Net written premium for the three and twelve months ended December 31, 2007 was $219 million and $564 million, respectively, an increase of $169 million and a decrease of $45 million versus the same periods in 2006. The increase in the quarter primarily reflects an increase in internal reinsurance premium and the impact of the Company's workers compensation "booked as billed" adjustment, partially offset by a decrease in individual life business, primarily structured settlement contracts. The decrease in year-to-date net written premium was driven by a decline in individual life business, primarily immediate annuity sales, partially offset by an increase in internal reinsurance premium and the Company's workers compensation "booked as billed" adjustment.

Results of Operations – Corporate and Other

	Three Months Ended December 31,			Twelve Months Ended December 31,		
$ in Millions	**2007**	**2006**	**Change**	**2007**	**2006**	**Change**
Revenues	$629	$419	50.1%	$1,926	$2,112	(8.8%)
PTOI before catastrophes and net incurred losses attributable to prior years and current accident year re-estimation	($142)	$23	NM	($100)	$164	NM
Catastrophes[1]	11	(26)	NM	13	(35)	NM
Net incurred losses attributable to prior years:						
- Asbestos & environmental[2]	(65)	(19)	NM	(160)	(22)	NM
- All other[3]	(157)	(43)	NM	(519)	(177)	193.2
Current accident year re-estimation[4]	-	-	-	-	-	-
Pre-tax operating loss	($353)	($65)	NM	($766)	($70)	NM

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 2004 U.S. hurricanes and the 2005 U.S. hurricanes. In addition, losses related to the 2005 U.S. hurricanes and the 2004 U.S. 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"). Internally reinsured catastrophe losses are not reported net of net catastrophe reinsurance premium earned. Catastrophe losses, where applicable, include the impact of accelerated earned catastrophe premiums and earned reinstatement premiums.

2 Net of allowance for uncollectible reinsurance of ($14) and ($11) million for the three and twelve months ended December 31, 2007, respectively, and $11 million and $12 million for the comparable periods of 2006.

3 Net of amortization of deferred gains on retroactive reinsurance of $6 million and $21 million for the three and twelve months ended December 31, 2007, respectively, and $9 million and $25 million for the comparable periods of 2006.

4 Re-estimation of current accident year loss reserves for the nine months ended September 30, 2007 and 2006.

NM = Not Meaningful

Revenues for the three and twelve months ended December 31, 2007 were $629 million and $1.926 billion, respectively, an increase of $210 million and a decrease of $186 million versus the same periods 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 and twelve months ended December 31, 2007 was $141 million and $525 million, respectively, an increase of $29 million and a decrease of $248 million versus the same periods in 2006. The changes in both periods reflect the earned premium associated with the changes in net written premium in 2006 and 2007.

Net investment income for the three and twelve months ended December 31, 2007 was $154 million and $782 million, respectively, decreases of $75 million and $37 million from the same periods in 2006. The decreases in both periods reflect lower yields on the fixed maturity portfolio, due primarily to the Company's increased investment in tax-exempt securities. Both periods were further impacted by higher investment expenses due to an increase in variable incentive compensation and interest income related to fixed income assets assumed from the Ohio Casualty acquisition, net of purchase price. The year-to-date decrease was partially offset by an increase in investment income related to limited partnerships, limited liability companies, and commercial mortgage loans due to the Company's increased investment in those asset classes, consistent with its diversification strategy. Results in the quarter reflect a decrease in investment income related to limited partnerships and limited liability companies compared to the same period in 2006.

Net realized investment gains for the three and twelve months ended December 31, 2007 were $296 million and $440 million, respectively, increases of $262 million and $120 million over the same periods in 2006. The increase in the quarter was primarily driven by a $226 million gain on the sale of a restricted equity holding. The year-to-date increase was less significant than the quarter due to a timing difference of a comparably sized gain recognized in the third quarter of 2006 as compared to 2007. In addition, year-to-date gains included a $32 million gain from the sale of a Company owned property.

Fee and other revenues for the three and twelve months ended December 31, 2007 were $38 million and $179 million, respectively, decreases of $6 million and $21 million from the same periods in 2006. The decreases in both periods reflect a decline in the sale and production of oil and gas from the Liberty Energy subsidiary operation and to the loss of revenue associated with the sale of a Company owned property.

Claims, benefits and expenses for the three and twelve months ended December 31, 2007 were $686 million and $2.252 billion, respectively, increases of $236 million and $390 million over the same periods in 2006. The increases in both periods reflect an increase in incurred losses attributable to prior years related to workers compensation and direct site pollution claims on new and existing accounts, an increase in variable annuity reserves and other corporate expenses and higher interest expense as a result of the Company's March 2007 and August 2006 debt offerings. The year-to-date increase reflects a $95 million increase in asbestos reserves related to the Company's completion of its biennial ground-up asbestos study in the third quarter of 2007. The increases in both periods were partially offset by a decrease in reserves related to Individual Life business, principally immediate annuities, and a decrease in adverse reserve development on assumed reinsurance lines.

Pre-tax operating loss for the three and twelve months ended December 31, 2007 was $353 million and $766 million, respectively, increases of $288 million and $696 million over the same periods 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 December 31, 2007 and December 31, 2006:

$ in Millions	**As of December 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	$46,934	86.9%	$41,102	87.0%
Equity securities, available for sale, at fair value	3,285	6.1	2,619	5.6
Trading securities, at fair value	16	-	22	-
Limited partnerships and limited liability companies	2,134	4.0	1,435	3.0
Commercial mortgage loans	657	1.2	322	0.7
Short-term investments	764	1.4	1,550	3.3
Other investments	214	0.4	211	0.4
Total invested assets	$54,004	100.0%	$47,261	100.0%

Total invested assets as of December 31, 2007 were $54.004 billion, an increase of $6.743 billion or 14.3% over December 31, 2006. This increase was primarily due to $4.177 billion in invested assets acquired with the Ohio Casualty purchase on August 24, 2007. In addition, strong cash flow from operations, continued growth in investment income, and a portion of the proceeds received from the Company's March 2007 debt offering contributed to the increase. This was partially offset by the liquidation of assets to fund the Ohio Casualty purchase.

Fixed maturities as of December 31, 2007 were $46.934 billion, an increase of $5.832 billion or 14.2% over December 31, 2006. The increase reflects net fixed maturities acquired from the Ohio Casualty purchase, and the aforementioned change in the amount of cash available to invest.

Equity securities, available for sale, as of December 31, 2007 were $3.285 billion ($2.692 billion common stock and $593 million preferred stock), an increase of $666 million or 25.4% over December 31, 2006.

This increase was driven by the addition of Ohio Casualty equities ($325 million), new commitments and change in the market value of securities held.

Limited partnerships and limited liability companies as of December 31, 2007 were $2.134 billion, an increase of $699 million or 48.7% over December 31, 2006. These investments consist of traditional private equity partnerships of $1.392 billion, real estate partnerships of $337 million, and other partnerships (primarily energy) of $405 million. The increase over December 31, 2006 was driven by new investments across all three categories as the Company continues to diversify its private equity portfolio. The Company's investments in limited partnerships and limited liability companies are long-term in nature and highly illiquid. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Commercial mortgage loans as of December 31, 2007 were $657 million, an increase of $335 million or 104.0% over December 31, 2006. The increase reflects new investments in this asset class, which is consistent with the Company's diversification strategy.

Short term investments as of December 31, 2007 were $764 million, a decrease of $786 million or 50.7% from December 31, 2006. This decrease from December 31, 2006 was driven by other previously mentioned investment opportunities and liquidity requirements, including the acquisition of Ohio Casualty.

As of December 31, 2007, the Company had unfunded commitments in traditional private equity partnerships, commercial mortgage loans, energy, and real estate of $953 million, $463 million, $458 million, and $431 million, respectively. As of December 31, 2007, the Company had commitments to purchase various residential mortgage-backed securities at a cost and fair market value of $29 million.

As of December 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 table summarizes the Company's fixed maturity portfolio by security type as of December 31, 2007 and December 31, 2006:

$ in Millions	**As of December 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	$3,318	7.1%	$4,658	11.3%
Mortgage and asset-backed securities	13,491	28.7	12,267	29.8
U.S. state and municipal	10,001	21.3	6,612	16.1
Corporate and other	17,438	37.2	15,354	37.4
Foreign government securities	2,686	5.7	2,211	5.4
Total fixed maturities	$46,934	100.0%	$41,102	100.0%

The changes in asset allocation as of December 2007 compared to December 2006 are primarily driven by the Ohio Casualty acquisition. The decrease in U.S. Government and agency securities was primarily driven by the liquidation of securities to fund the Ohio Casualty purchase. This was offset by an increase in U.S. state and municipal and Corporate and other securities due to the addition of Ohio Casualty invested assets. In addition, the Company's investment strategy for U.S. state and municipal securities continues to reflect its increased tactical allocation based on investment opportunities, tax status and the business environment.

The following table summarizes the Company's exposure to alt-A and sub-prime mortgage collateral as of December 31, 2007:

$ in Millions	As of December 31, 2007		
	Alt-A	**Sub-prime**	**Total**
Liberty Mutual Group (excluding Ohio Casualty)	$161	$16	$177
Ohio Casualty	44	80	124
Consolidated	$205	$96	$301

As of December 31, 2007, the Company's exposure to sub-prime ($96 million or 0.18% of invested assets) and alt-A mortgage collateral ($205 million or 0.38% of invested assets) was primarily AAA rated.

The following table summarizes the Company's allocation of fixed maturities by credit quality as of December 31, 2007 and December 31, 2006:

$ in Millions	As of December 31, 2007		As of December 31, 2006	
Fixed Maturities by Credit Quality*	**Market Value**	**% of Total**	**Market Value**	**% of Total**
AAA	$24,576	52.4%	$21,954	53.4%
AA+, AA, AA-	7,586	16.2	5,706	13.9
A+, A, A-	7,196	15.3	6,631	16.1
BBB+, BBB, BBB-	4,405	9.4	3,995	9.7
BB+, BB, BB-	1,797	3.8	1,699	4.1
B+, B, B-	1,165	2.5	1,047	2.6
CCC or lower	209	0.4	70	0.2
Total fixed maturities	$46,934	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 to investment grade securities increased slightly to 93.3% at December 31, 2007 from 93.1% December 31, 2006. The improvement was driven primarily by the sale of non-investment grade securities and the acquisition of Ohio Casualty.

The Company had 6.7% of its fixed maturity securities invested in non-investment grade securities at December 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.

The following table summarizes the Company's allocation of fixed maturities by maturity date as of December 31, 2007 and December 31, 2006:

$ in Millions	**As of December 31, 2007**		**As of December 31, 2006**	
Fixed Maturities by Maturity Date	**Market Value**	**% of Total**	**Market Value**	**% of Total**
1 yr or less	$1,376	3.0%	$1,946	4.7%
Over 1 yr through 5 yrs	9,295	19.8	7,679	18.7
Over 5 yrs through 10 yrs	9,567	20.4	7,937	19.3
Over 10 years	13,205	28.1	11,273	27.5
Mortgage and asset-backed securities	13,491	28.7	12,267	29.8
Total fixed maturities	$46,934	100.0%	$41,102	100.0%

During 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 and twelve months ended December 31, 2007 and 2006:

$ in Millions	**Three Months Ended December 31,**		**Twelve Months Ended December 31,**	
Net Investment Income	**2007**	**2006**	**2007**	**2006**
Taxable interest income	$580	$543	$2,211	$2,089
Tax-exempt interest income	101	60	342	200
Dividends	23	10	83	52
Limited partnerships and limited liability companies[1]	68	93	345	304
Commercial mortgage loans[1]	9	-	27	-
Other investment income	2	15	7	20
Gross investment income	783	721	3,015	2,665
Investment expenses	(40)	(31)	(130)	(117)
Net investment income	$743	$690	$2,885	$2,548

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

Net investment income for the three and twelve months ended December 31, 2007 was $743 million and $2.885 billion, respectively, increases of $53 million and $337 million over the same periods in 2006. The increases in both periods primarily reflect higher interest income due to higher invested assets resulting from continued strong cash flows from operations and the proceeds received from the Company's August 2006 and March 2007 debt offerings. Both periods also reflect an increase in interest income related to fixed income assets assumed from the acquisition of Ohio Casualty, net of purchase price and higher dividend income due to the Company's increased investment in equity securities. Year-to-date net investment income also increased as a result of the Company's increased investment in limited partnerships, limited liability companies and commercial mortgage loans consistent with its diversification strategy. These increases in gross investment income, however, were constrained by lower yields on the fixed maturity portfolio due primarily to the Company's increased investment in tax-exempt securities. The increase in investment expenses in both periods was primarily attributable to higher variable incentive compensation.

Net Realized Investment Gains (Losses)

The following tables summarize the Company's net realized investment gains (losses) for the three and twelve months ended December 31, 2007 and 2006:

$ in Millions **Net Realized Investment Gains (Losses)**	**Sales & Dispositions**	**Impairments**	**Change in Trading Security Unrealized**	**Total**
Three Months Ended December 31, 2007:				
Fixed maturities	($11)	($11)	$ -	($22)
Common and preferred stock	54	(5)	-	49
Other	265	-	-	265
Total	$308	($16)	$-	$292
Three Months Ended December 31, 2006:				
Fixed maturities	$19	($3)	$-	$16
Common and preferred stock	30	(1)	-	29
Other	(11)	(2)	-	(13)
Total	$38	($6)	$-	$32
Twelve Months Ended December 31, 2007:				
Fixed maturities	($7)	($25)	$-	($32)
Common and preferred stock	158	(7)	-	151
Other	332	(15)	-	317
Total	$483	($47)	$-	$436
Twelve Months Ended December 31, 2006:				
Fixed maturities	$34	($39)	$-	($5)
Common and preferred stock	98	(5)	-	93
Other	261	(6)	-	255
Total	$393	($50)	$-	$343

$ in Millions	**Three Months Ended December 31,**		**Twelve Months Ended December 31,**	
Components of Net Realized Investment Gains (Losses)	**2007**	**2006**	**2007**	**2006**
Fixed maturities:				
Gross realized gains	$42	$50	$124	$105
Gross realized losses	(64)	(34)	(156)	(110)
Equities:				
Gross realized gains	85	35	199	112
Gross realized losses	(36)	(6)	(48)	(19)
Other:				
Gross realized gains	267	1	338	273
Gross realized losses	(2)	(14)	(21)	(18)
Total net realized investment gains (losses)	$292	$32	$436	$343

Net realized investment gains for the three and twelve months ended December 31, 2007 were $292 million and $436 million, respectively, increases of $260 million and $93 million from the same periods in 2006. The increase in the quarter was primarily driven by a $226 million gain on the sale of a restricted equity.

The year-to-date increase was less significant than the quarter due to a timing difference of a comparably sized gain recognized in the third quarter of 2006 as compared to 2007. In addition, year-to-date gains included a $32 million gain from the sale of a Company owned property.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration of potential impairment as of December 31, 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	($1)	$158	($10)	$90
Mortgage and asset-backed securities	(30)	1,807	(110)	3,641
U.S. state and municipal	(39)	2,396	(15)	437
Corporate and other	(200)	5,257	(273)	4,602
Foreign government securities	(42)	876	(10)	539
Equities	(198)	933	(6)	24
Total	($510)	$11,427	($424)	$9,333

Unrealized losses increased from $636 million as of December 31, 2006 to $934 million as of December 31, 2007 primarily due to an increase in credit spreads. The Ohio Casualty assets assumed in the third quarter of 2007 had a minimal impact on unrealized gains and losses, as these assets were valued at fair value on the date of acquisition on August 24, 2007. Approximately 60.6% of the unrealized losses ($566 million) exist on holdings where the fair value as of December 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 December 31, 2007 are temporary.

The gross unrealized losses recorded on equity securities at December 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 December 31, 2007 totaled $54.004 billion.

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

$ in Millions	**As of December 31, 2007**	**As of December 31, 2006**
Commercial paper	$-	$-
Revolving credit facilities	70	50
Current maturities of long-term debt	21	121
Total short-term debt	$91	$171

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

$ in Millions	**As of December 31, 2007**	**As of December 31, 2006**
6.75% Notes, due 2008	$-	$15
5.00% Prudential notes, due 2008	-	4
8.00% Prudential notes—series B due 2013	260	260
5.75% Senior notes, due 2014	500	500
7.30% Senior notes, due 2014[1]	200	-
6.70% Senior notes, due 2016	250	250
7.00% Junior subordinated notes due 2067[2]	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 2087[3]	700	-
7.697% Surplus notes, due 2097	500	500
7.10% – 7.86% Medium term notes, with various maturities	25	27
Subtotal	4,388	3,209
Unamortized discount[4]	(28)	(34)
Total long-term debt excluding current maturities	$4,360	$3,175

[1] Reflects debt issued by Ohio Casualty.
[2] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements (see discussion in Liquidity and Capital Resources section).
[3] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements (see discussion in Liquidity and Capital Resources section).
[4] Reflects purchase price adjustment of $7 million related to Ohio Casualty $200 million senior notes, due 2014.

The Company issues commercial paper through Liberty Mutual Group Inc. ("LMGI"). On June 25, 2007, LMGI increased its commercial paper program, guaranteed by LMIC, from $600 million to $1 billion. The program is backed by a $750 million five-year revolving credit facility. To date, no funds have been borrowed under the facility.

On April 5, 2007, LMGI entered into a $250 million 3-year unsecured revolving credit facility for general corporate purposes. To date, no funds have been borrowed under the facility.

Liberty Corporate Capital Limited entered into a $100 million 364 day revolving credit facility, which became effective October 26, 2007. 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. As of December 31, 2007, no borrowings were outstanding under the facility.

In the third quarter of 2007, the Company borrowed $1 billion of funds under the $1.25 billion short-term revolving credit facility established on June 15, 2007 to facilitate the acquisition of Ohio Casualty. As of December 31, 2007, no borrowings were outstanding under this 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 December 31, 2007, no borrowings were outstanding under the facility.

The Company's Venezuelan subsidiary, Inversora Segucar, C.A., entered into a $90 million revolving credit facility to provide liquidity for working capital purposes. As of December 31, 2007, total short-term borrowings under the Venezuelan credit facility were approximately $70 million.

The $80 million decrease in short-term debt outstanding is due to the redemption of the Company's 8.2% Surplus Notes on May 4, 2007 for $121 million. This decrease was partially offset by an increase of $20 million in outstanding borrowings under the Venezuelan credit facility and the current maturity of the Company's 6.75% notes due in 2008 for $15 million.

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 $1.185 billion increase in long-term debt outstanding was primarily the result of this offering. In addition, as a result of the Ohio Casualty acquisition, Ohio Casualty's $200 million of 7.30% senior notes due 2014 are included as part of the Company's long-term debt outstanding.

Consolidated interest expense for the twelve months ended December 31, 2007 was $320 million, representing an increase of $108 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 December 31, 2007, the Company, through its downstream subsidiary LMGI, had $3.291 billion of debt outstanding, excluding discount.

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 its debt, as could a redomestication, merger or consolidation of LMIC, LMFIC or EICOW to a different domiciliary state.

The authorization control level risk-based capital (as of December 31, 2006) and 2008 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	**2007**	**2006**	**Change**	**2008**
LMIC [3]	NA	554%	NA	$1,182
LMFIC	NA	579%	NA	$88
EICOW [3]	NA	395%	NA	$130

[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.
NA= Not Available

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 twelve months ended December 31, 2007, Corporate Services recorded $281 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 $14.155 billion and $12.131 billion at December 31, 2007, and December 31, 2006, respectively. The increase in surplus reflects net income of $1.013 billion (the sum of earnings from the Company’s 49 domestic insurance companies and dividends from subsidiaries), capital contributions from the parent, LMGI, of $1.201 billion, affiliated unrealized gains of $183 million, partially offset by unaffiliated unrealized losses of $48 million, the redemption of surplus notes of $121 million and non admitted goodwill of $294 million related to the Company's acquisition of Ohio Casualty. The balance of the increase in statutory surplus primarily reflects changes in deferred taxes, foreign exchange and non-admitted assets.

CRITICAL ACCOUNTING POLICIES

Critical Accounting Estimates

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

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

Effective December 31, 2007, the Company adopted Statement of Financial Accounting Standards 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 the Company to (a) recognize the funded status of its pension, supplemental pension and postretirement benefit plans on the consolidated balance sheet as an asset or liability, measured as the difference between plan assets at fair value and the benefit obligation as of the employer's fiscal year end, with a corresponding adjustment to accumulated other comprehensive income ("AOCI"), net of tax; and to (b) recognize as a component of AOCI, net of tax, actuarial gains or losses or prior service cost or credit that arise during the period but are not recognized as a components of net periodic benefit cost. Consistent with the provisions of FAS 158, these amounts will be subsequently recognized in the income statement pursuant to the Company's historical accounting policy for amortizing such amounts with a corresponding offset to AOCI. The provisions of FAS 87 and FAS 106 continue to apply in measuring plan assets and benefit obligations, as of the date of fiscal year-end statement of financial position, and in determining net periodic benefit cost. The provisions of FAS 158 are not to be applied retrospectively. The adoption of SFAS 158 as of December 31, 2007 decreased other assets by $245, increased other liabilities by $198, increased deferred taxes by $155, and decreased accumulated other comprehensive income, a component of policyholders' equity by $288, net of tax. Adoption of FAS 158 did not affect the Company's result of operation or liquidity as FAS 158 does not affect the determination of net periodic benefit costs.

Effective January 1, 2007, the Company adopted 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. 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. Management has concluded the exemption applies for the Company's investment in its mortgage backed securities, and as a result, SFAS 155 did not impact the Company's consolidated financial statements.

Effective January 1, 2007, the Company adopted the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants' ("AcSEC") 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 adoption of SOP 05-1 did not impact the Company's consolidated financial statements.

Effective January 1, 2007, the Company adopted Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*" ("FIN 48") issued by the FASB in June 2006. 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. As a result of the adoption, the Company recognized a decrease of approximately $11 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 tax benefits within 12 months of the reporting date.

The Company does not expect any material changes to the unrecognized tax benefits within 12 months of the reporting date.

The IRS is currently reviewing the Company's federal tax returns for the 1999 through 2005 tax years. Any adjustments that might 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.

Effective April 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), "*Share-Based Payments*" ("SFAS 123(R)"). The Company has elected to continue to measure its awards at their intrinsic value. Compensation cost related to these plans is determined in accordance with plan formulas and recorded ratably over the years the employee service is provided. The adoption of SFAS 123(R) did not impact the Company's consolidated financial statements.

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board (FASB) Statement of Position No. FAS 115-1 and FAS 124-1, "*Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments*" ("FSP FAS 115-1 and FAS 124-1"), which provides guidance on determining whether investment impairment is other-than-temporary regardless of the intent to sell and when a security is impaired due to fluctuations in interest rates. The adoption of the statement did not have a material impact on 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 evaluating the impact of adoption, but does not expect the provisions of SFAS No. 157 to have a material effect on its results of operations, financial condition, or liquidity.

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 does not expect the provisions of SFAS No. 159 to have a material effect on its results of operations, financial condition, or liquidity.

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 provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. In March 2007, the EITF released issue No. 06-10, "*Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements* ("EITF 06-10"). This issue requires a company to recognize a liability for future life insurance benefits in accordance with SFAS 106 or Opinion 12. Both EITF 06-4 and EITF 06-10 are effective for the Company for fiscal years beginning after December 15, 2007. The Company is evaluating the impact of adoption, but does not expect the provisions of either issue to have a material effect on its results of operations, financial condition or liquidity.

In December 2007, the FASB issued SFAS No. 160, "*Accounting for Noncontrolling Interests" ("SFAS 160").* FAS 160 will result in the consolidation of all non-controlling interests within the income statement and balance sheet of the Company for all consolidated subsidiaries. SFAS 160 is required to be adopted on January 1, 2009. Prospective adoption is required, except for the required reclasses which are to be applied retrospectively. Early adoption is not permitted. The Company is in the process of evaluating the impact of adoption.

In December 2007, the FASB issued SFAS No. 141('R), *"Applying the Acquisition Method"* ("SFAS 141('R)"). This issue will result in significant changes to accounting for business combinations. Prospective adoption is required and early adoption is not permitted. The Company is required to adopt SFAS 141('R) effective January 1, 2009. The Company is in the process of evaluating the impact of adoption.

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.

Unpaid Claims and Claim Adjustment Expenses

Reserves for property-casualty unpaid claims and claim adjustment expenses were $42.992 billion and $38.606 billion at December 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 A&E reserves for unpaid claims and claim adjustment expenses were $1.334 billion and $1.386 billion at December 31, 2007 and December 31, 2006, respectively, net of reinsurance and including an allowance for doubtful accounts. The year-to-date decrease was due primarily to ongoing settlement activity of asbestos and environmental claims partially offset by an increase in asbestos reserves stemming from the biennial asbestos reserve study.

In the third quarter of 2007, the Company completed its biennial ground-up asbestos reserve study and increased its asbestos reserves by $95 million. The study was completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and it included all major segments of the Company's direct, assumed, and ceded asbestos claims. In addition, an internationally known actuarial consulting firm performed its own independent review of the Company's asbestos reserves and confirmed the reasonableness of the reserve increase.

As a result of Company internal studies on environmental claims, in 2007 the Company increased net loss and allocated loss adjustment expenses by $64 million. The primary driver was an increase in direct site pollution claims on new and existing accounts for Agency Markets.

As part of the internal review, potential exposures of large policyholders were individually evaluated using the company's proprietary stochastic model, which is consistent with the latest published actuarial paper on asbestos reserving. Among the factors reviewed in depth by the team specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, types of injury, state jurisdictions, legal defenses, and reinsurance potential. Small policyholders were evaluated using aggregate methods that utilized information developed from the large policyholders. Additionally, a provision of pure IBNR was established for the potential emergence of first-time filers of future asbestos claims.

All A&E claims against policies issued prior to 1986 by EICOW and its affiliates are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company’s 2003 acquisition of PruPac included $175 million and $118 million of gross and net 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 $56 million for the twelve months ended December 31, 2007 and $60 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 $15.518 billion and $15.564 billion at December 31, 2007 and December 31, 2006, respectively, net of allowance for doubtful accounts. The decrease was primarily due to the ongoing settlement of 2005 hurricane claims, offset by the acquisition of Ohio Casualty.

The reinsurance recoverables from Nationwide Indemnity Company have been fully guaranteed by its parent, Nationwide Mutual Insurance Company, 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 Reinsurance Credit Committee that meets quarterly to monitor and review the credit quality of the existing reinsurance portfolio, discuss emerging trends in the reinsurance marketplace, and ensure that the current portfolio of reinsurance is in compliance with the committee’s security standards. The committee is directly responsible for establishing the rating, collateral, and diversification requirements governing the Company’s purchase and use of reinsurance.

Approximately 95% of the Company’s reinsurance recoverable balance, net of collateral held and including voluntary and involuntary pools and associations, was placed with reinsurers rated A- or better from A.M. Best at December 31, 2007. Collateral held against outstanding gross reinsurance recoverable balances was $5.259 billion and $4.802 billion at December 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. In addition, the average net reinsurance recoverable balance from individual reinsurers rated below A- or not rated by A.M. Best was approximately $1 million as of December 31, 2007.

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

The Company is party to retroactive reinsurance arrangements where a significant portion of the consideration was retained on a "funds held" basis and interest is credited on the balance at a weighted average rate of approximately 7.7% annually. These contracts resulted in deferred gains (including experience related profit accruals of $195 million) that are amortized into income using the effective interest method over the estimated settlement periods. At December 31, 2007 and December 31, 2006, deferred gains related to these reinsurance arrangements were $786 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 year ended December 31, 2007 was $116 million as compared to $125 million for the year ended December 31, 2006. Deferred gain amortization for the year ended December 31, 2007 was $57 million as compared to $95 million for the year ended December 31, 2006. Reinsurance recoverables related to these transactions, including experience related profit accruals, were $2.222 billion and $2.258 billion as of December 31, 2007 and December 31, 2006, respectively.

Additionally, the Company has an aggregate stop loss program covering substantially all of Commercial Markets voluntary workers compensation business from the fourth quarter 2000 through the fourth quarter 2002 accident year periods. Under these contracts, losses in excess of a specified loss ratio are reinsured up to a maximum loss ratio and were accounted for as prospective reinsurance at inception. However, due to a material contract change at the January 1, 2002 renewal, any premium and loss activity subsequent to December 31, 2001 is accounted for as retroactive reinsurance for coverage provided from the fourth quarter 2000 through the fourth quarter 2001 covered accident year periods. The retroactive portion of the aggregate stop loss program is included in the preceding paragraph. Approximately $(2) million and $1 million of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2007, with additional premium of $1 million and $1 million, respectively. Approximately $45 million and $32 million of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2006, with additional premium of $29 million and $23 million, respectively. Approximately $38 million and $31 million of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2005, with additional premium of $24 million and $22 million, respectively. The income statement impact of ceding the additional losses and premium on the fourth quarter 2000 through fourth quarter 2001 covered accident year periods was deferred for GAAP purposes and is amortized into income using the effective interest method over the estimated settlement period.

In 2006, LMIC entered into multi-year property catastrophe reinsurance agreements with Mystic Re Ltd. ("Mystic Re"), a Cayman Islands domiciled reinsurer, to provide $525 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. In 2007, LMIC supplemented this reinsurance in a similar transaction with Mystic Re II Ltd. ("Mystic Re II"), a Cayman Islands domiciled reinsurer, to provide $150 million of additional reinsurance coverage for LMIC and its affiliates in the event of a Northeast and/or Florida hurricane event. The Company has not recorded any recoveries under these programs. Neither Mystic Re nor Mystic Re II has any other reinsurance in force.

Impairment Losses on Investments

The total impairment losses on investments for the three and twelve months ended December 31, 2007 were $16 million and $47 million, respectively, an increase of $10 million and a decrease of $3 million compared to the same periods 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 40 and 31 VIEs for which it is not the primary beneficiary at December 31, 2007 and 2006, respectively. The Company's investments in VIEs were $386 million and $208 million at December 31, 2007 and December 31, 2006, respectively. The Company's maximum exposure to losses from VIEs was $786 million and $481 million as of December 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 of each insurance subsidiary that has entered into derivative transactions. Pursuant to the policy, the Company may enter into derivative transactions. As of December 31, 2007 and December 31, 2006, the Company had several derivative instruments in its portfolio, which included warrants and two interest rate swaps acquired with the assets and liabilities of the Genesis life insurance business. As of December 31, 2007 and December 31, 2006, the value of these instruments was approximately ($5) million and $4 million, respectively. The decrease in value was due to the disposition of warrants and market decline. Additionally, the Company recognized approximately $7 million and $2 million in net realized investment gains through December 31, 2007 and December 31, 2006, respectively. The increase in net gains was due to proceeds earned from the disposition of the aforementioned warrants.

Deferred Acquisition Costs and Acquired In-force Policy Intangibles

Total deferred policy acquisition costs and acquired in-force policy intangibles were $1.982 billion and $1.662 billion as of December 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. Acquired in-force policy intangibles are costs associated with the acquisition of Ohio Casualty that equal the fair value of in-force insurance contracts at the date of acquisition.

Goodwill and Intangibles

Goodwill and intangible assets were $2.292 billion and $907 million at December 31, 2007 and December 31, 2006, respectively. The increase was primarily due to the acquisition of Ohio Casualty.

Deferred Income Taxes

The net deferred income tax asset was $1,469 billion and $1.490 billion as of December 31, 2007 and December 31, 2006, respectively, net of a valuation allowance of $117 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 2005 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.

On January 23, 2008, the Company received a favorable ruling from the United States District Court, District of Massachusetts, with respect to *Liberty Mutual Insurance Co. v. United States* and *Liberty Mutual Fire Ins. Co. v. United States*. These cases are a suit for refund of overpaid federal income tax for tax year 1990, based on the treatment of salvage and subrogation, in the amount of $43 million plus statutory interest related thereto. The District Court has scheduled a pretrial conference for March 20, 2008, and has ordered counsel for the parties to meet prior to that time to discuss settlement and to identify contested facts and issues that remain for trial. At this time, the Company does not know what issues and facts the government may contest or whether settlement is more likely than not.

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 2006 direct written premium. The Company also ranks 95th on the Fortune 500 list of largest corporations in the United States based on 2006 revenue. As of December 31, 2007, LMG had $94.679 billion in consolidated assets, $82.313 billion in consolidated liabilities, and $25.961 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 40,000 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.