Washington, Pennsylvania

Corpus Christi, Texas

Albufeira

BRISBANE, AUSTRALIA

Caracas, Venezuela

Minneapolis, Minnesota

Bangkok, Thailand

Albufeira, Portugal

Liberty Mutual Group

Portugal

Bangkok, Thailand

Corpus Christi, Texas

BRISBANE, AUSTRALIA

Washington, Pennsylvania

Minneapolis, Minnesota

Caracas, Venezuela

2007 Annual Report

Washington, Pennsylvania

Corpus Christi, Texas

Albufeira

Brisbane, Australia

Minneapolis, Minnesota

Caracas, Venezuela

Bangkok, Thailand

Albufeira, Portugal

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Caracas, Venezuela

Liberty Mutual Group assesses and assumes risk, and helps people and businesses prevent and manage loss. Customers' needs differ, however, depending on the situation, market conditions, location and even culture. How – and how well – we meet those needs is what differentiates us.

Contents:

EDMUND F. KELLY
CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER

In last year's Policyholder Letter, I said we expected market conditions to be increasingly competitive in 2007, but we could still achieve profitable growth. Both turned out to be true, and I'm pleased to say Liberty Mutual Group had another very successful year, with each of our businesses showing good organic growth. This is all the more gratifying since we were the only major property and casualty insurance company to show significant growth.

We only deserve to grow, however, if we take good care of our policyholders. While we're pleased that we went another year without a major hurricane hitting the mainland U.S., we did encounter several events, including the fires in Southern California, where our claims people, once again, responded to policyholder needs with a stellar performance. Our catastrophe response teams were on the ground before the smoke had cleared. We issued pre-funded debit cards for short-term living expenses and promptly settled contents losses. But rebuilding a home burned to the foundation is more than just getting a check. For many customers rebuilding will take many months, and our claims people are committed to supporting each of them every step along the way, working side-by-side to find and select architects, engineers and contractors to rebuild and get them back home. We are doing the right thing for our policyholders and setting Liberty Mutual apart from its competitors.

We can only respond in this way, and carry our company's mission forward, if we run our business on a financially solid basis. In 2007 we experienced approximately 10 percent growth in total revenue, and produced a very respectable $1.5 billion in net income. We also strengthened our balance sheet and, once again, our Investment Department produced spectacular results.

"In addition to achieving good financial results, we continued to invest and build for the future."

In addition to achieving good financial results, we continued to invest and build for the future. In the U.S., we acquired Ohio Casualty Corporation and moved rapidly to merge that operation into our Agency Markets strategic business unit. We welcome Ohio Casualty employees, agents and policyholders, and I look forward to building on that excellent franchise.

Internationally, in the first quarter of 2008 we expanded in Brazil through the acquisition of Indiana Seguros, a writer of auto insurance delivered primarily through automobile dealers. This addition of a new distribution channel significantly enhanced our market reach in a fast-growing economy.

In our green-fields operation in Poland, which uses a direct response distribution model, we issued our first auto policy in September. It is interesting that 25 percent of new business since then has been purchased entirely online.

In Vietnam, another start-up business, we were the first foreign company to be granted a full license to distribute to all segments of the economy. This reflects both the good work done by our team in Vietnam and the Vietnamese government's follow-through on its commitments to the World Trade Organization to open this market.

Looking at our domestic businesses in more detail, despite significant growth in Commercial middle-markets, we along with the industry have seen a reduction in the number of reported claims. So we reorganized the Commercial Markets claims operations that serve our middle-market customers to better balance cost and effectiveness.

In Agency Markets, over and above the acquisition and integration of Ohio Casualty, we worked hard to improve our service support to our independent agency partners. We put particular emphasis on our personal lines products, not only providing better products, but also making it much easier for our independent agents to quote, bind and issue policies. The result was growth in that segment for the first time in years.

In Personal Markets, our traditional direct personal lines operation, we continued to grow our sales force and, in an agreement that benefits both companies, we added GEICO as a distribution channel for Liberty Mutual homeowners insurance. We also were extremely pleased to be recognized for "An Outstanding Customer Service Experience" by the J.D. Power and Associates Certified Call Center Program℠.

> "In Agency Markets, over and above the acquisition and integration of Ohio Casualty, we worked hard to improve our service support to our independent agency partners."

In last year's report, I stated that the politics of natural catastrophes would occupy us, and indeed they did. In Florida, for example, we had intended to slightly reduce our homeowners exposure, and bring rates to an economically viable level. However, Florida legislative action prevented us from achieving our needed exposure and rate levels. Florida experienced no major hurricane in 2007. The state, and the insurance industry, dodged a couple of bullets: two of the strongest Atlantic hurricanes in history passed just south and hit Mexico. Had those hurricanes taken a slightly more northerly path, it would have been a very different year for Florida and the insurance industry.

The continued politicization of the insurance market in Florida, and other states as well, is unfortunate. The private market worldwide has more than enough capital to provide needed protection, and price control is a flawed economic policy. It was top-down price control in the mid-1970s that led to rapid, double-digit inflation in the U.S. economy, and today, in such countries as Venezuela and Zimbabwe, suppression of food prices in the hope of increasing affordability has resulted in empty shelves. That is exactly what is going on in the catastrophe-prone areas of the U.S. Suppressing the prices the industry can charge has led to a shortfall in insurance capacity.

This debate will occupy us for some time. Unfortunately, some in our industry have allowed themselves to become overexposed in catastrophe-prone areas, and they feel compelled to invite the federal government into the market to bail them out. We believe strongly that neither the industry, its policyholders nor taxpayers would benefit from such involvement over the long haul.

Not all was negative on the political front. Congress passed and President Bush signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007, our top legislative priority in 2007. TRIA provides a high-level federal backstop that makes it possible for our company and industry to safely offer coverage for terrorist events.

> "Congress passed and President Bush signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007, our top legislative priority in 2007."

As we enter 2008, the general business climate is, of course, quite negative. The reverberations of the subprime debacle and the ensuing constriction in credit availability have the potential for dampening economic growth, if not causing a recession.

The lower interest rates in response to the crisis will in fact increase the nominal cost of insurance as investment income will be lower. Too much capital, very low interest rates and a slowing economy mean we must manage the business very carefully in 2008 to make sure we underwrite and renew the right business at the right price. The specter of inflation, as lower interest rates weaken the dollar, makes the management task more complex. I'm confident that we have the people and tools to do this.

In closing, I want to thank our policyholders for their business, our agents and other business partners for their support, and our employees for their great efforts. As always, a special thanks goes to our Board of Directors for their support, advice and governance.

"Too much capital, very low interest rates and a slowing economy mean we must manage the business very carefully in 2008 to make sure we underwrite and renew the right business at the right price."

While price is important, it is only one component of our competitive package. We continue to improve our customer service throughout our organization. As but one example, the movement of our offices to the Voice-Over Internet Protocol telephone system has greatly enhanced our ability to provide local service backed up by a national response network. In fact, our significant information systems development budget recognizes that our policyholders, agency partners and all with whom we deal have increased service-level expectations from all businesses. We gladly accept the challenge of improving service to win new business and maintain the loyalty of existing customers.

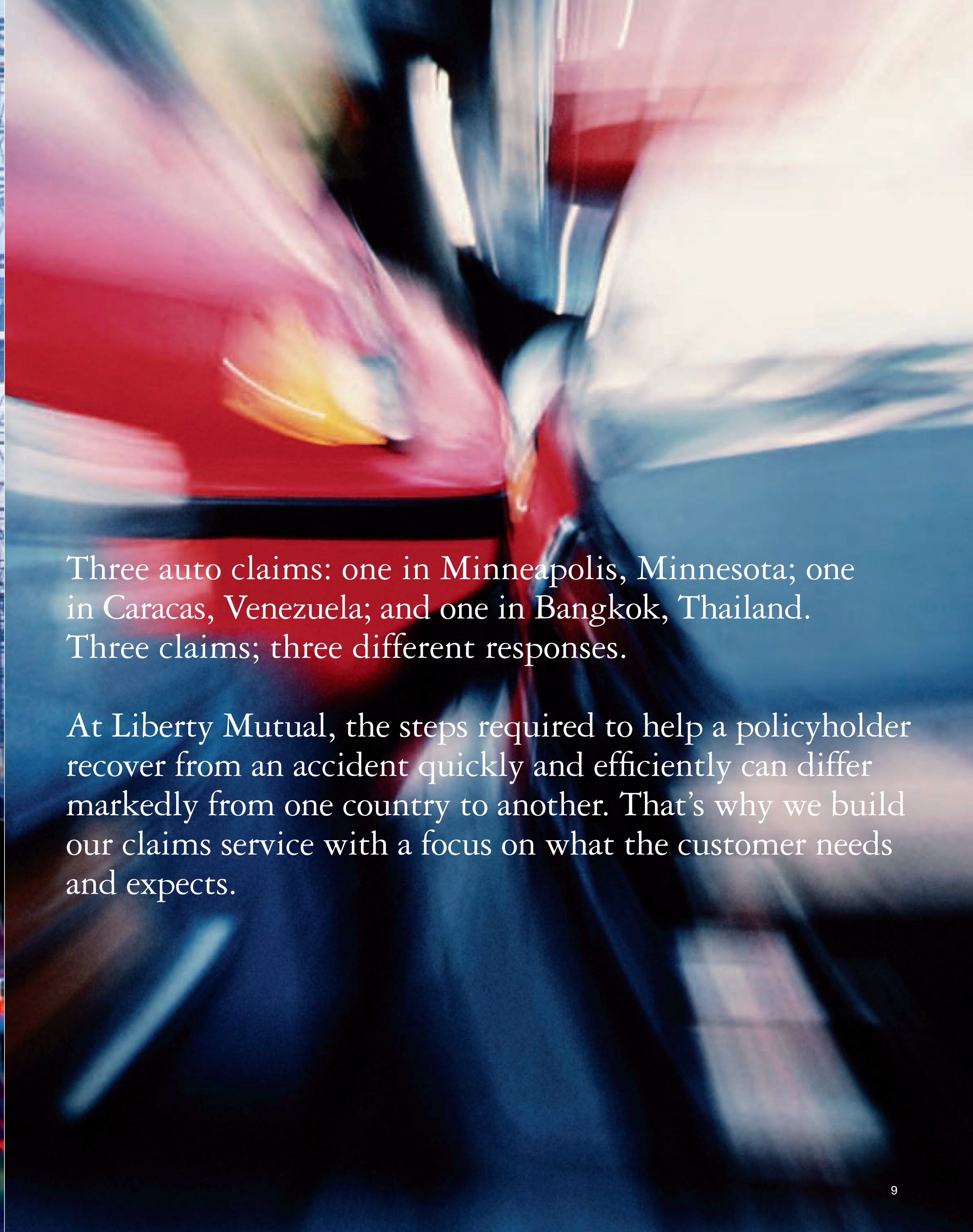
It is with some sadness that we say goodbye to Directors Paul Darling, who's been on the Board for eighteen years, and Ken Rose, who's been with us for nine years. We will miss them both. Their insights, advice and guidance have helped us immeasurably in our significant success. We wish Paul and his wife Joanne, and Ken and his wife Micki, all the best.

Edmund F. Kelly

EDMUND F. KELLY
CHAIRMAN, PRESIDENT AND
CHIEF EXECUTIVE OFFICER

In order to produce the very best outcomes for our customers, our people and processes adjust to subtle, and not-so-subtle, differences in markets and locations within the U.S. and worldwide. Different service expectations, and different cultures and local conditions, can require unique solutions. But whether in Minneapolis or Brisbane, what drives us is a desire to treat our customers fairly, handle their claims quickly and appropriately, and shape our products and services to benefit them over the long term.

Different cultures. Same outcomes.



Three auto claims: one in Minneapolis, Minnesota; one in Caracas, Venezuela; and one in Bangkok, Thailand. Three claims; three different responses.

At Liberty Mutual, the steps required to help a policyholder recover from an accident quickly and efficiently can differ markedly from one country to another. That's why we build our claims service with a focus on what the customer needs and expects.

Keeping customers informed. Getting them back on the road quickly. Ensuring quality repairs. To successfully address these claims fundamentals, we must adapt from one country to another, depending on cultural nuances, market conditions and customer expectations.

Venezuela

In Venezuela, where car ownership is a point of pride, the number of vehicles on the road exploded from 2.0 million in 2000 to 2.8 million in 2007, a 40 percent increase in only seven years.

When an accident occurs, Venezuelans judge their insurer on the quality and speed of repairs, which we know can vary greatly depending on the appraiser's experience, how well the insurer knows and manages its body shops and the availability of spare parts. Seguros Caracas de Liberty Mutual (SCLM) distinguishes itself in all three areas.

Whether we receive a claim by phone or a visit to one of 38 SCLM offices, we ask the policyholder to select a body shop from among more than 400 repair facilities in the Liberty network, 18 of which handle Liberty claims exclusively. We then appraise the damage, either at the body shop or our office, and submit the claim within minutes using a hand-held device.

SCLM's two Liberty Express facilities handle minor repairs. But when repairs are more substantial, our agreements with the country's largest spare part suppliers ensure fast, high-quality repair work that otherwise might take months.

In the event a car is stolen, a major problem in Venezuela, we ensure its quick recovery by tracking its location with an electronic vehicle locator device installed in certain vehicles. Finding, rather than replacing, a stolen car is critical in a country with a monthly inflation rate exceeding 2.5 percent.

Expert claims handling is one reason SCLM is the largest insurer in Venezuela.

United States

Speed of claim resolution and constant communication are key differentiators among auto insurers in the U.S. How quickly and fairly we resolve claims, and communicate progress along the way, are often the factors that determine whether a customer stays with us for the long term.

Stacy Pike's experience backs this up. Returning to her car from an evening out in Minneapolis, she found it vandalized, with minor damage to the car itself but $2,000 worth of items stolen, including a GPS device, laptop computer and coat. When she phoned her claim into the Liberty Mutual Call Center, that call triggered a series of communications that kept her informed.

The call center representative explained the next steps in the claims process and, while on the phone, scheduled an appraisal at a Total Liberty Care (TLC) car repair shop. After confirming the appointment, Liberty contacted Stacy again to review the appraisal, and handle any questions or concerns.

Communication with Stacy continued with another progress call, and a final follow-up call to gauge her thoughts on the claim experience. Backing up each call were easy-to-understand emails starting with contact information and concluding with a short, customer satisfaction survey.

"In a day of electronic voice messaging and email, you excel in customer service," Stacy said. "You deserve more than a pat-on-the-back for a job well done."

Thailand

In Bangkok, you will find motorcycles, cars and occasionally 12-wheel trucks maneuvering against traffic, or one-way roads that reverse direction depending on the time of day. In this somewhat chaotic environment, most auto claims are adjusted at the scene of the accident, so it's important our claims professionals get there quickly.

When you call our Thai company's call center, which processes 10,000 auto claims a month, they take down the accident information and pinpoint your location on digital maps – in or outside Bangkok.

Once located, and using the Global Positioning System, the call center sends the customer's information – name, policy number, accident details – to the hand-held device of the mobile adjuster closest to the accident. Riding a motor scooter, the adjuster quickly arrives on the scene, checks the damage, takes photos and prints out a claim acknowledgement. He then transmits the signed claim form back to the call center.

By being the first on the scene, and equipped with hand-held communication devices, mobile printers and digital cameras, our adjusters dramatically reduce waiting, communication and repair time, which explains why LMG Insurance is quickly positioning itself as the leader in claims service.

Different risks. Same ingenuity.

They're both huge, high-dollar construction projects. They both involve numerous contractors and subcontractors, tight schedules and the very real risk of something going wrong. But these two projects, one in Texas, the other in Australia, bring distinct risk management challenges as well.

A Gulf Coast refinery posed an interesting challenge – insurance coverage for as many as 200 outside contractors for a limited amount of time. Halfway around the world, a highway construction project in Australia required coverage for the principal, civil engineers and contractors. In both instances, it's our expertise and local knowledge that overcame these particular challenges.

The Ipswich Motorway

The $700 million upgrade to the Ipswich Motorway in Queensland, Australia, which includes an expansion from four to six lanes, a transformation of the current roundabout to a multi-level system interchange and provision for a new rail line, is much needed. The original highway network joining Brisbane with the western cities of Ipswich, Toowoomba, Gatton and Warwick, has seen its traffic volume, and accident rate, increase dramatically due to explosive residential and industrial growth.

For major public works projects such as this, Australia has a unique and innovative approach to construction from a contracting perspective, including 'no fault, no blame' agreements such as "alliancing". With an alliance, non-traditional contracting principals are placed on parties involved (including the principal, major contractors and consultants) to develop a team approach and eliminate disputes.

For this project specifically, the SAFElink Alliance, which includes the Queensland Department of Main Roads, a Liberty International Underwriters (LIU) customer since 2003, as well as civil engineers and contractors, turned to their broker Aon and LIU to work closely together to structure tailored insurance coverage that combines contractor general liability and professional indemnity coverage specific to the needs of the Alliance's contractual relationships.

"Arrangements like this don't exist in the U.S.," said Brisbane-based LIU Underwriter Peter O'Leary, "and it demonstrates our willingness to address the unique relationship among the State of Queensland and its contractors."

Flint Hills Resources

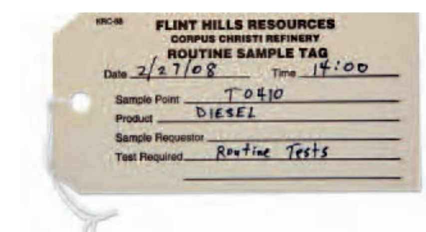
Most construction projects have a beginning and an end. Work complete, the contracted workers move on to their next job. And there's the rub. How, when a contracted worker reports an injury, do the project owner and insurer know the incident didn't occur on an earlier, unrelated job?

This is a particular concern for refineries, such as Liberty Mutual Commercial Markets customer Flint Hills Resources, LP (FHR), which operates refineries in Alaska, Minnesota and Texas with a combined crude oil processing capacity exceeding 800,000 barrels per day. Unlike building or highway construction, a refinery, such as FHR's 1,800-acre facility in Corpus Christi, Texas, is constantly updating and replacing equipment and systems.

While the goal for both FHR and Liberty Mutual is always an injury-free workplace, accidents can happen. This is particularly true during a "turnaround," when as many as 1,500 contracted workers are onsite working 24 hours a day installing replacement systems or equipment to maintain existing processes. Each day, FHR may have as many as 200 contractors engaged at one time, and thus turns to Liberty Mutual to provide an Owner-Controlled Insurance Program (OCIP), which combines all contractors under the same master coverage.

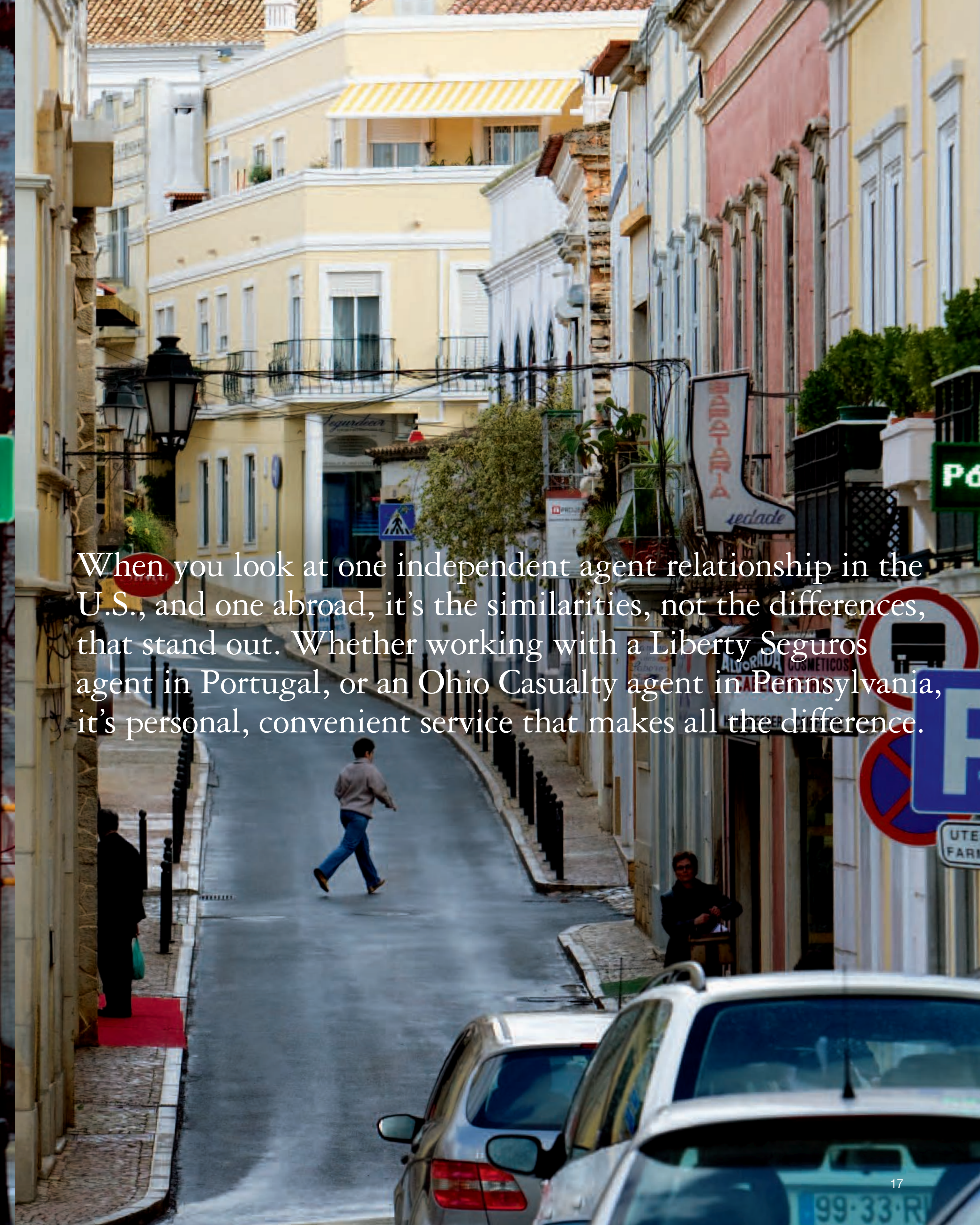
Should an enrolled worker report an on-the-job injury, FHR and Liberty Mutual's OCIP claims team work to ensure the injured employee receives immediate medical attention, while verifying the date, time and location of the accident. The focus then shifts to getting the worker back on the job as soon as possible.

This combined effort, along with Liberty Mutual's and FHR's relentless focus on workplace safety, represents the best in risk management programs.



Different countries. Same relationships.

When you look at one independent agent relationship in the U.S., and one abroad, it's the similarities, not the differences, that stand out. Whether working with a Liberty Seguros agent in Portugal, or an Ohio Casualty agent in Pennsylvania, it's personal, convenient service that makes all the difference.



It's all about relationships. For an owner of a $2 million independent agency in suburban Pittsburgh, access to an insurer's decision makers can make or break a relationship. Across the Atlantic Ocean in southernmost Portugal, it's a strong tie with their sales rep, but it's also service that has a husband-and-wife agency sold on Liberty Seguros.

Jim Cote – Pennsylvania

Price isn't everything. Just ask Jim Cote, co-owner of the B&W Insurance Agency in Washington, Pa., just outside Pittsburgh. B&W has served Southwestern Pennsylvania for more than 35 years, and in the last five years boosted its revenues from $300,000 to $2 million.

Jim attributes much of his agency's success to his relationship with Ohio Casualty, a Liberty Mutual Agency Markets company and, most important, the access Ohio Casualty provides to key decision makers. "They may not always have the lowest price but, with Ohio Casualty, I know I can reach the people who make things happen, even if that means being more flexible with the company's underwriting guidelines," Jim said. "That means everything in this business."

Jim recalls a particular instance when he asked Ohio Casualty to quote on a large electrical contractor. "My contact at Ohio Casualty expressed some concern about the size and scope of the contractor, not to mention the liability, and bumped the request up to Craig Ceasar, whom I've known for 13 years," he said.

Knowing the request came from B&W, Craig, a regional manager, didn't just review the paperwork, he met with the potential customer's owners. "I was so impressed with their safety procedures that we incorporated some of them into our own loss prevention offerings," Craig said. Needless to say, Ohio Casualty approved the business.

Analidio and Dória Ponte – Portugal

Analidio and Dória Ponte live and breathe insurance. Not surprising when you consider they've been married for 21 years and, working together for the past 15, have an insurance agency in Albufeira, Portugal, a fast-growing resort town on the country's south coast.

The Pontes appreciate a close personal working relationship with their insurer, but having a convenient Liberty Seguros office helps as well. That's why Liberty, which entered the Portuguese insurance market in 2003, added or upgraded more than 30 branch offices throughout the country. "The easier you are to work with, the more likely an agent will place business with you," said Pola Alturas, their Liberty Seguros sales representative and 25-year insurance veteran.

"There's a different mentality when you deal with Liberty Seguros," said Analidio, who has seen his agency's commercial business increase five-fold since associating with Liberty Seguros. "Whether I call the home office in Lisbon, or visit their local office in Faro, I know I'll get a prompt response."

Such was the case when a visiting Liberty Seguros personal lines policyholder, whose agent was in Lisbon, saw the Pontes' Liberty Seguros office logo and dropped by with an urgent request for proof of insurance. "You're in the right place; I can help you," said Analidio, knowing a quick call to the nearby Faro office would resolve the matter, which it did. Since then, the policyholder opened a business in Albufeira, and placed his commercial insurance with Liberty Seguros.

(DOLLARS IN MILLIONS) DECEMBER 31	2007	2006	2005
Liberty Mutual Group			
Revenues	25,961	23,520	21,161
PTOI	1,762	1,915	607
Net income	1,518	1,626	1,027
Cash flow from operations	4,042	3,895	3,706
Total assets	94,679	85,498	78,824
GAAP combined ratio	100.3%	99.3%	105.7%
Personal Markets			
Revenues	5,829	5,602	5,435
PTOI	744	696	529
Cash flow from operations	720	789	495
Total assets	10,616	10,848	10,278
GAAP combined ratio	92.0%	92.1%	94.7%
Commercial Markets			
Revenues	6,489	6,075	5,619
PTOI	472	335	226
Cash flow from operations	1,661	1,455	1,001
Total assets	28,353	27,487	26,912
GAAP combined ratio	103.5%	104.8%	107.2%
Agency Markets			
Revenues	5,569	4,841	4,548
PTOI	834	497	429
Cash flow from operations	1,183	1,157	1,134
Total assets	18,683	11,152	9,913
GAAP combined ratio	92.4%	96.5%	97.2%
International			
Revenues	6,148	4,890	3,903
PTOI	478	457	(249)
Cash flow from operations	1,269	838	962
Total assets	18,735	17,687	14,515
GAAP combined ratio	99.7%	97.2%	117.0%
Other*			
Revenues	1,926	2,112	1,656
PTOI	(766)	(70)	(328)
Cash flow from operations	(791)	(344)	114

* Other includes Individual Life, discontinued operations (including asbestos and environmental), interest expense, internal reinsurance programs, net investment income after allocations to business units, certain expenses not allocated to the business units, net realized gains and losses from domestic operations, other revenues from corporate subsidiaries, and federal and foreign tax payments.

Liberty Mutual Group results include all significant business units of Liberty Mutual. Each business unit is reported in accordance with generally accepted accounting principles.

Liberty Mutual Group is a diversified global insurer whose largest line of business is private passenger auto, based on 2007 net written premium.

On December 31, 2007, Liberty Mutual Group had $94.7 billion in consolidated assets and approximately $26.0 billion in consolidated revenue. Liberty Mutual ranks 95th on the Fortune 500 list of largest U.S. corporations based on 2006 revenue, and is the sixth-largest property and casualty insurer in the U.S. based on 2006 direct written premium.

Headquartered in Boston, Liberty Mutual Group employs approximately 41,000 people in more than 900 offices throughout the world.

Liberty Mutual Group has four strategic business units – Personal Markets, Commercial Markets, Agency Markets and Liberty International – with no single unit contributing more than 25 percent of net premium written.

The company offers a wide range of insurance products and services, including private passenger automobile, home-owners, workers compensation, commercial multiple peril/fire, commercial automobile, general liability, global specialty products, group disability and surety.

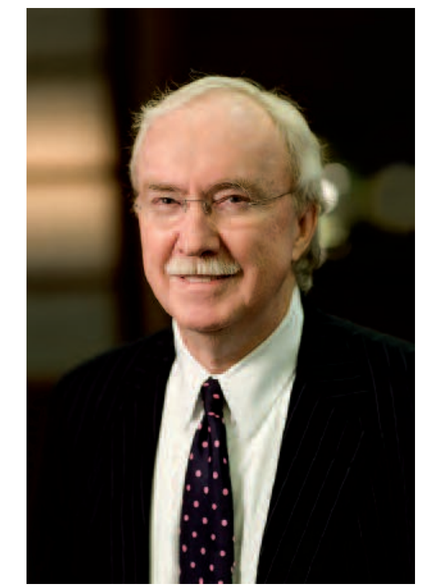
Liberty Mutual Group revenues for 2007 were approximately $26.0 billion, a 10.4 percent increase over 2006. Net investment income was approximately $2.9 billion, a 13.2 percent increase over 2006, on cash flow from operations of $4.0 billion. Pre-tax operating income for 2007 was $1.8 billion, a decrease of 8 percent from 2006. The Group's property and casualty combined ratio increased to 100.3 percent in 2007 from 99.3 percent in 2006, and policyholders' equity increased by $1.5 billion to $12.4 billion.

J. PAUL CONDRIN, III, PRESIDENT
PERSONAL MARKETS

GARY R. GREGG, PRESIDENT
AGENCY MARKETS

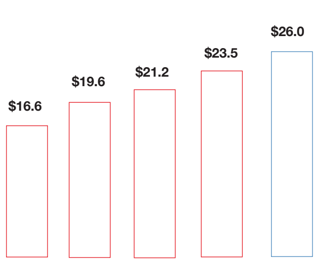
DAVID H. LONG, PRESIDENT
COMMERCIAL MARKETS

THOMAS C. RAMEY, CHAIRMAN AND PRESIDENT
LIBERTY INTERNATIONAL

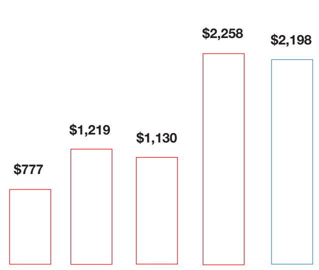


A. ALEXANDER FONTANES, EXECUTIVE VICE PRESIDENT AND CHIEF INVESTMENT OFFICER

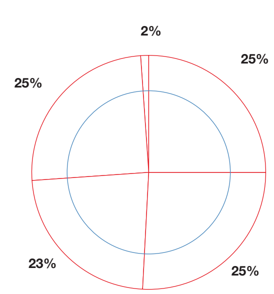
REVENUES
IN BILLIONS



PRE-TAX INCOME FROM CONTINUING OPERATIONS
IN MILLIONS

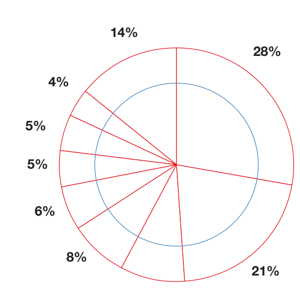


STRATEGIC BUSINESS UNITS
$22.5 B NET WRITTEN PREMIUM



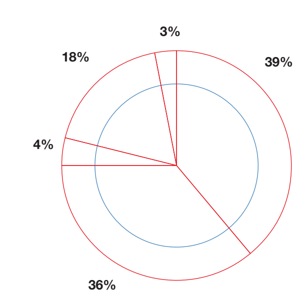
INTERNATIONAL 25%
PERSONAL MARKETS 25%
AGENCY MARKETS 23%
COMMERCIAL MARKETS 25%
OTHER 2%

SIGNIFICANT LINES OF BUSINESS
$22.5 B NET WRITTEN PREMIUM



PRIVATE PASSENGER AUTOMOBILE 28%
WORKERS COMPENSATION 21%
HOMEOWNERS 9%
COMMERCIAL MULTI-PERIL/FIRE 8%
INTERNATIONAL LOCAL BUSINESS 6%
COMMERCIAL AUTOMOBILE 5%
LIU REINSURANCE 5%
GENERAL LIABILITY 4%
OTHER 14%

DIVERSIFICATION BY DISTRIBUTION CHANNEL
BASED ON DIRECT WRITTEN PREMIUM



DIRECT SALES FORCE 39%
INDEPENDENT AGENTS 36%
EXCLUSIVE AGENTS 4%
BROKERS 18%
OTHER 3%

Liberty Mutual's Personal Markets provides full lines of coverage for private passenger automobile, homeowners, valuable possessions and personal liability through its own sales force in more than 350 offices throughout the U.S., two direct response centers, appointed third-party producers and the internet. It also offers a wide range of traditional and variable life insurance and annuity products. Personal Markets' largest source of new business is its more than 10,800 sponsored affinity group relationships, including employers, credit unions, and professional and alumni associations. Liberty Mutual's affinity program is the industry's most-sponsored voluntary auto and home insurance benefit.

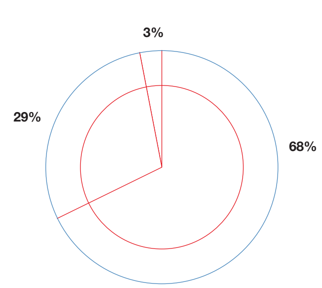
Distribution
- Direct Sales Force
- Telesales Centers
- Internet
- Third-Party Producers

By The Numbers
- ninth-largest writer of personal lines insurance in the U.S.
- 4.6 million auto and home policies
- 10,800 affinity relationships
- 1,730 field sales representatives
- 450 telesales counselors
- 10,650 employees

FINANCIAL RESULTS

	2007	2006	2005
Revenues	$5.8 B	$5.6 B	$5.4 B
Pre-tax operating income	$744 M	$696 M	$529 M
Cash flow from operations	$720 M	$789 M	$495 M
GAAP combined ratio	92.0%	92.1%	94.7%
Policies in force	4,961,751	4,812,921	4,670,548

PRODUCT MIX
% 2007 NET WRITTEN PREMIUM



PRIVATE PASSENGER AUTOMOBILE 68%
HOMEOWNERS 29%
OTHER 3%

Liberty Mutual Agency Markets' property, casualty and specialty insurance carriers distribute their products through independent agents and brokers. Core property and casualty products, including a comprehensive set of personal and commercial coverages, are available from the following regional companies:

- America First Insurance™ (Gulf Region)
- Colorado Casualty™ (Mountain Region)
- Golden Eagle Insurance™ (Pacific Region)
- Indiana Insurance™ (Midwest Region)
- Liberty Northwest® (Pacific Northwest Region)
- Montgomery Insurance™ (Southeast Region)
- Ohio Casualty™ (Mideast Region)
- Peerless Insurance™ (Northeast Region)

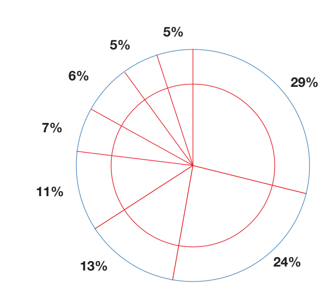
Specialty Operations include:
- Summit (workers compensation)
- Specialty Products Group
  - Liberty Mutual Surety™
  - Liberty Agency Underwriters

By The Numbers
- 14,000 independent agencies
- 936,000 personal lines and 514,000 commercial lines regional company policies in force with average premiums of $900 and $5,700, respectively
- 27,000 Summit policies in force with average premiums of $31,000
- fifth-largest U.S. surety operation
- 7,000 employees

FINANCIAL RESULTS

	2007	2006	2005
Revenues	$5.6 B	$4.8 B	$4.5 B
Pre-tax operating income	$834 M	$497 M	$429 M
Cash flow from operations	$1.2 B	$1.2 B	$1.1 B
GAAP combined ratio	92.4%	96.5%	97.2%

PRODUCT MIX
% 2007 NET WRITTEN PREMIUM



WORKERS COMPENSATION 29%
COMMERCIAL MULTI-PERIL 24%
COMMERCIAL AUTOMOBILE 13%
PERSONAL AUTOMOBILE 11%
HOMEOWNERS 7%
SURETY 6%
GENERAL LIABILITY 5%
OTHER 5%

Liberty Mutual's Commercial Markets provides mid-sized and large companies with high-quality insurance products and services through six business units:

National Market, which serves the complex needs of large companies through brokers and a direct sales force;

Business Market, which serves middle-market businesses that prefer a direct relationship;

Wausau Insurance Companies, which serves middle-market businesses through agents and brokers;

Liberty Mutual Property, which provides property insurance to middle-market businesses through brokers and a direct sales force;

Liberty Mutual Reinsurance, which provides reinsurance to insurance companies in the U.S. and other countries; and,

Group Market, which provides group disability and life products and services to middle-market and large companies through employee benefits brokers and consultants.

Distribution Channels

- National and Regional Brokers
- Agents
- Employee Benefits Brokers and Consultants
- Direct Sales Force

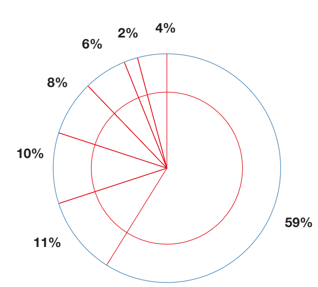
By The Numbers

- eighth-largest commercial lines writer in the U.S. based on 2006 direct written premium
- 638,000 claims call center calls
- 22,800 customers
- 180 offices
- $1.4 billion in medical bill review savings in 2007
- 10,350 employees

FINANCIAL RESULTS

	2007	2006	2005
Revenues	$6.5 B	$6.1 B	$5.6 B
Pre-tax operating income	$472 M	$335 M	$226 M
Cash flow from operations	$1.7 B	$1.5 B	$1.0 B
GAAP combined ratio	103.5%	104.8%	107.2%

PRODUCT MIX
% 2007 NET WRITTEN PREMIUM



- WORKERS COMPENSATION 59%
- GENERAL LIABILITY 11%
- COMMERCIAL AUTOMOBILE 10%
- GROUP DISABILITY AND LIFE 8%
- COMMERCIAL MULTI-PERIL AND FIRE 6%
- ASSUMED REINSURANCE 2%
- OTHER LINES 4%

Liberty International provides personal and small commercial lines insurance through operations in 14 countries. Liberty International Underwriters, a global specialty commercial lines insurance and reinsurance business, writes a variety of products including casualty, specialty casualty, marine, energy, engineering, construction and aviation through 36 offices worldwide. Liberty Syndicate 4472 at Lloyd's of London writes on a global basis.

Country Operations 58 PERCENT OF INTERNATIONAL NET WRITTEN PREMIUM

Asia

Liberty Insurance Company Ltd. (China)
Liberty International HK Ltd. (Hong Kong)
Liberty Insurance Pte. Ltd. (Singapore)
LMG Insurance Co., Ltd. (Thailand)
Liberty Insurance Limited (Vietnam)

Europe

Liberty Direct (Poland)
Liberty Seguros S.A. (Portugal)
Liberty Seguros Compania de Seguros y Reaseguros, S.A. (Spain)
Genesis Seguros Generales S.A. (Spain)
Liberty Sigorta, A.S. (Turkey)

Latin America

Liberty ART S.A. (Argentina)
Liberty Seguros Argentina S.A.
Liberty Seguros (Brazil)
Liberty Compania de Seguros Generales S.A. (Chile)
Liberty Seguros, S.A. (Colombia)
Seguros Caracas de Liberty Mutual C.A. (Venezuela)

Liberty International Underwriters (LIU) 42 PERCENT OF INTERNATIONAL NET WRITTEN PREMIUM

Liberty Syndicate Management
Liberty Mutual Insurance Europe
LIU Australia
LIU Canada

LIU CONTINUED

LIU Hong Kong
LIU Singapore
LIU U.A.E.
LIU U.S.

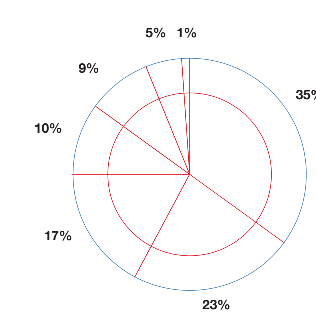
By The Numbers

- second-largest U.S.-based international property and casualty insurance company
- offices in 24 countries
- net written premium grew 23 percent in 2007 with a compound annual growth rate of 19 percent since 1998
- 7,700 employees

FINANCIAL RESULTS

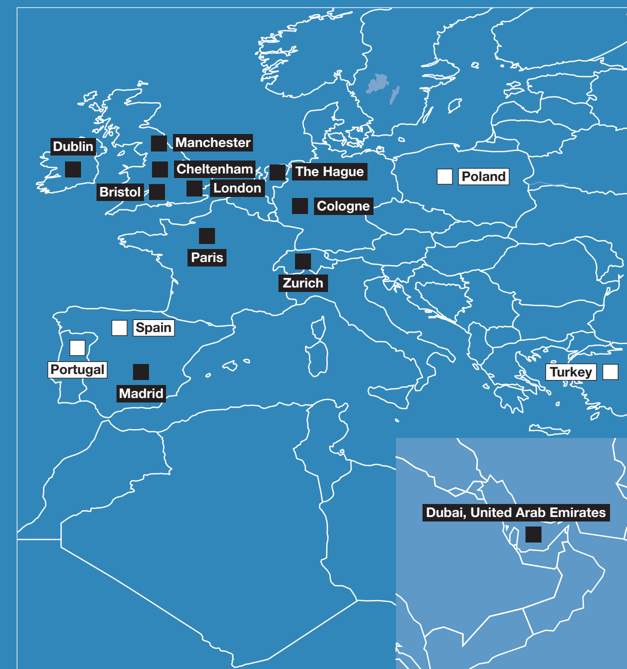
	2007	2006	2005
Revenues	$6.1 B	$4.9 B	$3.9 B
Pre-tax operating income	$478 M	$457 M	$(249) M
Cash flow from operations	$1.3 B	$838 M	$962 M
GAAP combined ratio	99.7%	97.2%	117.0%

PRODUCT MIX
% 2007 NET WRITTEN PREMIUM



LOCAL BUSINESS
- PRIVATE PASSENGER AUTOMOBILE 35%
- ALL OTHER 23%

- LIU REINSURANCE 17%
- LIU INLAND MARINE PROGRAM 10%
- LIU THIRD PARTY 9%
- LIU FIRST PARTY 5%
- LIU OTHER 1%



■ Liberty International Underwriters offices
□ Local Companies: Personal Lines, Small Commercial
● Headquarters

CONSOLIDATED STATEMENTS OF INCOME

LIBERTY MUTUAL HOLDING COMPANY INC.

(DOLLARS IN MILLIONS)

YEARS ENDED DECEMBER 31,	2007	2006	2005
Revenues			
Premiums earned	**$ 21,887**	$ 19,794	$ 17,580
Net investment income	**2,885**	2,548	2,247
Net realized investment gains	**436**	343	523
Fee and other revenues	**753**	835	811
Total revenues	**25,961**	23,520	21,161
Claims, Benefits and Expenses			
Benefits, claims and claim adjustment expenses	**16,092**	14,609	14,272
Insurance operating costs and expenses	**3,856**	3,425	2,912
Amortization of deferred policy acquisition costs	**3,297**	2,827	2,480
Interest expense	**320**	212	184
Interest credited to policyholders	**198**	189	183
Total claims, benefits and expenses	**23,763**	21,262	20,031
Income from continuing operations before income tax expense	**2,198**	2,258	1,130
Income tax expense	**680**	632	91
Income from continuing operations	**1,518**	1,626	1,039
Discontinued operations, net of tax	**—**	—	(12)
Net income	**$ 1,518**	$ 1,626	$ 1,027

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED BALANCE SHEETS

LIBERTY MUTUAL HOLDING COMPANY INC.

(DOLLARS IN MILLIONS)

DECEMBER 31,	2007	2006
Assets:		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost of $46,848 and $40,981)	**$ 46,934**	$ 41,102
Equity securities, available for sale, at fair value (cost of $2,418 and $1,664)	**3,285**	2,619
Trading securities, at fair value (cost of $16 and $14)	**16**	22
Short-term investments	**764**	1,550
Mortgage loans	**657**	322
Other investments	**2,348**	1,646
Total investments	**54,004**	47,261
Cash and cash equivalents	**3,199**	3,512
Premium and other receivables (net of allowance of $99 and $101)	**6,491**	6,075
Reinsurance recoverables (net of allowance of $331 and $315)	**15,518**	15,564
Deferred tax assets (net of valuation allowance of $117 and $101)	**1,469**	1,490
Deferred acquisition costs and acquired in-force policy intangibles	**1,982**	1,662
Goodwill and other intangible assets	**2,292**	907
Prepaid reinsurance premiums	**1,180**	1,230
Separate account assets	**3,431**	3,049
Other assets	**5,113**	4,748
Total assets	**$ 94,679**	$ 85,498
Liabilities:		
Unpaid claims and claim adjustment expenses and future policy benefits:		
Property and casualty	**$ 42,992**	$ 38,606
Life	**6,063**	5,591
Other policyholder funds and benefits payable	**2,818**	2,658
Unearned premiums	**10,562**	9,343
Funds held under reinsurance treaties	**1,941**	1,823
Short-term debt	**91**	171
Long-term debt	**4,360**	3,175
Separate account liabilities	**3,431**	3,049
Other liabilities	**10,055**	10,187
Total liabilities	**82,313**	74,603
Policyholders' equity:		
Unassigned equity	**11,621**	10,092
Accumulated other comprehensive income	**745**	803
Total policyholders' equity	**12,366**	10,895
Total liabilities and policyholders' equity	**$ 94,679**	$ 85,498

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF CASH FLOWS

LIBERTY MUTUAL HOLDING COMPANY INC.

(DOLLARS IN MILLIONS)

YEARS ENDED DECEMBER 31,	2007	2006	2005
Cash flows from operating activities:			
Net income from continuing operations	**$ 1,518**	$ 1,626	$ 1,039
Adjustments to reconcile net income to net cash provided by operating activities, net of effects from purchases of companies:			
Depreciation and amortization	**260**	238	217
Realized investment gains	**(436)**	(343)	(523)
Undistributed private equity investment gains	**(324)**	(275)	(208)
Premium, other receivables, and reinsurance recoverables	**781**	669	(2,545)
Deferred policy acquisition costs	**(122)**	(154)	(144)
Liabilities for insurance reserves	**2,151**	1,865	5,153
Taxes payable, net of deferred	**123**	169	(195)
Other, net	**91**	100	912
Total adjustments	**2,524**	2,269	2,667
Net cash provided by operating activities	**4,042**	3,895	3,706
Cash flows from investing activities:			
Purchases of investments	**(19,719)**	(20,952)	(20,273)
Sales and maturities of investments	**18,405**	16,508	16,955
Property and equipment purchased, net	**(259)**	(762)	(306)
Payment for purchase of companies, net of cash acquired	**(2,700)**	(48)	(28)
Other investing activities	**(403)**	317	(143)
Net cash used in investing activities	**(4,676)**	(4,937)	(3,795)
Cash flows from financing activities:			
Net activity in policyholder accounts	**34**	69	20
Debt financing, net	**889**	646	373
Net security lending activity and other financing activities	**(602)**	684	297
Net cash provided by financing activities	**321**	1,399	690
Net cash used in discontinued operations, principally operating activities	**–**	–	(36)
Net (decrease) increase in cash and cash equivalents	**(313)**	357	565
Cash and cash equivalents, beginning of year	**3,512**	3,155	2,590
Cash and cash equivalents, end of year	**$ 3,199**	$ 3,512	$ 3,155
Supplemental disclosure of cash flow information:			
Income taxes paid	**$ 563**	$ 496	$ 264

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF CHANGES IN POLICYHOLDERS' EQUITY

LIBERTY MUTUAL HOLDING COMPANY INC.

(DOLLARS IN MILLIONS)

	UNASSIGNED EQUITY	ACCUMULATED OTHER COMPREHENSIVE INCOME	POLICYHOLDERS' EQUITY
Balance, January 1, 2005	$ 7,439	$ 1,258	$ 8,697
Comprehensive income			
Net income	1,027	–	1,027
Other comprehensive loss, net of taxes:			
Unrealized losses on securities	–	(171)	(171)
Less: reclassification adjustment for gains and losses included in net income	–	(340)	(340)
Minimum pension liability adjustment	–	(306)	(306)
Foreign currency translation adjustments	–	(49)	(49)
Other comprehensive loss, net of taxes	–	(866)	(866)
Total comprehensive income			161
Balance, December 31, 2005	$ 8,466	$ 392	$ 8,858
Comprehensive income			
Net income	1,626	–	1,626
Other comprehensive income, net of taxes:			
Unrealized gains on securities	–	211	211
Less: reclassification adjustment for gains and losses included in net income	–	(223)	(223)
Minimum pension liability adjustment	–	312	312
Foreign currency translation adjustments	–	111	111
Other comprehensive income, net of taxes	–	411	411
Total comprehensive income			2,037
Balance, December 31, 2006	$ 10,092	$ 803	$ 10,895
Adjustment for adoption of FIN 48 (Note 1)	**11**	**–**	**11**
Comprehensive income			
Net income	**1,518**	**–**	**1,518**
Other comprehensive income, net of taxes:			
Unrealized gains on securities	**–**	**213**	**213**
Less: reclassification adjustment for gains and losses included in net income	**–**	**(283)**	**(283)**
Minimum pension liability adjustment	**–**	**23**	**23**
Foreign currency translation adjustments	**–**	**277**	**277**
Other comprehensive income, net of taxes	**–**	**230**	**230**
Total comprehensive income			**1,748**
Adjustment for adoption of FAS 158 (Note 1)	**–**	**(288)**	**(288)**
Balance, December 31, 2007	**$ 11,621**	**$ 745**	**$ 12,366**

SEE ACCOMPANYING NOTES TO THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc. and its subsidiaries (collectively "LMHC" or the "Company"). Certain reclassifications have been made to the 2006 and 2005 consolidated financial statements to conform with the 2007 presentation. All material intercompany transactions and balances have been eliminated.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management 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 (1) unpaid losses and loss expense reserves, including asbestos and environmental reserves and associated reinsurance recoverables and loss sensitive premiums receivable; (2) allowance for uncollectible reinsurance and policyholder receivables; (3) fair value determination and other than temporary impairments of the investment portfolio; (4) deferred acquisition costs; (5) the valuation of goodwill and intangible assets; and (6) valuation allowance on deferred taxes. While management believes that the amounts included in the consolidated financial statements reflect their best estimates and assumptions, these amounts ultimately could be materially different from the amounts currently provided for in the consolidated financial statements.

Nature of Operations

The Company conducts substantially all of its business through four strategic business units: Personal Markets, Commercial Markets, Agency Markets and International.

The Company's Personal Markets business unit, with $5,829 of revenues in 2007, writes property and casualty insurance covering personal risks, primarily personal automobile and homeowners.

The Commercial Markets business unit, with $6,489 of revenues in 2007, is organized into separate marketing and underwriting groups, each of which focuses on a particular customer base, product grouping, or distribution channel to provide tailored products and services that specifically address customers' needs. The Commercial Markets business unit includes National Market, Business Market, Wausau Insurance, Liberty Mutual Property, Group Market, and Other Markets. Other Markets include Liberty Mutual Reinsurance and state-mandated involuntary market workers compensation and automobile assigned risk plans. The Commercial Markets coverages include workers compensation, commercial automobile, general liability, including product liability, multiple peril, group disability and life insurance, property, and a variety of other coverages. Commercial Markets is also a servicing carrier for workers compensation and commercial automobile involuntary market pools.

The Agency Markets business unit, with $5,569 of revenues in 2007, is composed of nine regionally branded insurance companies that focus on the small commercial market and personal market. It also includes Liberty Mutual Surety (nationwide contract and commercial surety) and Summit, (mono-line workers compensation in the Southeast, primarily Florida). Agency Markets companies distribute their products and services primarily through independent agents and brokers.

In the fourth quarter of 2007, the Company realigned Wausau Insurance into the Commercial Markets business unit to organize its operations with those of other Liberty Mutual businesses that serve middle market and national customers.

The Company's International business unit, with $6,148 of revenues in 2007, provides insurance products and services through two distinct approaches: local businesses, which sell personal and commercial lines products, and Liberty International Underwriters ("LIU") which sells specialty commercial lines worldwide. The local businesses consists of local insurance operations selling traditional property, casualty, health and life insurance products to individuals and businesses in countries with a large and growing middle class. Automobile insurance is the predominant line of business. In South America, the Company operates in Venezuela, Argentina, Colombia, Brazil and Chile. In Asia, the Company writes business in Singapore, Thailand, Vietnam and China (including Hong Kong). In Europe, the Company operates in Spain, Portugal, Turkey and Poland.

LIU is composed of global specialty commercial insurance and reinsurance operations with subsidiaries based in London and branch operations in Australia and Canada. The London operations consist of Liberty Mutual Insurance Europe Ltd., with branches in Spain, United Kingdom, Hong Kong, France, Singapore, Switzerland, Germany, the Netherlands, United Arab Emirates and Ireland, and Lloyd's of London, Syndicate 4472 with branches in France and Germany. LIU operations provide a variety of specialty products including casualty, marine, engineering, energy, directors and officers, errors and omissions, aviation, property and professional liability insurance, together with multi-line insurance and reinsurance, including property catastrophe reinsurance, written through Lloyd's of London.

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 component of net periodic benefit cost. Consistent with the provisions of SFAS 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 Statement of Financial Accounting Standards No. 87, *"Employers' Accounting for Pensions" and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions"* ("SFAS 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 SFAS 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 tax assets by $155, and decreased AOCI, a component of policyholders' equity by $288, net of tax. Adoption of SFAS 158 did not affect the Company's results of operation or liquidity as SFAS 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 free-standing 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 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"). SOP 05-1 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"* ("SFAS 97"). As defined by SOP 05-1, 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 Financial Accounting Standards Board ("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 unassigned equity.

As of the date of adoption of FIN 48, the total amount of unrecognized tax benefits was approximately $107, including approximately $85 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 accrued as of January 1, 2007. The Company has not had any material changes to the unrecognized benefits within the last 12 months since the adoption 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 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 FASB Statement of Position No. FAS 115-1 and FAS 124-1, *"Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments,"* 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 Statement of Financial Accounting Standards 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 157 to have a material effect on its results of operations, financial condition or liquidity.

In February 2007, the FASB issued Statement of Financial Accounting Standards 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 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. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The Company will adopt EITF 06-04 on January 1, 2008. The Company does not expect the provisions of EITF 06-4 to have a material effect on its results of operations, financial condition, or liquidity.

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. EITF 06-10 is effective for the Company for fiscal years beginning after December 15, 2007. The Company will adopt EITF 06-10 on January 1, 2008, and is evaluating the impact of adoption, but does not expect the provisions of EITF 06-10 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"). SFAS 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 reclassifications 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.

Investments
Fixed maturity securities classified as available for sale are debt securities that have principal payment schedules, held for indefinite periods of time, and are used as a part of the Company's asset/liability strategy or sold in response to risk/reward characteristics, liquidity needs or similar economic factors. These securities are carried at fair value with the corresponding unrealized investment gains or losses, net of deferred income taxes, reported in accumulated other comprehensive income.

Equity securities classified as available for sale include common equities and non-redeemable preferred stocks and are reported at quoted market values. Changes in the market values of these securities, net of deferred income taxes, are reflected as unrealized investment gains or losses in accumulated other comprehensive income.

Trading securities are securities bought principally for the purpose of sale in the near term and are reported at market value. Changes in market value are recognized in income as realized gains or losses in the current period.

Realized gains and losses on sales of investments are recognized in income using the specific identification method. Unrealized losses that are other-than-temporary are recognized as realized losses. The Company reviews fixed income and public equity securities for impairment on a quarterly basis and private equity and co-investment securities on a semi-annual basis. Securities are reviewed for both quantitative and qualitative considerations including, but not limited to, (1) the extent of the decline in fair value below book value, (2) the duration of the decline, (3) significant adverse changes in the financial condition or near term prospects for the investment or issuer, (4) significant changes in the business climate or credit ratings of the issuer, (5) general market conditions and volatility, (6) industry factors, and (7) the past impairment history of the security holding or the issuer. All mortgage-backed securities and asset-backed securities are reviewed for other-than-temporary impairment treatment in accordance with the guidance of EITF Issue No. 99-20, *"Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets."* 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.

For mortgage-backed fixed maturity securities, the Company recognizes income using a constant effective yield based on anticipated prepayments over the economic life of the security. The mortgage-backed portfolio is accounted for under the retrospective method and prepayment assumptions are based on market expectations. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments and any resulting adjustment is included in net investment income.

Cash equivalents are short-term, highly liquid investments that are both readily convertible into known amounts of cash and so near to maturity that they present insignificant risk of changes in value due to changing interest rates. The Company's cash equivalents include debt securities purchased with maturities of three months or less at acquisition and are carried at amortized cost that approximates fair value.

Short-term investments are debt securities with maturities at acquisition between three months and one year, are considered available for sale and are carried at amortized cost, which approximates fair value.

All Variable Interest Entities ("VIEs") for which the Company is the primary beneficiary are consolidated into the Company's financial statements.

Other investments, principally investments in limited partnerships, are accounted for using the equity method. Equity investments in privately held businesses are accounted for under the cost method where market value data is unavailable for the underlying investment.

Mortgage loans are stated at amortized cost less a valuation allowance for potentially uncollectible amounts.

Derivatives
All derivatives are recognized on the balance sheet at fair value. On the date a contract is entered into, the Company designates the derivative as either (1) a hedge of a fair value of a recognized asset ("fair value hedge"), (2) an economic hedge ("non-designated derivative"), or (3) a cash flow hedge. Changes in the fair value of a derivative that is highly effective and is designated as a fair value hedge, along with the loss or gain on the hedged asset attributable to the hedged risk, are recorded in current period operations as a component of net investment income. Changes in the fair value of non-designated derivatives are reported in current period operations as a component of net realized gains and losses and the derivative is included in other assets or liabilities. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge is reported as a component of other comprehensive income and reclassified into earnings in the same period in which the hedged items affects earnings. The ineffective portion of the cash flow hedge is recorded directly to earnings. The Company owns fixed maturity securities which have an option to convert to equity. The derivative features embedded are ancillary to the overall investment. This type of activity is unrelated to hedging. The Company uses various derivative instruments to hedge exposure against interest rates and equity market returns guaranteed by certain life products. In addition, there may be call, put or conversion options embedded in certain bonds it has purchased. These derivatives are not material to the Company's financial statements.

Securities Lending
The Company participates in a securities lending program to generate additional income, whereby certain domestic fixed income securities are loaned for a short period of time from the Company's portfolio to qualifying third parties via a lending agent. Terms of the agreement are for borrowers of these securities to provide collateral of at least 102% of the market value of the loaned securities. Acceptable collateral may be in the form of cash or U.S. government securities. The market value of the loaned securities is monitored and additional collateral is obtained if the market value of the collateral falls below 102% of the market value of the loaned securities. Under the terms of the securities lending program, the lending agent indemnifies the Company against borrower defaults. The loaned securities remain a recorded asset of the Company; however, the Company records a liability for the amount of cash collateral held, representing its obligation to return the collateral related to the loaned securities.

Goodwill and Intangible Assets
Goodwill and intangible assets are tested for impairment at least annually using a two-step process. The first step is performed to identify potential impairment and, if necessary, the second step is performed for the purpose of measuring the amount of impairment, if any. Impairment is recognized only if the carrying amount is not recoverable from the discounted cash flows using a "market" rate and is measured as the difference between the carrying amount and the implied fair value. Other changes in the carrying amount of goodwill are primarily caused as a result of foreign currency translation adjustments and adjustments to valuation allowances for acquired tax losses. Intangible assets subject to amortization are amortized on a straight-line basis over their estimated useful lives.

Deferred Policy Acquisition Costs & Acquired Policy In-Force Intangibles
Costs that vary with and are primarily related to the acquisition of new insurance and investment contracts are deferred and amortized over the respective policy terms. Deferred policy acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment. For short-duration contracts, acquisition costs include commissions, underwriting expenses and premium taxes. For long-duration insurance contracts, these costs include first year commissions in excess of annual renewal commissions and variable sales, underwriting and administrative expenses.

As a result of the Company's acquisition of the Ohio Casualty Corporation, the Company recognized an intangible asset equal to the fair value of the acquired in-force policies. Amortization of this asset will occur over the remaining policy term.

For short-duration contracts, acquisition costs are amortized in proportion to earned premiums. For traditional long-duration contracts, acquisition costs are amortized over the premium paying period of the related policies using assumptions consistent with those used in computing policy benefit reserves. For universal life insurance, annuity, and investment products, acquisition costs are amortized in relation to expected gross profits.

For long-duration contracts, to the extent unrealized gains or losses on fixed income securities carried at fair value would result in an adjustment of estimated gross profits had those gains or losses actually been realized, the related unamortized deferred policy acquisition costs are recorded net of tax as a reduction of the unrealized capital gains or losses and included in accumulated other comprehensive income.

Real Estate and Other Fixed Assets

The costs of buildings, furniture, and equipment are depreciated, principally on a straight-line basis, over their estimated useful lives (a maximum of 39.5 years for buildings, 10 years for furniture, and 5 years for equipment). Expenditures for maintenance and repairs are charged to income as incurred while expenditures for improvements are capitalized and depreciated.

Separate Account Assets and Liabilities

Separate and variable accounts represent funds for which investment income and investment gains and losses accrue directly to the policyholders who bear the investment risk. Each account has specific investment objectives, and the assets are carried at fair value. The assets of each account are legally segregated and are not subject to claims that arise out of any other business of the Company. The liabilities of these accounts are equal to the account assets. Investment income, realized investment gains (losses), and policyholder account deposits and withdrawals related to separate accounts are excluded from the consolidated statements of income. The fees earned for administrative and contract holder maintenance services performed for these separate accounts are included in fee and other revenue.

Insurance Liabilities and Reserves

For short-duration contracts, the Company establishes reserves for unpaid insurance claims and claim adjustment expenses covering events that occurred in 2007 and prior years. These reserves reflect estimates of the total cost of claims reported but not yet paid and the cost of claims not yet reported, as well as the estimated expenses necessary to settle the claims. Reserve estimates are based on past loss experience modified for current claim trends, as well as prevailing social, economic and legal conditions. Final claim payments, however, may ultimately differ from the established reserves, since these payments might not occur for several years. Reserve estimates are continually reviewed and updated, and any resulting adjustments are reflected in current operating results. The Company does not discount reserves other than tabular discounting on the long-term indemnity portion of workers compensation claims, the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states, and specific asbestos structured settlements. Reserves are reduced for estimated amounts of salvage and subrogation and deductibles recoverable from policyholders.

For long-duration contracts, measurement of liabilities is based on generally accepted actuarial techniques but requires assumptions about mortality, lapse rates, and assumptions about future returns on related investments. Annuity and structured settlement contracts without significant mortality or morbidity risk are accounted for as investment contracts, whereby the premium received plus interest credited less policyholder withdrawals represents the investment contract liability. Implied credited interest rates for domestic structured settlement contracts in force averaged 5.8%, 5.9%, and 6.2% for 2007, 2006, and 2005, respectively. Implied credited interest rates for foreign structured settlement contracts in force were between 2.5% and 6.0% in 2007, 2006 and 2005. Credited rates for domestic universal life contracts in force were between 3.5% and 6.3% in 2007, 4.0% and 6.3% in 2006, and 3.5% and 7.0% in 2005. Credited rates for foreign universal life contracts in force were between 1.3% and 6.0% in 2007, 2.0% and 6.0% in 2006, and 1.0% and 6.0% in 2005. Liabilities for future policy benefits for traditional life policies have been computed using the net level premium method based upon estimated future investment yields (between 2.5% and 10.3% in 2007 and 4.5% and 10.3% in 2006 and 2005), mortality assumptions (based on the Company's experience relative to standard industry mortality tables) and withdrawal assumptions (based on the Company's experience).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
LIBERTY MUTUAL HOLDING COMPANY INC.
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

Policyholder Dividends

Policyholder dividends are accrued using an estimate of the ultimate amount to be paid in relation to premiums earned based on the underlying contractual obligations.

For domestic property-casualty insurance, certain insurance contracts, primarily workers compensation policies, are issued with dividend plans to be paid subject to approval by the insurer's board of directors. The premium related to such policies approximated 4% of domestic property-casualty insurance premiums written for the year ended December 31, 2007, and 5% of premiums written for each of the years ended December 31, 2006 and 2005. Additionally, certain jurisdictions impose excess profits taxes which limit the profitability of particular lines of business, and any excess is returned to the policyholder in the form of a dividend.

For life insurance, dividends to participating policyholders are calculated as the sum of the difference between the assumed mortality, interest and loading, and the actual experience of the Company relating to participating policyholders. As a result of statutory regulations, the major portion of earnings from participating policies inures to the benefit of the participating policyholders and is excluded from the consolidated net income and policyholders' equity. Participating policies approximate 39% of ordinary life insurance in force for the year ended December 31, 2007 and 40% for each of the years ended December 31, 2006 and 2005. Participating policies approximate 33%, 37%, and 35% of premium for the years ended December 31, 2007, 2006 and 2005, respectively.

Long-Term Incentive and Performance Based Incentive Plans

The Company maintains short- and long-term incentive compensation plans. Long-term plans that vest over the requisite service period and are based upon notional units are accounted for under SFAS 123(R). Additionally, the Company provides various performance based incentive compensation to the majority of employees meeting the participation requirements of the respective plans.

Compensation cost related to these plans is determined in accordance with plan formulas and recorded over the years the employee service is provided.

Revenue Recognition

For short-duration insurance contracts, premiums are reported as earned income generally on a pro-rata basis over the terms of the related policies. For retrospectively rated policies and contracts, premium estimates are continually reviewed and updated and any resulting adjustments are reflected in current operating results. For traditional long-duration insurance contracts (including term and whole life contracts and annuities), premiums are earned when due. For annuities and structured settlements without significant mortality or morbidity risk (investment contracts) and universal life contracts (long-duration contracts with terms that are not fixed or guaranteed), revenues represent investment income earned on the related assets. Universal life and annuity contract revenues also include mortality, surrender, and administrative fees charged to policyholders.

Reinsurance

All assets and liabilities related to ceded reinsurance contracts are reported on a gross basis in the consolidated balance sheets. Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on a basis consistent with the terms of the reinsurance contracts. The consolidated statements of income reflect premiums, benefits, and settlement expenses net of reinsurance ceded.

Transactions that do not transfer risk are included in other assets or other liabilities. Ceded transactions that transfer risk but are retroactive are included in reinsurance recoverables. The excess of estimated liabilities for claims and claim costs over the consideration paid net of experience adjustments is established as a deferred credit at inception. The deferred amounts are subsequently amortized using the effective interest method over the expected settlement period. The periodic amortization is reflected in the accompanying consolidated statements of income through operating costs and expenses.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liabilities associated with the reinsured business. The Company evaluates reinsurance collectibility and a provision for uncollectible reinsurance is recorded.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

Translation of Foreign Currencies

The Company translates the financial statements of its foreign operations into U.S. dollars from the functional currency designated for each foreign unit, generally the currency of the primary economic environment in which it does its business. Assets and liabilities are translated into U.S. dollars at period-end exchange rates, while income and expenses are translated using average rates for the period. Deferred tax positions are not established for adjustments arising from foreign operations whose earnings are considered to be permanently reinvested (See Note 10). Translation adjustments are recorded as a separate component of accumulated other comprehensive income. Foreign currency amounts are remeasured to the functional currency, and the resulting foreign exchange gains or losses are reflected in earnings.

For subsidiaries operating in highly inflationary economies, monetary assets and liabilities are translated at the rate of exchange as of the balance sheet date and non-monetary items are translated at historical rates. Gains and losses from balance sheet translation adjustments and foreign currency transactions are included in net income.

The aggregate exchange (losses) and gains included in income from continuing operations for the years ended December 31, 2007, 2006, and 2005 were $(6), $(5), and $23, respectively. These amounts have been included in insurance operating costs and expenses in the accompanying consolidated statements of income.

Income Taxes

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 basis 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 investments, insurance reserves, unearned premiums, retroactive deferred gains, tax credits, deferred policy acquisition costs, certain employee benefits expenses, and net operating losses.

Service Revenues and Expenses

Service revenues consist primarily of fees generated from processing business for involuntary assigned risk pools, self insured customers, and risk retention groups and are earned on a pro-rata basis over the term of the related policies and are included in fee and other revenues in the consolidated statements of income.

Accumulated Other Comprehensive Income

Other comprehensive income consists principally of unrealized gains and losses on certain investments in debt and equity securities, foreign currency translation adjustments, and pension liability adjustments.

The components of accumulated other comprehensive income, net of related deferred acquisition costs and taxes, for the years ending December 31, 2007, 2006, and 2005 are as follows:

	2007	2006	2005
Unrealized gains on securities	**$ 574**	$644	$ 656
Foreign currency translation and other adjustments	**456**	179	68
Pension liability adjustment (1)	**(285)**	(20)	(332)
Accumulated other comprehensive income	**$ 745**	$803	$ 392

(1) 2007 includes the impact of adoption of SFAS 158 of $(288).

Catastrophe Exposure

The Company writes insurance and reinsurance contracts that cover catastrophic events. The Company's policies cover unpredictable natural and other disasters, such as hurricanes, windstorms, earthquakes, floods, fires, terrorist attacks, and explosions. Although the Company purchases reinsurance to mitigate its exposure to certain catastrophic events, claims from catastrophic events could cause substantial volatility in its financial results for any fiscal year and have a material adverse effect on its financial condition.

The Terrorism Risk Insurance Act, as amended by the Terrorism Insurance Program Reauthorization Act of 2007, requires all commercial property and casualty insurers writing business in the U.S. to make terrorism coverage available to commercial policyholders and provides a Federal backstop for certified terrorist acts which result in losses above individual insurance company deductible amounts. The Terrorism Act directly applies to the Company's U.S. property and casualty insurance business.

In 2008, on eligible lines of business, participating insurers will receive reimbursement from the Federal government for 85% of paid losses in excess of the insurer's deductible, provided the aggregate industry losses exceed $100 to a maximum industry loss of $100,000. The Company estimates its deductible for commercial policies subject to the Terrorism Act (the amount the Company will have to pay before the Federal backstop becomes available) to be $1,659 in 2008. This amounts to 20% of the Company's direct earned premium from commercial lines of business subject to the Terrorism Act and approximately 8.7% on a net of tax basis of policyholders' equity of the Company at December 31, 2007, prior to consideration of terrorism reinsurance that the Company has purchased for 2008. As of the effective date of the Reauthorization Act, December 26, 2007, the U.S. government may "certify," and the Terrorism Act will cover, losses caused by any individual, foreign or domestic. Damage outside the U.S. is not covered except in limited circumstances, such as damage to a U.S. air carrier. The Terrorism Act will remain in effect until December 31, 2014. There can be no assurance that it will be extended beyond that date.

(2) DIVESTITURES AND DISCONTINUED OPERATIONS

Discontinued Operations

In December 2004, the Company's management approved a plan to sell the pension externalization business of Seguros Genesis S.A. operations. The Company completed the disposition in December 2005.

	2005
Revenues	$ —
Operating expenses	(1)
Income before realized loss and income tax benefit	1
Realized loss	(19)
Income tax benefit	(6)
Net loss	$ (12)

(3) ACQUISITIONS AND GOODWILL

Ohio Casualty Corporation

On August 24, 2007 Liberty Mutual Group completed the acquisition of Ohio Casualty Corporation ("Ohio Casualty"). Pursuant to the terms of the purchase agreement, the Company paid cash of $44.00 per share in exchange for all outstanding shares of the Ohio Casualty common stock for a total purchase price of $2,784. The results of operations for the acquired business are included in the financial statements subsequent to August 24, 2007. Net income for Ohio Casualty subsequent to acquisition was $57. The operations of Ohio Casualty were merged into the Agency Markets strategic business unit. The Company believes that this acquisition will significantly strengthen Agency Markets' independent agency business and expand its independent agency distribution.

The total purchase price was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was primarily determined using the income approach, which discounts expected cash flows to present value using estimates and assumptions determined by management. The Company is in the process of finalizing the fair value of the acquired business and related restructuring efforts; therefore, the allocation of the purchase price is subject to refinement.

The purchase price allocation based on the opening balance sheet of August 24, 2007, as of December 31, 2007 is as follows:

Assets:	
Total investments	$4,176
Cash and cash equivalents	105
Premium and other receivables	396
Reinsurance recoverables	611
Goodwill and intangible assets	1,315
Other assets	341
Total assets	$6,944
Liabilities:	
Unpaid claims and claim adjustment expenses	$2,698
Unearned premiums	698
Funds held under reinsurance treaties	113
Long-term debt	207
Other liabilities	444
Total liabilities	$4,160

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

Intangible Assets

	CARRYING VALUE AUGUST 24, 2007	CARRYING VALUE DECEMBER 31, 2007	PERIOD (YEARS)	METHOD
Agency relationship	$237	$233	20	Straight-line
Non-compete agreements	4	3	2	Straight-line
Trademarks	33	33	Not subject to amortization	Not subject to amortization
State licenses	22	22	Not subject to amortization	Not subject to amortization
Total intangible assets[1]	$296	$291		

[1] THE ABOVE TABLE EXCLUDES THE ACQUIRED IN-FORCE POLICY INTANGIBLE, WHICH IS INCLUDED IN DEFERRED ACQUISITION COSTS AND ACQUIRED IN-FORCE POLICY INTANGIBLES ON THE CONSOLIDATED BALANCE SHEET.

For the year ended December 31, 2007, the Company recognized $5 of amortization expense which is reflected in insurance operating costs and expenses on the consolidated statement of income. Estimated amortization for the years ended December 31, 2008 through 2012 is $14, $13, $12, $12, and $12, respectively.

Restructuring Activities

As part of the Ohio Casualty acquisition, management has received board authorization to implement certain restructuring efforts, principally employee and contract terminations. Total Ohio Casualty restructuring costs incurred for the year ended December 31, 2007 were $38, of which $26 was recognized as assumed liabilities as part of purchase accounting for the acquisition. Payments made against these reserves were $11 in 2007. Payments under restructuring reserves are expected to be substantially completed in 2008.

Seker Sigorta A.S.

On September 5, 2006, and during the course of the fourth quarter of 2006, the Company, through its Spanish subsidiary, Liberty Seguros Compania de Seguros y Reaseguros S.A. ("Liberty Seguros"), acquired 90.425% of Seker Sigorta A.S., a mid-sized insurer located in Istanbul, Turkey. Goodwill recognized from the transaction was $102. The results of operations for the acquired business, which are not material, are included in the financial statements subsequent to September 2006.

(4) INVESTMENTS

Components of Net Investment Income

YEARS ENDED DECEMBER 31,	2007	2006	2005
Taxable interest income	$2,211	$2,089	$2,028
Tax-exempt interest income	342	200	75
Dividends	83	52	53
Limited partnerships and limited liability companies	345	304	227
Commercial mortgage loans	27	—	—
Other investment income	7	20	16
Gross investment income	3,015	2,665	2,399
Investment expenses	(130)	(117)	(152)
Net investment income	$2,885	$2,548	$2,247

Components of Net Realized Investment Gains

YEARS ENDED DECEMBER 31,	2007	2006	2005
Fixed maturities			
Gross realized gains	$ 124	$ 105	$ 263
Gross realized losses	(156)	(110)	(92)
Equities			
Gross realized gains	199	112	101
Gross realized losses	(48)	(19)	(39)
Other			
Gross realized gains	338	273	301
Gross realized losses	(21)	(18)	(11)
Net realized investment gains	$ 436	$ 343	$ 523

During the years ended December 31, 2007, 2006, and 2005, other-than-temporary impairments recognized were $47, $50, and $18, respectively.

During the years ended December 31, 2007, 2006, and 2005, proceeds from sales of fixed maturities available for sale were $8,006, $5,432, and $8,385, respectively. The gross realized gains and (losses) on such sales totaled $60 and $(81) in 2007, $60 and $(47) in 2006, and $220 and $(68) in 2005. The net realized gains (losses) related to trading securities held as of the end of the year amounted to $0, $8, and $7 for the years ended December 31, 2007, 2006, and 2005.

Components of Change in Net Unrealized Investment Gains

	2007	2006	2005
Fixed maturities	$ (35)	$(308)	$(893)
Equities	(88)	220	77
Other	3	(1)	3
Adjustments to deferred policy acquisition costs	33	71	26
Net change in unrealized investment losses	(87)	(18)	(787)
Deferred income taxes	17	6	276
Net change in unrealized investment losses, net of tax	$ (70)	$ (12)	$(511)

Available for Sale Investments

The gross unrealized gains and losses and fair values of available for sale investments at December 31, 2007, and 2006, are as follows:

DECEMBER 31, 2007	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
U.S. government and agency securities	$ 3,156	$ 173	$ (11)	$ 3,318
Mortgage and asset-backed securities of government and corporate agencies	13,459	172	(140)	13,491
U.S. state and municipal	9,902	153	(54)	10,001
Corporate and other	17,636	275	(473)	17,438
Foreign government securities	2,695	43	(52)	2,686
Total fixed maturities	46,848	816	(730)	46,934
Total equity securities	2,418	1,071	(204)	3,285
Total securities available for sale	$ 49,266	$1,887	$ (934)	$ 50,219

DECEMBER 31, 2006	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
U.S. government and agency securities	$ 4,625	$ 113	$ (80)	$ 4,658
Mortgage and asset-backed securities of government and corporate agencies	12,386	105	(224)	12,267
U.S. state and municipal	6,533	110	(31)	6,612
Corporate and other	15,267	355	(268)	15,354
Foreign government securities	2,170	54	(13)	2,211
Total fixed maturities	40,981	737	(616)	41,102
Total equity securities	1,664	975	(20)	2,619
Total securities available for sale	$ 42,645	$1,712	$ (636)	$ 43,721

At December 31, 2007, and 2006, securities carried at $3,020 and $2,813, respectively, were on deposit with regulatory authorities as required by law.

At December 31, 2007, and 2006, the fair values of fixed maturities loaned were approximately $819 and $1,257, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately $467 and $1,066 as of December 31, 2007, and 2006, respectively. Other investments collateral received in connection with the loaned securities was approximately $377 and $218 as of December 31, 2007, and 2006, respectively.

The amortized cost and fair value of fixed maturities at December 31, 2007, by contractual maturity are as follows:

	AMORTIZED COST	FAIR VALUE
Due to mature:		
One year or less	$ 1,374	$ 1,376
Over one year through five years	9,266	9,295
Over five years through ten years	9,627	9,567
Over ten years	13,122	13,205
Mortgage and asset-backed securities of government and corporate agencies	13,459	13,491
Total fixed maturities	$46,848	$46,934

Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration that individual securities have been in a continuous unrealized loss position at December 31, 2007, that are not deemed to be other-than-temporarily impaired.

	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	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 of government and corporate agencies	(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

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The following table shows a schedule of the Company's unrealized losses and fair value by security type by duration that individual securities have been in a continuous unrealized loss position at December 31, 2006, that are not deemed to be other-than-temporarily impaired.

	LESS THAN 12 MONTHS		GREATER THAN 12 MONTHS	
	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES	UNREALIZED LOSSES	FAIR VALUE OF INVESTMENTS WITH UNREALIZED LOSSES
U.S. government and agency securities	$ (10)	$ 1,416	$ (70)	$ 2,233
Mortgage and asset-backed securities of government and corporate agencies	(21)	2,633	(203)	6,118
U.S. state and municipal	(16)	1,657	(15)	179
Corporate and other	(55)	3,599	(213)	4,852
Foreign government securities	(8)	635	(5)	268
Equities	(16)	281	(4)	38
Total	$(126)	$10,221	$(510)	$13,688

The above table for 2007 includes $165 of unrealized losses related to securities issued and guaranteed by the United States government, its agencies, government sponsored enterprises and state and municipal governments. There was $566, or approximately 61%, of the unrealized losses as of December 31, 2007, on securities where the market value of the security was 10% or less below the book value for the security. The increase in unrealized losses was primarily driven by the increase in credit spreads from December 31, 2006, to December 31, 2007. The unrealized losses as of December 31, 2007, involve approximately 12,300 lots across more than approximately 3,400 different securities within the holdings of the Company.

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.

Variable Interest Entities

The Company's exposure to investment structures subject to analysis under FIN 46(R) relates primarily to investments in energy and private equity limited partnerships that are accounted for under the equity method. Two VIEs in the energy investment sector have been consolidated in the Company's 2007, 2006, and 2005 financial statements as the Company has been deemed to be the primary beneficiary. In addition, the Company had investments in 40 and 31 VIEs at December 31, 2007 and 2006, respectively, for which it was not the primary beneficiary. The Company's investments in VIEs were $386 and $208 at December 31, 2007 and 2006, respectively. The Company's maximum exposure to losses from VIEs is $786 and $481 as of December 31, 2007 and 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.

Investments in Mortgage Loans

In December 2006, the Company acquired participation certificates in commercial mortgage loans as a result of a distribution of assets in the dissolution of a limited partnership investment. The loans received from the partnership were originated and underwritten by the general partner, a third-party commercial loan manager that continues to originate and underwrite commercial mortgage loans in which the Company participates. At December 31, 2007 and 2006, the carrying value of the loans were $657 and $322, respectively. Additionally, the Company's participation in any one commercial mortgage loan acquired does not exceed 49% of the loan value.

(5) DEFERRED POLICY ACQUISITION COSTS AND ACQUIRED IN-FORCE POLICY INTANGIBLE

The following reflects the policy acquisition costs and acquired in-force policy intangible deferred for amortization against future income and related amortization charged to income:

YEARS ENDED DECEMBER 31,	2007	2006	2005
Balance at beginning of year	**$ 1,662**	$ 1,476	$ 1,354
Acquisition costs deferred	**3,456**	3,005	2,602
Acquired in-force policy intangible [1]	**161**	8	—
Amortization charged to continuing income	**(3,297)**	(2,827)	(2,480)
Balance at end of year	**$ 1,982**	$ 1,662	$ 1,476

[1] THE ACQUIRED IN-FORCE POLICY INTANGIBLE WAS RECOGNIZED IN CONJUNCTION WITH THE COMPANY'S PURCHASE OF OHIO CASUALTY ON AUGUST 24, 2007 AND THE ACQUISITION OF SEKER SIGORTA A.S. ON SEPTEMBER 5, 2006.

(6) ASBESTOS AND ENVIRONMENTAL RESERVES

The Company has exposure to asbestos and environmental claims that emanate principally from general liability policies written prior to the mid-1980's. In establishing the Company's asbestos and environmental reserves, the Company estimates case basis reserves for anticipated losses and bulk reserves for claim adjustment expenses and incurred but not reported claims reserves ("IBNR"). The Company maintained casualty excess of loss reinsurance during the relevant periods. The reserves are reported net of cessions to reinsurers and include any reserves reported by ceding reinsurers on assumed reinsurance contracts.

Upon their de-affiliation from the Nationwide Group and affiliation with the Company, Employers Insurance Company of Wausau ("EICOW"), Wausau Business Insurance Company ("WBIC"), Wausau General Insurance Company ("WGIC"), and Wausau Underwriters Insurance Company ("WUIC") entered into ceded reinsurance contracts whereby Nationwide Indemnity Company assumed full responsibility for obligations on certain policies with effective dates prior to January 1, 1986, including all asbestos and environmental exposures.

The process of establishing reserves for asbestos and environmental claims is subject to greater uncertainty than the establishment of reserves for liabilities relating to other types of insurance claims. A number of factors contribute to this greater uncertainty surrounding the establishment of asbestos and environmental reserves, including, without limitation: (i) the lack of available and reliable historical claims data as an indicator of future loss development, (ii) the long waiting periods between exposure and manifestation of any bodily injury or property damage, (iii) the difficulty in identifying the source of asbestos or environmental contamination, (iv) the difficulty in properly allocating liability for asbestos or environmental damage, (v) the uncertainty as to the number and identity of insureds with potential exposure, (vi) the cost to resolve claims, and (vii) the collectibility of reinsurance.

The uncertainties associated with establishing reserves for asbestos and environmental losses and loss adjustment expenses are compounded by the differing, and at times inconsistent, court rulings on environmental and asbestos coverage issues involving: (i) the differing interpretations of various insurance policy provisions and whether asbestos and environmental losses are or were ever intended to be covered, (ii) when the loss occurred and what policies provide coverage, (iii) whether there is an insured obligation to defend, (iv) whether a compensable loss or injury has occurred, (v) how policy limits are determined, (vi) how policy exclusions are applied and interpreted, (vii) the impact of entities seeking bankruptcy protection as a result of asbestos-related liabilities, (viii) whether clean-up costs are covered as insured property damage, and (ix) applicable coverage defenses or determinations, if any, including the determination as to whether or not an asbestos claim is a products/completed operation claim subject to an aggregate limit and the available coverage, if any, for that claim. The uncertainties cannot be reasonably estimated, but could have a material impact on the Company's future operating results and financial condition.

In the last few years the Company, as well as the industry generally, has seen decreases in the number of asbestos claims being filed. This turn to a more favorable trend is due to a number of factors. Screening activity used by some lawyers to find new plaintiffs has been as a result of questionable practices discovered in the Federal Silica Multi District Litigation. Court decisions in several key states (e.g., Mississippi) have been favorable to defendants. Most importantly, several states have enacted legislation in the past few years that contain medical criteria provisions aimed at reducing the number of lawsuits filed by unimpaired plaintiffs and providing prompt and fair compensation to those who meet the criteria.

Biennially, the Company completes comprehensive ground-up asbestos reserve studies. The studies are completed by a multi-disciplined team of internal claims, legal, reinsurance and actuarial personnel, and includes all major segments of the Company's direct, assumed, and ceded asbestos claims. As part of the internal reviews, potential exposures of large policyholders are individually evaluated using the Company's proprietary stochastic model, which is consistent with published actuarial papers on asbestos reserving. Among the factors reviewed in depth by the team of specialists are 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 are evaluated using aggregate methods that utilize information developed from the large policyholders. Between comprehensive studies, the Company monitors asbestos activity to determine whether or not any adjustment to reserves is warranted. Net increases to asbestos reserves were $90, $25 and $238 for the years ended December 31, 2007, 2006, and 2005, respectively.

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As a result of the Company's internal studies on environmental claims, in 2007 the Company increased net loss and allocated loss adjustment expenses by $64.

As a result of the significant uncertainty inherent in determining a company's asbestos and environmental liabilities and establishing related reserves, the amount of reserves required to adequately fund the Company's asbestos and environmental claims cannot be accurately estimated using conventional reserving methodologies based on historical data and trends. As a result, the use of conventional reserving methodologies frequently has to be supplemented by subjective considerations including managerial judgment. In that regard, 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 an aggregate liability that differs from current reserves by an amount that could be material to the Company's future operating results and financial condition.

The following tables summarize the activity for the Company's asbestos and environmental claims and claim adjustment expenses, a component of the Company's unpaid claims and claim adjustment expenses, for the years ended December 31, 2007, 2006, and 2005. Acquisition activity in 2007 relates to the purchase of Ohio Casualty:

	2007	2006	2005
Gross Asbestos:			
January 1 reserves	**$2,541**	$2,720	$2,399
Acquisitions	**53**	—	—
Incurred activity	**413**	152	614
Paid activity	**481**	331	293
Ending reserves	**$2,526**	$2,541	$2,720
Net Asbestos:			
January 1 reserves	**$ 872**	$1,066	$ 961
Acquisitions	**39**	—	—
Incurred activity	**90**	25	238
Paid activity	**240**	219	133
Ending reserves	**761**	872	1,066
Allowance for reinsurance on unpaid losses	**87**	100	110
Total unpaid losses including allowance for unpaid reinsurance	**$ 848**	$ 972	$1,176

Included in gross asbestos incurred for 2007, 2006, and 2005 are significant amounts attributable to claims against 1985 and prior policies issued by EICOW and its affiliates, which are 100% ceded to Nationwide Indemnity Company and guaranteed by Nationwide Mutual Insurance Company. In addition, the Company's 2003 acquisition of Prudential Property and Casualty Insurance Company, Prudential General Insurance Company, and Prudential Commercial Insurance Company (collectively referred to as "PruPac") included $175 and $118 of gross and net asbestos reserves, respectively. Any increase in asbestos reserves related to PruPac is reinsured by Vantage Casualty Insurance Company and guaranteed by Prudential Financial, Inc. The Company had paid losses associated with these reserves of $56 and $60 in 2007 and 2006, respectively.

	2007	2006	2005
Gross Environmental:			
January 1 reserves	**$585**	$775	$816
Acquisitions	**56**	—	—
Incurred activity	**57**	52	155
Paid activity	**77**	242	196
Ending reserves	**$621**	$585	$775
Net Environmental:			
January 1 reserves	**$414**	$452	$553
Acquisitions	**56**	—	—
Incurred activity	**64**	22	5
Paid activity	**48**	60	106
Ending reserves	**$486**	$414	$452

The Company's 2003 acquisition of PruPac included $15 and $12 of gross and net environmental reserves, respectively. Any increase in environmental 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 $1 in both 2007 and 2006.

(7) UNPAID CLAIMS AND CLAIM ADJUSTMENT EXPENSES

The Company establishes reserves for payment of claims and claim adjustment expenses that arise from the policies issued. As required by applicable accounting rules, no reserves are established until a loss, including a loss from a catastrophe, occurs. The Company's reserves are segmented into three major categories: reserves for reported claims (estimates made by claims adjusters); IBNR representing reserves for unreported claims and supplemental reserves for reported claims; and reserves for the costs to settle claims. The Company establishes its reserves net of salvage and subrogation by line of business or coverage and year in which losses occur.

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 litigation, medical costs, the costs of repair materials, and labor rates can all affect ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement can be. 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.

Catastrophes are an inherent risk of the property-casualty insurance business and have contributed to material period-to-period fluctuations in the Company's results of operations and financial position. The level of catastrophe losses experienced in any period cannot be predicted and can be material to the results of operations and financial position of the Company. Catastrophe losses incurred during the years ended December 31, 2007, 2006, and 2005, were $379, $558, and $1,560, respectively.

Please see Note 6 for a discussion of incurred attributable to prior years for asbestos and environmental reserves.

Activity in property and casualty unpaid claims and claim adjustment expenses of the Company is summarized as follows:

	2007	2006	2005
Balance as of January 1	**$38,606**	$38,067	$33,897
Less: unpaid reinsurance recoverables [1]	**12,462**	13,516	11,548
Net balance as of January 1	**26,144**	24,551	22,349
Balance attributable to dispositions, acquisitions, and affiliations	**2,133**	25	7
Incurred attributable to:			
Current year	**15,106**	12,854	13,082
Prior years:			
Asbestos and environmental	**147**	35	232
All other	**(256)**	376	83
Discount accretion	**84**	109	118
Total incurred	**15,081**	13,374	13,515
Paid attributable to:			
Current year	**7,176**	6,050	6,026
Prior years	**5,969**	6,027	5,192
Total paid	**13,145**	12,077	11,218
Amortization of deferred retroactive reinsurance gain	**83**	97	97
Net adjustment due to foreign exchange	**222**	174	(199)
Add: unpaid reinsurance recoverables [1]	**12,474**	12,462	13,516
Balance as of December 31	**$42,992**	$38,606	$38,067

[1] In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements discussed in Note 8, the Company has recorded retroactive reinsurance recoverable balances of $2,277, $2,292, and $2,247 at December 31, 2007, 2006, and 2005, respectively.

Incurred attributable to prior years, excluding asbestos and environmental, includes $83, $97, and $97 of amortization of deferred retroactive gain in the years ended December 31, 2007, 2006, and 2005, respectively. In 2007, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is due to favorable trends in personal auto and commercial multiple peril, partially offset by reserve increase for workers compensation. The prior year development in workers compensation is composed of unfavorable development in Commercial Markets, caused by higher than expected severity, partially offset by favorable development in Agency Markets, caused by better than expected severity and impact of Florida reform. In 2006, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily related to the workers compensation and assumed non-proportional liability lines of business, partially offset by personal auto and commercial auto lines of business.

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In 2005, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily related to the workers compensation line of business, partially offset by personal auto and homeowners lines of business.

Included in the unpaid claims and claim adjustment expenses are reserves from involuntary insurance pools. Changes to the involuntary pool reserves are received from the pools' administrators on a periodic basis and recorded by the Company. (Decreases) increases in discount accretion related to these involuntary pool reserves was ($11), $12, and $22 for the years ended December 31, 2007, 2006, and 2005, respectively.

The Company has not discounted unpaid property and casualty insurance claims and claim adjustment expenses other than tabular discounting on the long-term indemnity portion of workers compensation claims, the Company's disability claims as permitted by insurance regulations in certain states and specific asbestos structured settlements.

The tabular discounting on these workers compensation claims is based on Unit Statistical Plan tables as approved by the respective states and ranges from 3.5% to 4.0% for the years ended December 31, 2007, and 2006. Unpaid workers compensation claims and claim adjustment expenses at December 31, 2007, and 2006, include liabilities of $5,049 and $4,822 at discounted values of $3,584 and $3,395, respectively. Unpaid asbestos structured settlement claims at December 31, 2007 and 2006 include liabilities of $212 and $253 at discounted values of $174 and $206, respectively.

For certain commercial lines of insurance, the Company offers experience-rated insurance contracts whereby the ultimate premium is dependent upon the claims incurred. At December 31, 2007, and 2006, the Company held $3,823 and $3,763, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of $617 and $818 at December 31, 2007, and 2006, respectively. For the years ended December 31, 2007, 2006, and 2005, the Company recognized a (decrease) increase in premium income of $(105), $(28), and $86, respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of $517 and $534 as of December 31, 2007, and 2006, respectively.

At December 31, 2007, and 2006, the reserve for unpaid claim reserves was reduced by $4,812 and $4,414, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were $243 and $261 at December 31, 2007, and 2006, respectively.

Relating to future policy benefits, the discounting of the disability claims is based on the 1987 Commissioners Group Disability Table (CGDT) at annual discount rates varying from 4.5% to 5.0% in 2007 and 4.5% to 7.0% in 2006. Unpaid disability claims and claim adjustment expenses at December 31, 2007, and 2006, include liabilities of $1,098 and $1,019 carried at discounted values of $829 and $768, respectively.

(8) REINSURANCE

In the ordinary course of business, the Company assumes reinsurance and also cedes reinsurance to other insurers to reduce overall risk, including exposure to large losses and catastrophic events. The Company is also a member of various involuntary pools and associations and serves as a servicing carrier for residual market organizations.

A summary of reinsurance financial data reflected within the consolidated statements of income is presented below:

	2007		2006		2005	
	WRITTEN	**EARNED**	WRITTEN	EARNED	WRITTEN	EARNED
Direct	**$24,844**	**$24,250**	$23,158	$22,453	$20,518	$20,191
Assumed	**1,320**	**1,375**	1,341	1,328	1,473	1,426
Ceded	**3,626**	**3,738**	3,944	3,987	3,966	4,037
Net premiums	**$22,538**	**$21,887**	$20,555	$19,794	$18,025	$17,580

The following table summarizes the Company's reinsurance recoverables by reinsurers' Standard & Poor's ("S&P") rating (or the rating of any guarantor) as of December 31, 2007.

S&P RATING	REINSURANCE RECOVERABLES
AAA	$ 1,255
AA+, AA, AA-	5,205
A+, A, A-	3,614
BBB+, BBB, BBB-	12
BB+ or below	4
Involuntary Pools	3,024
Voluntary Pools	368
Other [1]	2,367
Gross Recoverables	15,849
Less: allowance	331
Net Recoverables	$15,518

[1] INCLUDES $876 AND $1,491 OF RECOVERABLES FROM NON-RATED REINSURERS AND CAPTIVE AND PROGRAM BUSINESS, RESPECTIVELY.

The Company remains contingently liable in the event reinsurers are unable to meet their obligations for paid and unpaid reinsurance recoverables and unearned premiums ceded under reinsurance agreements. As of December 31, 2007, the Company holds $5,259 of collateral as security under related reinsurance agreements in the form of funds, securities and/or letters of credit.

The Company has an aggregate reinsurance recoverable from Nationwide Indemnity Company in the amount of $2,119 and $2,113 as of December 31, 2007, and 2006, respectively. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company. Additionally, the Company has significant reinsurance recoverable concentrations with Swiss Reinsurance Group, Berkshire Hathaway Group, Everest Re Group and Munich Re totaling $1,702, $612, $600, and $514 respectively, as of December 31, 2007, net of offsetting collateral under the contracts.

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. Reinsurer credit risk with respect to any such involuntary pool or association is a function of the creditworthiness of all of the pool participants.

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) that are amortized into income using the effective interest method over the estimated settlement periods. At December 31, 2007, and 2006, deferred gains related to these reinsurance arrangements were $786 and $839, respectively, and are included in other liabilities within the consolidated balance sheets. Interest credited to the funds held balances for the years ended December 31, 2007, 2006, and 2005 was $116, $125, and $113, respectively. Deferred gain amortization was $57, $95, and $89 for the years ended December 31, 2007, 2006, and 2005, respectively. Reinsurance recoverables related to these transactions including experience related profit accruals were $2,222 and $2,258 as of December 31, 2007, and 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) and $1 of additional (gains) losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2007, with additional premium of $1 and $1, respectively. Approximately $45 and $32 of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2006, with additional premium of $29 and $23, respectively. Approximately $38 and $31 of additional losses were ceded to these retroactive and prospective contracts, respectively, during the year ended December 31, 2005, with additional premium of $24 and $22, 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, Liberty Mutual Insurance Company ("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 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. Mystic Re and Mystic Re II are Qualifying Special Purpose Entities, and therefore are exempt from consolidation.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(9) DEBT OUTSTANDING

Debt outstanding at December 31, 2007, and 2006, includes the following:

	2007	2006
Short-term debt:		
Commercial paper	$ –	$ –
Revolving credit facilities	70	50
Current maturities of long-term debt	21	121
Total short-term debt	$ 91	$ 171
Long-term debt:		
6.75% Notes, due 2008	$ –	$ 15
5.00% Notes, due 2008	–	4
8.00% Notes, due 2013	260	260
5.75% Notes, due 2014	500	500
7.30% Notes, due 2014[1]	200	–
6.70% Notes, due 2016	250	250
7.00% 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% Notes, due 2034	250	250
6.50% Notes, due 2035	500	500
7.50% Notes, due 2036	500	500
7.80% 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
	4,388	3,209
Unamortized discount[4]	(28)	(34)
Total long-term debt excluding current maturities	$4,360	$3,175

[1] Assumed as part of Ohio Casualty acquisition on August 24, 2007.

[2] The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.

[3] The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

[4] Includes purchase accounting adjustment of $7 related to the $200 Ohio Casualty Notes due in 2014.

Short-term Debt

The Company issues commercial paper to meet short-term operating needs. The total facility was $1,000 at December 31, 2007, and $600 at December 31, 2006, and is supported by a $750 line of credit facility. Commercial paper issued and outstanding at December 31, 2007, and 2006, was $0.

On April 5, 2007, Liberty Mutual Group Inc. ("LMGI") entered into a $250 3-year unsecured revolving credit facility for general corporate purposes. No funds have been borrowed to date under the facility.

On May 4, 2007, LMIC redeemed its $121 8.20% Surplus Note at maturity.

The Company's Venezuelan subsidiary, Inversora Segucar, C.A., entered into a $90 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.

Long-term Debt

On August 24, 2007, the Company assumed $200 of 7.30% Notes due 2014 as a result of the Ohio Casualty acquisition (the "OCAS Notes"). The fair value of the OCAS Notes as established as a result of Ohio Casualty purchase accounting is $207 and is reflected in the Consolidated Balance Sheets.

Payments of interest and principal of the surplus notes are expressly subordinate to all policyholder claims and other obligations of LMIC. Accordingly, interest and principal payments are contingent upon prior approval of the Commissioner of Insurance of the Commonwealth of Massachusetts.

At December 31, 2007, all of the long-term borrowings mature after 2011.

On March 7, 2007, LMGI issued junior subordinated notes (the "Notes") with a face amount of $1,000, consisting of $700 Series A junior subordinated notes (the "Series A Notes") and $300 Series B junior subordinated notes (the "Series B Notes"). The Notes are scheduled for redemption on March 15, 2037; the Series A notes have a par value call date and final fixed rate interest payment date of March 15, 2037 and a final maturity date of March 7, 2087; and the Series B notes have a par value call date and final fixed rate interest payment date of March 15, 2017 and a final maturity date of 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).

Capital lease obligations as of December 31, 2007, and 2006, were $87 and $103, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

In 2006 and 2005 the Company entered into an arrangement to sell and leaseback certain furniture and equipment. The weighted average interest rate on the lease is LIBOR plus 102 basis points. The transactions are accounted for as capital leases. As of December 31, 2007, the Company's amortization of the lease obligation under the sale-leaseback agreement through maturity is approximately $21 for 2008, $17 for 2009, $10 for 2010 and $6 for 2011.

Interest

The Company paid $299, $188, and $173 of interest in 2007, 2006, and 2005, respectively.

(10) FEDERAL AND FOREIGN INCOME TAXES

The Company files a consolidated U.S. federal income tax return for substantially all of its domestic operations. Pursuant to intercompany Federal income tax allocation agreements among each of these companies and their respective subsidiaries, the consolidated tax liabilities are allocated to each company based on its separate return tax liability. Tax benefits are allocated to each company for its portion of net operating losses and tax credit carry forwards in the year they are used by the consolidated group. Intercompany tax balances are settled quarterly. A provision is made, where applicable, for taxes on foreign operations.

The components of Federal and foreign income tax expense (benefit) related to continuing operations are:

YEARS ENDED DECEMBER 31,	2007	2006	2005
Current tax expense (benefit):			
United States Federal	$411	$530	$286
United States Federal benefit of net operating losses	–	(18)	(34)
Foreign	100	125	74
Total current tax expense	511	637	326
Deferred tax expense (benefit):			
United States Federal	139	(7)	(85)
Foreign	30	2	(150)
Total deferred tax expense (benefit)	169	(5)	(235)
Total Federal and foreign income tax expense	$680	$632	$ 91

A reconciliation of the income tax expense attributable to continuing operations computed at U.S. Federal statutory tax rates to the income tax expense as included in the consolidated statements of income follows:

YEARS ENDED DECEMBER 31,	2007	2006	2005
Expected Federal income tax expense	**$769**	$790	$396
Tax effect of:			
Nontaxable investment income	**(110)**	(67)	(35)
Change in valuation allowance	**2**	(10)	(256)
Goodwill	**(15)**	(15)	(16)
IRS Settlement	**—**	(10)	—
Foreign	**(22)**	(43)	45
Other	**56**	(13)	(43)
Actual Federal and foreign income tax expense	**$680**	$632	$ 91

The significant components of the deferred income tax assets and liabilities at December 31, are summarized as follows:

	2007	2006
Deferred tax assets:		
Unpaid claims discount	**$ 588**	$ 616
Unearned premium reserves	**573**	509
Net operating losses	**344**	342
Employee benefits	**520**	355
Retroactive reinsurance deferred gain	**284**	301
Credits	**61**	73
Other	**253**	160
	2,623	2,356
Less: valuation allowance	**(117)**	(101)
Total deferred tax assets	**2,506**	2,255
Deferred tax liabilities:		
Deferred acquisition costs	**518**	425
Net unrealized gains and other-than-temporary declines in investments	**358**	318
Intangibles	**102**	—
Other	**59**	22
Total deferred tax liabilities	**1,037**	765
Net deferred tax assets	**$1,469**	$1,490

The increase in the valuation allowance is primarily due to net operating losses generated in certain foreign subsidiaries where there is uncertainty in the timing and amount of the realization of these losses. Based on the assumption that future levels of income will be achieved, management believes it is more likely than not the net deferred tax assets will be realized.

The Company's subsidiaries had net operating loss carry forwards of $1,008 alternative minimum tax credit carry forwards of $1 and foreign tax credit carry forwards of $60 as of December 31, 2007. The net operating losses available in the U.S. and various non-U.S. tax jurisdictions will begin to expire, if not utilized, as follows:

2007	$ 7
2008	2
2009	5
2010	30
2011	26
Thereafter	938
Total	$1,008

The foreign tax credits will begin to expire, if not utilized, in 2012 and the alternative minimum tax credits do not expire.

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the United States where such earnings are permanently reinvested. At December 31, 2007, unremitted earnings of foreign subsidiaries were $795. If these earnings were distributed in the form of dividends or otherwise, the Company would be subject to U.S. income taxes less an adjustment for applicable foreign tax credits.

The American Jobs Creation Act of 2004 introduced a special 85% dividends received deduction on the repatriation of certain foreign earnings to a United States taxpayer, provided certain criteria are met. The maximum amount of foreign earnings eligible for the deduction is limited to the greater of $500 or the amount shown in the Company's most recent audited financial statements prior to June 30, 2003, as earnings permanently reinvested outside of the United States. In 2005, the Company repatriated a total of $161 from its foreign subsidiaries and recorded a related tax expense of $18.

The IRS has completed its review of the Company's federal income tax returns through the 1998 tax year and is currently reviewing income tax returns for the 1999 through 2005 tax years. Any adjustments that may result from the IRS examinations 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
LIBERTY MUTUAL HOLDING COMPANY INC.
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The Company adopted the provisions of FIN 48, on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a decrease of approximately $11 in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007, balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	$107
Additions based on tax positions related to the current year	—
Additions for tax positions of prior years	60
Reductions for tax positions of prior years	—
Settlements	8
Balance at December 31, 2007	$175

Included in the balance at December 31, 2007, are $79 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in Federal and foreign income tax expense. During the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately $10, $11, and $15 in interest and penalties. The Company had approximately $53 and $50 of interest and penalties accrued at December 31, 2007, and 2006, respectively.

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 taxes for tax year 1990, based on the treatment of salvage and subrogation, in the amount of $43 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.

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

(11) BENEFIT PLANS

The Company acquired Ohio Casualty effective August 24, 2007. The Ohio Casualty benefit plans are combined with the Company benefit plans results in the Benefit Plans footnote.

The Company sponsors non-contributory defined benefit pension plans ("the Plans") covering substantially all U.S. and Canadian employees. The benefits and eligibility are based on age, years of service, and the employee's compensation, as more fully described in the Plans. Some foreign subsidiaries sponsor pension plans (principally non-contributory) which provide benefits based on final pay.

The Company sponsors supplemental retirement plans to provide pension benefits above the levels provided by the pension plans without regard to the statutory earnings limitations of qualified defined benefit pension plans. The supplemental plans are unfunded.

The Company also provides certain healthcare and life insurance benefits ("Postretirement") covering substantially all U.S. and Canadian employees. Life insurance benefits are based on a participant's final compensation subject to the plan maximum.

Assets of the defined benefit pension and postretirement plans consist primarily of investments in a subsidiary life insurance company's separate accounts that invest primarily in fixed income and Standard and Poor's 500 Index of equity securities. At December 31, 2007, and 2006, assets of the Plans totaling $3,203 and $2,882, respectively, were held in separate accounts of the Company.

The Company sponsors defined contribution savings plans for substantially all U.S. (a 401(k) plan) and Canadian (a Deferred Profit Sharing Plan) employees who meet certain eligibility requirements. During 2007, 2006, and 2005, employees could contribute a percentage of their annual compensation on a before and after-tax basis, subject to Federal limitations. The benefits are based on the employee's contribution amount and Company profitability. In 2007, 2006, and 2005, the Company made matching contributions of $128, $88, and $76, respectively, including the supplemental defined contribution plans.

Compensation expense related to the Company's long-term and short-term incentive compensation plans was $557, $488, and $355, for the years ended December 31, 2007, 2006, and 2005, respectively.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The following table sets forth the assets, obligations, and assumptions associated with the various U.S., Canadian, and certain foreign subsidiary pension and postretirement benefits. The amounts are recognized in the accompanying consolidated balance sheets as of December 31, 2007, and 2006, and consolidated statements of income for the years ended December 31, 2007, 2006, and 2005.

	PENSION		SUPPLEMENTAL PENSION		POSTRETIREMENT	
	2007	2006	**2007**	2006	**2007**	2006
Change in benefit obligations:						
Benefit obligation at beginning of year	**$ 3,355**	$ 3,368	**$ 224**	$ 233	**$ 512**	$ 508
Service costs	**148**	154	**8**	10	**19**	19
Interest costs	**213**	184	**13**	13	**31**	28
Amendments	**53**	—	**2**	—	**—**	—
Actuarial (gains) losses	**(192)**	(245)	**4**	(17)	**(53)**	(24)
Currency exchange rate change	**15**	1	**1**	—	**1**	—
Acquisition	**336**	—	**2**	—	**65**	—
Benefits paid	**(131)**	(110)	**(16)**	(15)	**(21)**	(23)
Other	**42**	3	**—**	—	**—**	4
Benefit obligations at end of year	**$ 3,839**	$ 3,355	**$ 238**	$ 224	**$ 554**	$ 512
Accumulated benefit obligations	**$ 3,348**	$ 2,830	**$ 184**	$ 172	**$ 554**	$ 512
Change in plan assets:						
Fair value of plan assets at beginning of year	**$ 2,987**	$ 2,526	**$ —**	$ —	**$ 18**	$ 19
Actual return on plan assets	**259**	352	**—**	—	**1**	2
Currency exchange rate change	**10**	1	**—**	—	**—**	—
Acquisition	**363**	—	**—**	—	**1**	—
Employer contribution	**205**	225	**—**	—	**18**	20
Benefits paid	**(129)**	(110)	**—**	—	**(21)**	(23)
Other	**1**	(7)	**—**	—	**—**	—
Fair value of plan assets at end of year	**$ 3,696**	$ 2,987	**$ —**	$ —	**$ 17**	$ 18
Funded status of Plan	**$ (143)**	$ (368)	**$ (238)**	$ (224)	**$ (537)**	$ (494)
Amounts recognized in the Statement of Financial Position:						
Noncurrent assets	**$ 36**	n/a	**$ —**	n/a	**$ —**	n/a
Current liabilities	**—**	n/a	**(8)**	n/a	**(10)**	n/a
Noncurrent liabilities	**(179)**	n/a	**(230)**	n/a	**(527)**	n/a
Net asset (liability) at end of year	**$ (143)**	n/a	**$ (238)**	n/a	**$ (537)**	n/a
Amounts recognized in Accumulated Other Comprehensive Income:						
Net gain (loss)	**$ 359**	n/a	**$ 73**	n/a	**$ (74)**	n/a
Prior service costs	**46**	n/a	**10**	n/a	**(32)**	n/a
Net transition (asset) liability	**(17)**	n/a	**—**	n/a	**77**	n/a
Total	**$ 388**	n/a	**$ 83**	n/a	**$ (29)**	n/a

The estimated net actuarial loss, prior service cost, and transition obligation for the pension, supplemental pension and postretirement welfare plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2008 fiscal year are $16, $8, and $(5), respectively for pension and supplemental plans and $(2), $(3), and $9, respectively, for retiree welfare plans.

The net benefit costs for the years ended December 31, 2007, 2006, and 2005, include the following components:

DECEMBER 31, 2007	PENSION	SUPPLEMENTAL PENSION	POST-RETIREMENT
Components of net periodic benefit costs			
Service costs	**$ 148**	**$ 8**	**$ 19**
Interest costs	**213**	**13**	**31**
Expected return on plan assets	**(231)**	**—**	**(1)**
Amortization of unrecognized:			
Net loss	**36**	**4**	**—**
Prior service cost	**4**	**3**	**(3)**
Net transition (assets) obligation	**(5)**	**—**	**9**
Net periodic benefit costs	**$ 165**	**$ 28**	**$ 55**

DECEMBER 31, 2006	PENSION	SUPPLEMENTAL PENSION	POST-RETIREMENT
Components of net periodic benefit costs			
Service costs	$ 154	$ 10	$ 19
Interest costs	184	13	28
Expected return on plan assets	(199)	—	(2)
Settlement charge	(2)	—	—
Amortization of unrecognized:			
Net loss	59	8	—
Prior service cost	1	2	(3)
Net transition (assets) obligation	(6)	—	9
Net periodic benefit costs	$ 191	$ 33	$ 51

DECEMBER 31, 2005	PENSION	SUPPLEMENTAL PENSION	POST-RETIREMENT
Components of net periodic benefit costs			
Service costs	$ 127	$ 9	$ 14
Interest costs	173	13	27
Expected return on plan assets	(201)	—	(1)
Settlement charge	—	—	—
Amortization of unrecognized:			
Net loss (gain)	18	6	(1)
Prior service cost	3	2	(3)
Net transition (assets) obligation	(5)	—	10
Net periodic benefit costs	$ 115	$ 30	$ 46

The measurement date used to determine pension and other postretirement measurements is December 31, 2007.

Weighted-average actuarial assumptions for benefit obligations are set forth in the following table:

DECEMBER 31,	**2007**	2006
Pension		
Discount rate	**6.50%**	6.00%
Rate of compensation increase	**4.70%**	4.70%
Supplemental Pension		
Discount rate	**6.50%**	6.00%
Rate of compensation increase	**4.90%**	4.90%
Postretirement		
Discount rate	**6.50%**	6.00%

Weighted-average actuarial assumptions for net periodic benefit costs are set forth in the following table:

DECEMBER 31,	**2007**	2006	2005
Pension			
Discount rate	**6.00%**	6.25%	5.50%
Expected return on plan assets	**7.50%**	7.50%	8.00%
Rate of compensation increase	**4.70%**	4.70%	5.20%
Supplemental Pension			
Discount rate	**6.00%**	6.25%	5.50%
Rate of compensation increase	**4.90%**	4.90%	4.90%
Postretirement			
Discount rate	**6.00%**	6.25%	5.50%
Expected return on plan assets	**7.15%**	7.15%	7.15%

The discount rate assumption used to determine the benefit obligations is based on a yield curve approach where the cash flow related to the retirement plan liability stream is discounted at an interest rate specifically applicable to the timing of the cash flow. The yield curve is developed from the December 31, 2007 Citigroup Pension Discount Curve. The process calculates the present value of these cash flows and determines the equivalent single discount rate that produces the same present value of the future cash flows. The equivalent single discount rate is then rounded to the nearest 25 basis points.

In choosing the expected long-term rate of return, the Company's Retirement Board considered the historical returns of equity and fixed income markets in conjunction with today's economic and financial market conditions.

The weighted-average healthcare cost trend rates are expected to be 9.4% in 2008 graded down to 5.2% in 2016. Healthcare cost trend rate assumptions have a material impact on the postretirement benefit obligation. A one-percentage point change in assumed healthcare cost trend rates would have the following effects:

	1% POINT INCREASE	1% POINT DECREASE
Effect on Postretirement Benefit Obligation	$ 55	$ 50
Effect on total service and interest costs	$ 7	$ 6

Plan Assets

The Plans' weighted-average asset allocation by asset category is as follows:

ASSET CATEGORY	2007	2006
Equity Investments	**51%**	58%
Debt Investments	**26%**	24%
Other	**23%**	18%
Total	**100%**	100%

The fundamental investment policies of the Plans have been formulated so they balance the primary objectives of (1) achieving long-term growth sufficient to fund, as fully practicable, future obligations and (2) supporting the short-term requirement of meeting current benefit payments, all after giving due consideration to the underlying characteristics of the Company's employment base. Overall, the Plans' policies have traditionally emphasized the maximization of long-term returns in a manner that is consistent with an asset base that: consists of high quality investments as a means of enhancing capital preservation; is broadly diversified; generates a relatively high level of investment income in accordance with the level of risk incurred; and is generally, highly marketable.

Asset allocation and selection guidelines for the Plans have been developed around the aforementioned fundamental policies. Equities have been considered the most appropriate asset class for the Plans given their record of superior, long-term, real rates of return and the Plans' ability to accommodate the shorter-term volatility typically associated with equity investments. The guidelines for equity investing have historically focused on high quality stocks and the diversification of risk. The Plans' target allocation for equity investments is 65%, with a range of 45% to 80%.

The other major component of the Plans' assets consists of debt investments. The primary investment objective for this class of assets is to balance the pursuit of total return and the generation of a relatively high level of investment income. Emphasis is placed on high quality investments and the diversification of risk. The Plans' target allocation for debt investments is 29%, with a range of 17% to 42%.

The remaining assets of the Plans are maintained in cash or invested in limited partnerships, which are principally engaged in venture capital investing and other so-called "non-traditional" forms of investment. The Plans' target allocation for other investments is 6%, with a range of 3% to 12%. The increase in Other from the target is primarily attributable to an increase in money market assets and short-term securities.

The Postretirement Plan weighted-average asset allocations by asset category are as follows:

ASSET CATEGORY	2007	2006
Equity Investments	**35%**	34%
Debt Investments	**17%**	14%
Other	**48%**	52%
Total	**100%**	100%

The Postretirement Plan maintains assets in an insurance contract used to pay current life insurance premiums for certain retirees. These amounts are classified as other assets. The investment strategy for this portion of the assets places a greater emphasis on funding current benefits and a lesser emphasis on long-term growth.

Cash Flows

Contributions

The Company contributed $205 to the qualified plans, and directly funded $16 to retirees in the supplemental pension plans in 2007. In addition, the Company directly funded $18 to the postretirement benefit plans in 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
LIBERTY MUTUAL HOLDING COMPANY INC.
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The Company expects to contribute approximately $150 to the qualified plans, and directly fund $8 to retirees in the supplemental pension plans in 2008. In addition, the Company expects to directly fund $31 to the postretirement benefit plans gross of the Medicare Subsidy in 2008.

Expected Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate are expected to be paid:

	PENSION	SUPPLEMENTAL PENSION	POST-RETIREMENT WELFARE PLANS	POST-RETIREMENT MEDICARE SUBSIDY
2008	$ 144	$ 8	$ 31	$ (4)
2009	148	13	32	(5)
2010	153	14	34	(5)
2011	160	15	36	(6)
2012	169	16	37	(7)
2013-2016	1,025	96	222	(50)

(12) FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, *"Disclosures about Fair Value of Financial Instruments"* ("SFAS 107") requires disclosure of fair value information about financial instruments, as defined therein, for which it is practicable to estimate such fair value. SFAS 107 excludes certain financial instruments, including those related to certain insurance contracts. In the measurement of the fair value of certain financial instruments, quoted market prices were not available and other valuation techniques were utilized. These derived fair value estimates are significantly affected by the assumptions used. The following methods and assumptions were used to estimate the fair value of the financial instruments presented:

Fixed maturities: Fair values for fixed maturities were generally based on quoted market prices. For certain fixed-maturity securities for which quoted market prices were not available, fair values were estimated using values obtained from independent pricing services, or in the case of private placements, were determined by discounting expected future cash flows using a current market rate applicable to the yield, credit quality, and maturity of the securities.

Equity and trading securities: Fair values for equity and trading securities were based upon quoted market prices.

Other investments: Fair values represent the Company's equity in the partnerships' net assets as determined by the respective general partners and equity investments in privately held businesses where fair value approximates cost where market value data is unavailable for the underlying investment.

Mortgage loans: The fair values of commercial mortgage loans were estimated using option adjusted valuation discount rates.

Cash, cash equivalents, and short-term investments: The carrying amounts reported in the consolidated balance sheets for these instruments approximate fair values.

Individual and group annuities: Fair values for deferred annuity contracts are equal to current net surrender value. Fair values of liabilities under investment-type insurance contracts, including individual and group annuities, are estimated using discounted cash flow calculations at pricing rates at December 31, 2007, and 2006.

Debt outstanding: Fair values of commercial paper and short-term borrowings approximate carrying value. Fair values of long-term debt were based on either quoted market prices or estimated using discounted cash flow analyses based on the Company's incremental borrowing rate at December 31, 2007, and 2006.

The fair values and carrying values of the Company's financial instruments at December 31, 2007, and 2006 are as follows:

	2007		2006	
	CARRYING VALUE	**FAIR VALUE**	CARRYING VALUE	FAIR VALUE
Fixed maturity securities	**$46,934**	**$46,934**	$41,102	$41,102
Equity securities	**3,285**	**3,285**	2,619	2,619
Trading securities	**16**	**16**	22	22
Other investments	**2,348**	**2,348**	1,646	1,646
Short-term investments	**764**	**764**	1,550	1,550
Mortgage loans	**657**	**645**	322	313
Cash and cash equivalents	**3,199**	**3,199**	3,512	3,512
Individual and group annuities	**951**	**995**	938	999
Debt	**4,451**	**4,390**	3,346	3,554

(13) COMMITMENTS AND CONTINGENT LIABILITIES

Various lawsuits against the Company have arisen in the normal course of business. Contingent liabilities arising from litigation, income taxes, and other matters are not considered material in relation to the financial position of the Company.

The Company has been in various insurance coverage disputes with Armstrong World Industries ("Armstrong") for over twenty years relating to asbestos liabilities and insurance covering the period of 1973 to 1981. In July 2004, the Company prevailed in a favorable arbitration ruling before an appellate panel regarding Armstrong's available insurance coverage. Armstrong has filed, in the United States District Court for the Eastern District of Pennsylvania, a motion to vacate the 2004 appellate arbitration award that was favorable to the Company. The Company has filed a cross-motion seeking to confirm the award. Both motions have been briefed and remain pending at this time. Armstrong also filed a Chapter 11 Bankruptcy petition in the United States Bankruptcy Court for the District of Delaware in December 2000. A plan of reorganization was confirmed in August 2006, and Armstrong formally emerged from bankruptcy as of October 2, 2006. A declaratory judgment action, filed against the Company by Armstrong in 2002, is also pending in the United States District Court for the Eastern District of Pennsylvania. In that action, Armstrong is seeking coverage for asbestos claims under insurance policies issued to it during the period of 1973 to 1981, including, but not limited to, damages and a declaration regarding the availability, applicability, and scope of alleged non-product coverage not subject to the aggregate limits of the policies. Armstrong contends that a significant portion of its asbestos liability arises from operations that would entitle Armstrong to insurance coverage under the disputed policies without regard to the aggregate limit of liability. The Pennsylvania coverage action is currently in the initial pleading stages and, while it has been inactive by agreement of the parties since 2002, the court recently reactivated the case at a Rule 16 Scheduling Conference on October 22, 2007. The Company intends to vigorously defend its position in all pending coverage litigation, including any argument that coverage issues were finally determined in the bankruptcy proceedings. Management believes that the ultimate liability, if any, to Armstrong will not be resolved for at least one year and very likely may not be known for several years. In the opinion of management, the outcome of these pending matters is difficult to predict and an adverse outcome could have a material adverse effect on the Company's business, financial condition, and results of operations.

The Company leases certain office facilities and equipment under operating leases expiring in various years through 2016. Rental expense amounted to $215, $185, and $175, for the years ended December 31, 2007, 2006, and 2005, respectively. In addition, the Company is party to two land leases expiring in 2025 and 2101. The Company also owns certain office facilities and receives rental income from tenants under operating leases expiring in various years through 2022. Rental income amounted to $35, $36, and $3 for the years ended December 31, 2007, 2006, and 2005, respectively.

Future minimum rental payments and receipts under non-cancelable leases with terms in excess of one year are estimated as follows:

	OPERATING LEASES	LAND LEASES	RENTAL INCOME	NET LEASE OBLIGATIONS
2008	$153	$ 1	$ 32	$122
2009	140	1	32	109
2010	104	1	32	73
2011	58	1	23	36
2012	42	1	18	25
2013 – 2032	76	20	69	27
2033 – 2052	—	20	—	20
2053 – 2101	—	96	—	96
Total	$573	$141	$206	$508

The Company entered into arrangements to sell and lease-back certain equipment through 2010. The transactions are accounted for as operating leases. Rental expense amounted to $13, $13, and $12 for the years ended December 31, 2007, 2006, and 2005, respectively. Future minimum rental payments under these leases are estimated as follows:

2008	$13
2009	13
2010	10
Total	$36

At December 31, 2007, the Company had unfunded capital commitments to private equity, commercial mortgages, and energy investments of $2,305.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
LIBERTY MUTUAL HOLDING COMPANY INC.
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

At December 31, 2007, the Company had commitments to purchase various mortgage-backed securities settling in 2008, at a cost of $29 with a fair value of $29, which are included as fixed maturities in the consolidated balance sheets.

At December 31, 2007, the Company had $782 of undrawn letters of credit outstanding secured by assets of $824.

Liabilities for guaranty fund and other insurance-related assessments are accrued when an assessment is probable, when it can be reasonably estimated, and when the event obligating the entity to pay an imposed or probable assessment has occurred (based on past premiums for life lines and future premiums for property and casualty lines). Liabilities for guaranty funds and other insurance-related assessments are not discounted and are included as part of other liabilities in the consolidated balance sheets. As of December 31, 2007, and 2006, the liability balance was $271 and $212, respectively. As of December 31, 2007, and 2006, included in other assets were $18 and $12, respectively, of related assets for premium tax offsets or policy surcharges. The related asset is limited to the amount that is determined based on future premium collections or policy surcharges from policies in force. Current assessments are expected to be paid out over the next five years, while premium tax offsets are expected to be realized within one year.

The Company has reinsurance funds held balances of approximately $1,627, which are subject to ratings triggers whereby if any of the Company's insurance financial strength ratings (with the three major rating agencies) fall below the A- or A3 categories, the funds may be required to be placed in trust and invested in assets acceptable to the Company. The Company has no additional material ratings triggers.

(14) POLICYHOLDERS' EQUITY

Statutory Surplus

The Statutory surplus of the Company's domestic insurance companies was $14,155 and $12,131 at December 31, 2007, and 2006, respectively. The Company's domestic insurance subsidiaries prepare the statutory basis financial statements in accordance with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual ("NAIC APP"), subject to any deviations prescribed or permitted by the insurance commissioners of the various insurance companies' states of domicile. The Company does not have any material permitted practices that deviate from the NAIC APP.

Dividends

The insurance subsidiaries' ability to pay dividends is restricted under applicable insurance law and regulations. Under the insurance laws of the domiciliary states of the insurance subsidiaries, an insurer may make an ordinary dividend payment if its surplus as regards to policyholders, following such dividend, is reasonable in relation to its outstanding liabilities and adequate to its financial needs. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Under the insurance laws of Massachusetts, the domiciliary state of LMIC, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends made within the preceding 12 months, exceeds the greater of 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or the insurer's net income for the 12-month period ending on the preceding December 31. Under the insurance laws of Wisconsin, the domiciliary state of Liberty Mutual Fire Insurance Company ("LMFIC") and EICOW, an extraordinary dividend is defined as a dividend whose fair market value, together with other dividends paid within the preceding 12 months, exceeds the lesser of (a) 10% of the insurer's surplus as regards policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the preceding calendar year, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three preceding calendar years minus realized capital gains for those calendar years and minus dividends paid within the first two of the preceding three calendar years. Changes in the extraordinary dividend regulation of the domiciliary states of LMIC, LMFIC, and EICOW could negatively affect LMGI's ability to pay principal and interest on the notes held at LMGI, as could a redomestication, merger, or consolidation of LMIC, LMFIC, or EICOW to a different domiciliary state. The maximum dividend payout in 2008 that may be made prior to regulatory approval is $1,400.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Liberty Mutual Holding Company Inc.

We have audited the accompanying consolidated balance sheets of Liberty Mutual Holding Company Inc. (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in policyholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liberty Mutual Holding Company Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2007, the Company adopted FASB Statement 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132 (R), and FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.*

We also have audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), Liberty Mutual Holding Company Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 15, 2008 expressed an unqualified opinion thereon.

Ernst + Young LLP

Boston, Massachusetts
February 15, 2008

MANAGEMENT'S REPORT ON THE EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors
Liberty Mutual Holding Company Inc.

Our management is responsible for establishing and maintaining adequate internal control over Liberty Mutual Holding Company Inc.'s (the Company) financial reporting. Our internal control system was designed to provide reasonable assurance to our management and board of directors regarding the preparation and fair presentation of published financial statements. We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework.

The Company completed its acquisition of Ohio Casualty Corporation (Ohio Casualty) on August 24, 2007. As permitted under prevailing guidance, Management's assessment as of December 31, 2007 does not include the internal control of the former Ohio Casualty, whose balance sheet is included in the Company's consolidated financial statements as of December 31, 2007. Such operations of Ohio Casualty constituted approximately $6.9 billion and $2.9 billion of the Company's total assets and net assets, respectively, as of December 31, 2007, and $536 million and $57 million of revenues and net income, respectively, for the year then ended.

Based on our assessment, which excludes an assessment of internal control of the acquired operations of Ohio Casualty, we conclude that the Company's internal control over financial reporting is effective as of December 31, 2007 in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. Ernst & Young LLP, our independent registered public accounting firm, have issued an audit report on the effectiveness of the Company's internal control over financial reporting.

Edmund F Kelly

EDMUND F. KELLY CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Dennis J Langwell

DENNIS J. LANGWELL SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

The Board of Directors
Liberty Mutual Holding Company Inc.

We have audited Liberty Mutual Holding Company Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Liberty Mutual Holding Company Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report On Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of the Ohio Casualty Corporation, which is included in the 2007 consolidated financial statements of Liberty Mutual Holding Company Inc., and constituted $6.9 billion and $2.9 billion of total and net assets, respectively, as of December 31, 2007 and $536 million and $57 million of revenues and net income, respectively, for the year then ended. Our audit of internal control over financial reporting of Liberty Mutual Holding Company Inc. also did not include an evaluation of the internal control over financial reporting of Ohio Casualty Corporation.

In our opinion, Liberty Mutual Holding Company Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Liberty Mutual Holding Company Inc. as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in policyholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, and our report dated February 15, 2008 expressed and unqualified opinion thereon.

Ernst + Young LLP

Boston, Massachusetts
February 15, 2008

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ANNUAL MEETING

Liberty Mutual Holding Company Inc. holds its annual meeting on the second Wednesday of April at 10 a.m. at the headquarters in Boston.

Policyholders of Liberty Mutual Insurance Company (a stock insurance company), Liberty Mutual Fire Insurance Company (a stock insurance company) and Employers Insurance Company of Wausau (a stock insurance company) are members of Liberty Mutual Holding Company Inc. If you are a policyholder of any of these entities at the time of such meetings, you are entitled to vote, either in person or by proxy. You may obtain a proxy form by writing to the Secretary of Liberty Mutual Holding Company Inc. at 175 Berkeley Street, Boston, MA 02117.

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