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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. as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in total equity, and cash flows for each of the three years in the period ended December 31, 2016. 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, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and 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, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 1, 2017 expressed an unqualified opinion thereon.

Ernst & Young LLP

March 1, 2017



Liberty Mutual Insurance
175 Berkeley Street
Boston, MA 02116
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Management's Report on the Effectiveness of Internal Control Over Financial Reporting

The Board of Directors Liberty Mutual Holding Company Inc.

Management of Liberty Mutual Holding Company Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles.

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.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016, based on the framework established in Internal Control – Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (COSO).

Based on its assessment, management concluded that the Company's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements as of December 31, 2016.

Ernst & Young LLP, our independent registered public accounting firm, has issued its report on the effectiveness of the Company's internal control over financial reporting, which follows this report.

David H. Long, *President and Chief Executive Officer*

Dennis J. Langwell, *Executive Vice President and Chief Financial Officer*



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Report of Independent Registered Public Accounting Firm on the Effectiveness of Internal Control Over Financial Reporting

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, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (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 the Effectiveness of 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 attestation standards established by the American Institute of Certified Public Accountants 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 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.

In our opinion, Liberty Mutual Holding Company Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, 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, 2016 and 2015, and the consolidated statements of income, comprehensive income, changes in total equity, and cash flows for each of the three years in the period ended December 31, 2016 of Liberty Mutual Holding Company Inc. and our report dated March 1, 2017 expressed an unqualified opinion thereon.

Ernst & Young LLP

March 1, 2017

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Income

(dollars in millions)

| | Years Ended December 31, | | |
|--|--------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Revenues | | | |
| Premiums earned | \$ 34,835 | \$ 33,884 | \$ 33,448 |
| Net investment income | 2,563 | 2,650 | 3,099 |
| Fee and other revenues | 1,037 | 1,107 | 1,274 |
| Net realized losses | (127) | (24) | (100) |
| Total revenues | 38,308 | 37,617 | 37,721 |
| Claims, Benefits and Expenses | | | |
| Benefits, claims and claim adjustment expenses | 24,213 | 23,201 | 23,036 |
| Operating costs and expenses | 6,901 | 7,070 | 6,742 |
| Amortization of deferred policy acquisition costs | 4,922 | 4,675 | 4,660 |
| Interest expense | 445 | 438 | 419 |
| Interest credited to policyholders | 283 | 265 | 261 |
| Total claims, benefits and expenses | 36,764 | 35,649 | 35,118 |
| Loss on extinguishment of debt | (76) | (1) | (34) |
| Restructuring costs | (70) | - | - |
| Income from continuing operations before income tax expense and non-controlling interest | 1,398 | 1,967 | 2,569 |
| Income tax expense | 329 | 524 | 744 |
| Consolidated net income from continuing operations | 1,069 | 1,443 | 1,825 |
| Discontinued operations (net of income tax expense of \$0, \$16 and \$79 in 2016, 2015 and 2014 respectively) | - | (909) | (35) |
| Consolidated net income | 1,069 | 534 | 1,790 |
| Less: Net income (loss) attributable to non-controlling interest | 63 | 20 | (24) |
| Net income attributable to Liberty Mutual Holding Company Inc. | \$ 1,006 | \$ 514 | \$ 1,814 |
| Net Realized Losses | | | |
| Other-than-temporary impairment losses: | 2016 | 2015 | 2014 |
| Total other-than-temporary impairment losses | \$ (368) | \$ (410) | \$ (251) |
| Change in portion of loss recognized in other comprehensive income | - | - | (1) |
| Other-than-temporary impairment losses | (368) | (410) | (252) |
| Other net realized gains | 241 | 386 | 152 |
| Net realized losses | \$ (127) | \$ (24) | \$ (100) |

See accompanying notes to the audited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Comprehensive Income (Loss)

(dollars in millions)

| | Years Ended December 31, | | |
|---|--------------------------|------------|----------|
| | 2016 | 2015 | 2014 |
| Consolidated net income | \$ 1,069 | \$ 534 | \$ 1,790 |
| Other comprehensive income (loss), net of taxes: | | | |
| Unrealized gains (losses) on securities | 145 | (1,278) | 808 |
| Change in pension and post retirement plans funded status | (43) | 154 | (974) |
| Foreign currency translation and other adjustments | 126 | (459) | (422) |
| Other comprehensive income (loss), net of taxes | 228 | (1,583) | (588) |
| Consolidated comprehensive income (loss) | 1,297 | (1,049) | 1,202 |
| Less: Comprehensive income (loss) attributable to non-controlling interest | 74 | 15 | (29) |
| Comprehensive income (loss) attributable to Liberty Mutual Holding Company Inc. | \$ 1,223 | \$ (1,064) | \$ 1,231 |

See accompanying notes to the audited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Balance Sheets

(dollars in millions)

| | <u>December 31,</u> <u>2016</u> | <u>December 31,</u> <u>2015</u> |
|---|------------------------------------|------------------------------------|
| Assets: | | |
| Investments | | |
| Fixed maturities, available for sale, at fair value (amortized cost of \$63,169 and \$61,393) | \$ 64,700 | \$ 62,794 |
| Equity securities, available for sale, at fair value (cost of \$2,164 and \$2,571) | 2,576 | 2,909 |
| Short-term investments | 1,147 | 272 |
| Commercial mortgage loans | 2,582 | 2,317 |
| Other investments | 6,025 | 5,691 |
| Total investments | 77,030 | 73,983 |
| Cash and cash equivalents | 4,608 | 4,227 |
| Premium and other receivables | 10,649 | 10,137 |
| Reinsurance recoverables | 13,820 | 13,575 |
| Deferred income taxes | 402 | 795 |
| Deferred acquisition costs | 3,348 | 3,164 |
| Goodwill | 4,850 | 4,758 |
| Prepaid reinsurance premiums | 1,082 | 1,098 |
| Other assets | 9,803 | 9,928 |
| Total assets | \$ 125,592 | \$ 121,665 |
| Liabilities: | | |
| Unpaid claims and claim adjustment expenses and future policy benefits: | | |
| Property and casualty | \$ 49,721 | \$ 49,323 |
| Life | 9,833 | 9,262 |
| Other policyholder funds and benefits payable | 6,768 | 6,601 |
| Unearned premiums | 17,823 | 16,951 |
| Funds held under reinsurance treaties | 202 | 205 |
| Current maturities of long-term debt | - | 249 |
| Long-term debt | 7,603 | 6,940 |
| Other liabilities | 13,255 | 12,893 |
| Total liabilities | 105,205 | 102,424 |
| Equity: | | |
| Unassigned equity | 21,670 | 20,664 |
| Accumulated other comprehensive loss | (1,304) | (1,521) |
| Total policyholders' equity | 20,366 | 19,143 |
| Non-controlling interest | 21 | 98 |
| Total equity | 20,387 | 19,241 |
| Total liabilities and equity | \$ 125,592 | \$ 121,665 |

See accompanying notes to the audited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Changes in Total Equity

(dollars in millions)

| | Unassigned Equity | Accumulated Other Comprehensive Income (Loss) | Total Policyholders' Equity | Non-Controlling Interest | Total Equity |
|--|----------------------|--|-----------------------------------|-----------------------------|-----------------|
| Balance, January 1, 2014 | \$ 18,336 | \$ 640 | \$ 18,976 | \$ 44 | \$ 19,020 |
| Comprehensive income (loss): | | | | | |
| Consolidated net income (loss) | 1,814 | - | 1,814 | (24) | 1,790 |
| Other comprehensive loss, net of taxes | - | (583) | (583) | (5) | (588) |
| Total comprehensive income (loss) | 1,814 | (583) | 1,231 | (29) | 1,202 |
| Capital contributions from non-controlling interest | - | - | - | 69 | 69 |
| Balance, December 31, 2014 | \$ 20,150 | \$ 57 | \$ 20,207 | \$ 84 | \$ 20,291 |
| Comprehensive income (loss): | | | | | |
| Consolidated net income | 514 | - | 514 | 20 | 534 |
| Other comprehensive loss, net of taxes | - | (1,578) | (1,578) | (5) | (1,583) |
| Total comprehensive income (loss) | 514 | (1,578) | (1,064) | 15 | (1,049) |
| Capital contributions from non-controlling interest | - | - | - | 1 | 1 |
| Dividends to non-controlling interest | - | - | - | (2) | (2) |
| Balance, December 31, 2015 | \$ 20,664 | \$ (1,521) | \$ 19,143 | \$ 98 | \$ 19,241 |
| Comprehensive income: | | | | | |
| Consolidated net income | 1,006 | - | 1,006 | 63 | 1,069 |
| Other comprehensive income, net of taxes | - | 217 | 217 | 11 | 228 |
| Total comprehensive income | 1,006 | 217 | 1,223 | 74 | 1,297 |
| Distributions and other adjustments to non-controlling interest | - | - | - | (151) | (151) |
| Balance, December 31, 2016 | \$ 21,670 | \$ (1,304) | \$ 20,366 | \$ 21 | \$ 20,387 |

See accompanying notes to the audited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Consolidated Statements of Cash Flows

(dollars in millions)

| | Years Ended December 31, | | |
|--|--------------------------|----------|----------|
| | 2016 | 2015 | 2014 |
| Cash flows from operating activities: | | | |
| Consolidated net income | \$ 1,069 | \$ 534 | \$ 1,790 |
| Less - (loss) income from Venezuela discontinued operations, net of tax expense | - | (909) | 46 |
| Income from operations excluding Venezuela discontinued operations | 1,069 | 1,443 | 1,744 |
| Adjustments to reconcile consolidated net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 824 | 889 | 794 |
| Realized losses (including loss on sale of discontinued operations) | 127 | 24 | 175 |
| Undistributed private equity investment gains | (73) | (86) | (572) |
| Premium, other receivables, and reinsurance recoverables | (788) | (509) | (2,937) |
| Deferred acquisition costs | (212) | (197) | (177) |
| Liabilities for insurance reserves | 1,808 | 1,959 | 1,184 |
| Taxes payable, net of deferred | 139 | 275 | 756 |
| Other, net | 123 | (255) | (337) |
| Total adjustments | 1,948 | 2,100 | (1,114) |
| Net cash provided by operating activities - excluding Venezuela discontinued operations | 3,017 | 3,543 | 630 |
| Net cash provided by operating activities - Venezuela discontinued operations | - | 696 | 607 |
| Net cash provided by operating activities | 3,017 | 4,239 | 1,237 |
| Cash flows from investing activities: | | | |
| Purchases of investments | (20,981) | (18,497) | (14,442) |
| Sales and maturities of investments | 17,942 | 15,591 | 14,330 |
| Property and equipment purchased, net | (435) | (905) | (863) |
| Cash paid for acquisitions and disposals, net of cash on hand | (125) | - | (1,045) |
| Other investing activities | 256 | (16) | 19 |
| Net cash used in investing activities - excluding Venezuela discontinued operations | (3,343) | (3,827) | (2,001) |
| Net cash used in investing activities - Venezuela discontinued operations | - | (70) | (105) |
| Net cash used in investing activities | (3,343) | (3,897) | (2,106) |
| Cash flows from financing activities: | | | |
| Net activity in policyholder accounts | 553 | 578 | 573 |
| Debt financing, net | 394 | 1 | 564 |
| Net security lending activity and other financing activities | (200) | (72) | (49) |
| Net cash provided by financing activities - excluding Venezuela discontinued operations | 747 | 507 | 1,088 |
| Net cash provided by financing activities - Venezuela discontinued operations | - | 1 | - |
| Net cash provided by financing activities | 747 | 508 | 1,088 |
| Effect of exchange rate changes on cash - excluding Venezuela discontinued operations | (40) | 1 | 20 |
| Effect of exchange rate changes on cash - Venezuela discontinued operations | - | (69) | (301) |
| Effect of exchange rate changes on cash | (40) | (68) | (281) |
| Net increase (decrease) in cash and cash equivalents - excluding Venezuela discontinued operations | 381 | 224 | (263) |
| Net increase in cash and cash equivalents - Venezuela discontinued operations | - | 558 | 201 |
| Net increase (decrease) in cash and cash equivalents | 381 | 782 | (62) |
| Cash and cash equivalents, beginning of year - excluding Venezuela discontinued operations | 4,227 | 4,003 | 4,266 |
| Cash and cash equivalents, end of period - excluding Venezuela discontinued operations | \$ 4,608 | \$ 4,227 | \$ 4,003 |
| Supplemental Disclosure of Cash Flow Information | | | |
| Income Taxes Paid | \$ 116 | \$ 148 | \$ 85 |

See accompanying notes to the audited consolidated financial statements.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Liberty Mutual Holding Company Inc., entities over which the Company exercises control including majority and wholly owned subsidiaries, and variable interest entities (“VIE”) when the Company is deemed the primary beneficiary (collectively “LMHC”, the “Company” or “we”). The minority ownership of consolidated affiliates is represented in equity as non-controlling interest. All material intercompany transactions and balances have been eliminated. Certain reclassifications have been made to the 2015 consolidated financial statements to conform to the 2016 presentation.

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“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 claims and claim adjustment expense reserves, including asbestos and environmental liability reserves and loss sensitive premium attributable to prior years, (2) reinsurance recoverables and associated uncollectible allowance, (3) fair value determination and other-than-temporary impairments of the investment portfolio and direct working interests in oil and gas properties, (4) recoverability of deferred acquisition costs, (5) valuation of goodwill and intangible assets, (6) deferred income tax valuation allowance, and (7) pension and postretirement benefit obligations. While the amounts included in the consolidated financial statements reflect management’s best estimates and assumptions, these amounts ultimately could vary.

Nature of Operations

The Company conducts substantially all of its business through three Strategic Business Units (“SBUs”): Global Consumer Markets, Commercial Insurance, and Global Specialty. A summary of each SBU follows:

The Company’s Global Consumer Markets business unit, with \$21,741 of revenues in 2016, is comprised of two market segments, U.S. Consumer Markets and Global Consumer Markets East | West. The U.S. Consumer Markets segment, with \$17,920 of revenues in 2016, sells automobile, homeowners and other types of property and casualty insurance coverage to individuals in the United States. U.S. Consumer Markets’ products are distributed through approximately 2,100 licensed employee sales representatives, approximately 600 licensed telesales counselors, independent agents, third-party producers and the Internet. U.S. Consumer Markets has more than 22,000 sponsored affinity groups (including employers, professional and alumni associations, credit unions, and other partnerships) which are a significant source of new business. The Global Consumer Markets East | West segment, with \$3,821 of revenues in 2016, sells property and casualty, health and life insurance products and services to individuals and businesses in two operating regions. Global Consumer Markets East | West was realigned effective in the first quarter of 2016. The realignment better positions Global Consumer Markets East | West for continued growth and improved profitability in an increasingly competitive global marketplace. The two operating regions that comprise Global Consumer Markets East | West are West, including Brazil, Colombia, Chile, Ecuador, Spain, Portugal, and Ireland; and East, including Thailand, Singapore, Hong Kong, Vietnam, Malaysia, India, China, Russia, and Turkey. Other includes internal reinsurance. Private passenger automobile insurance is the single largest line of business.

The Company’s Commercial Insurance business unit, with \$11,355 of revenues in 2016, offers a wide array of property and casualty, group benefits, and life insurance coverages through independent agents, brokers, benefit consultants, captive agents, and bank partners throughout the United States. Commercial Insurance is organized into the following four market segments: Business Insurance; National Insurance; Liberty Mutual Benefits; and Other Commercial Insurance. Business Insurance serves small and middle market customers through a regional operating model that combines local underwriting, market knowledge and service with the scale advantages of a national company. National Insurance provides commercial lines products and services, including third-party administration, to large businesses. Liberty Mutual Benefits provides short and long-term disability, accident, health and group life insurance to mid-sized and large businesses, as well as life and annuity products to individuals in the United States. Other Commercial Insurance primarily consists of internal reinsurance and assumed business from state-based workers compensation involuntary market pools. The Company is also a servicing carrier for state-based workers compensation involuntary market pools.

The Company’s Global Specialty business unit, with \$5,085 of revenues in 2016, comprises a wide array of products and services offered through three market segments: Liberty Specialty Markets (“LSM”), Liberty International Underwriters (“LIU”), and Liberty Mutual Surety (“LM Surety”). LSM provides a wide range of product capabilities and capacity for specialty markets worldwide and is organized into three business segments: Specialty, Commercial and Reinsurance. LIU sells inland marine and specialty insurance worldwide through offices in Asia, Australia, the Middle East, North America and Latin America. LM Surety is a leading provider of global contract and commercial surety bonds to businesses of all sizes. Other primarily consists of internal reinsurance.

Adoption of New Accounting Standards

Effective January 1, 2016, the Company adopted the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-02, *Amendments to the Consolidation Analysis* (“ASU 2015-02”) which amends the guidance for determining whether an entity is a VIE. ASU 2015-02 eliminates the separate consolidation guidance for limited partnerships and with it, the presumption that a general partner should consolidate a limited partnership. In addition, ASU 2015-02 changes the guidance for determining if fee arrangements qualify as variable interests and the effect fee arrangements have on the determination of the primary beneficiary. The Company adopted ASU 2015-02 on a modified retrospective basis. ASU 2015-02 did not have an effect on the Company’s results of operations or financial position, but changes to the Company’s current year disclosures were required.

Effective January 1, 2016, the Company adopted ASU 2015-03, *Imputation of Interest* (Accounting Standards Codification (“ASC”) 835), which requires debt issuance costs to be presented as a deduction from the carrying amount of the related debt, consistent with treatment required for debt

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

discounts. The Company has applied the guidance retrospectively and as a result has reclassified \$42 of unamortized debt issuance costs from other assets to long-term debt as of December 31, 2015.

For the year ended December 31, 2016, the Company adopted the FASB issued ASU 2015-09, *Disclosures about Short-Duration Contracts* (“ASU 2015-09”). The amendments apply to all insurance entities that issue short-duration contracts as defined in ASC 944, *Financial Services – Insurance*. The disclosures required by ASU 2015-09 are aimed at providing the users of the financial statements with more transparent information about initial claim estimates and subsequent adjustments to those estimates, methodologies and judgments in estimating claims, and the timing, frequency and severity of claims. The Company has included additional disclosures on loss reserves consistent with the FASB guidance.

No other accounting standards were adopted in 2016 by the Company.

Future Adoption of New Accounting Standards

The Company will adopt the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (“ASU 2014-09”). ASU 2014-09 was issued to clarify the principles for recognizing revenue, however, insurance contracts and financial instrument transactions are not within the scope of this guidance. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers*, which deferred the effective date of ASU 2014-09 by one year. Accordingly, ASU 2014-09 is effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The Company is currently evaluating the impact the adoption of ASU 2014-09 is expected to have on the Company’s financial statements.

The Company will adopt the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). ASU 2016-01 requires equity investments (excluding those accounted for under the equity method or those that result in consolidation) to be measured at fair value, with changes in fair value recognized in net income. ASU 2016-01 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of ASU 2016-01. The adoption is expected to have a material impact on the Company’s financial statements.

The Company will adopt the FASB issued ASU 2016-02, *Leases* (“ASU 2016-02”). The amendments will require a lessee to recognize a right-of-use asset and a lease liability on the balance sheet for leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The amendments of ASU 2016-02 are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of ASU 2016-02 is expected to have on the Company’s financial statements.

The Company will adopt the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”). ASU 2016-13 replaces the current incurred loss model with an expected credit loss model, which measures credit losses on financial instruments measured at amortized cost, and will require companies to recognize an allowance for expected credit losses. In addition, ASU 2016-13 also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. This amendment removes certain factors to consider when determining whether credit losses should be recognized and will require companies to recognize expected credit losses through an allowance. ASU 2016-13 is effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of ASU 2016-13. The impact on the Company’s results of operations, financial position or liquidity at the date of adoption will be determined by the financial instruments held by the Company and the economic conditions at that time.

There are no other accounting standards not yet adopted by the Company that are expected to have a material impact.

Investments

Fixed maturity securities classified as available for sale are debt securities that have principal payment schedules, are held for indefinite periods of time, and are used as a part of the Company’s capital strategy or sold in response to risk and reward characteristics, liquidity needs or similar economic factors. These securities are reported at fair value with changes in fair values, 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 fair values. Changes in fair values, net of deferred income taxes, are reported in accumulated other comprehensive income.

Realized gains and losses on sales of investments are recognized in income using the specific identification method. The Company reviews fixed maturity securities, equity securities, and other investments for impairment on a quarterly 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, (7) the past impairment of the security holding or the issuer, and (8) changes in foreign exchange.

For fixed maturity securities that the Company does not intend to sell or for which it is more likely than not that the Company would not be required to sell before an anticipated recovery in value, the Company separates impairments into credit loss and non-credit loss components. The determination of the credit loss component of the impairment charge is based on the Company’s best estimate of the present value of the cash flows expected to be collected from the fixed maturity security compared to its amortized cost and is reported as part of net realized gains. The non-credit component, the residual difference between the credit impairment component and the fair value, is recognized in other comprehensive income. The factors considered in making an evaluation of credit versus non-credit other-than-temporary impairments include: (1) failure of the issuer of the

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

security to make scheduled interest or principal payments (including the payment structure of the fixed maturity security and the likelihood the issuer will be able to make payments that increase in the future), (2) performance indicators of the underlying assets in the security (including default and delinquency rates), (3) vintage, (4) geographic concentration, (5) impact of foreign exchange rates on foreign currency denominated securities, and (6) industry analyst reports, sector credit ratings and volatility of the security's fair value.

For equity securities the Company does not have the intent and ability to hold to recovery, and for fixed maturity securities the Company intends to sell or for which it is more likely than not that the Company will be required to sell before an anticipated recovery in value, the full amount (fair value less amortized cost) of the impairment is included in net realized (losses) gains.

Upon recognizing an other-than-temporary impairment, the new cost basis of the investment is the previous amortized cost basis less the other-than-temporary impairment recognized in net realized gains. The new cost basis is not adjusted for any subsequent recoveries in fair value; however, for fixed maturity securities the difference between the new cost basis and the expected cash flows is accreted to net investment income over the remaining expected life of the investment.

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, which 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 reported at fair value with changes in fair values, net of deferred income taxes, reported in accumulated other comprehensive income.

Any VIE for which the Company is the primary beneficiary is consolidated into the Company's financial statements.

Other investments are comprised of loans, limited partnerships and other alternative investments. Loans are reported at amortized cost less an allowance for potentially uncollectible amounts. Limited partnerships and other alternative investments are reported using the equity method of accounting and, accordingly, the Company's share of earnings are included in net investment income. Due to the availability of financial statements, other alternative investments and limited partnership investment income is generally recorded on a three-month lag. The Company elects the fair value option on certain other investments and these investments are carried at fair value. Accordingly, changes in fair value are included in net investment income or net realized gains in the accompanying consolidated statements of income. Also included in other investments are equity investments in privately held businesses that are carried at fair value with changes in fair value reported in other comprehensive income.

Commercial mortgage loans are held for investment and stated at amortized cost less an allowance for loan loss for potentially uncollectible amounts.

Net investment income primarily consists of interest, dividends, and income from limited partnerships and certain other alternative investments. Interest income is recognized on an accrual basis using the effective interest method and dividend income is recognized at the ex-dividend date. Interest income for mortgage-backed fixed maturity securities is recognized 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.

Derivatives

All derivatives are recognized on the balance sheet at fair value and reported as other assets and other liabilities. At the inception of the contract, the Company designates the derivative as (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.

The Company entered into oil commodity swaps in 2015 and oil commodity options in 2016 that are classified as economic hedges. Hedge accounting was not applied and changes in fair value were recorded in net realized gains (losses) on the consolidated statements of income. These derivatives were not material to the Company's financial statements.

The Company entered into Euro forward transactions in 2015 that are classified as economic hedges. Hedge accounting was not applied and changes in fair value were recorded in net realized gains (losses) on the consolidated statements of income. These derivatives were not material to the Company's financial statements.

The Company entered into interest rate-lock and swap agreements that are classified as cash flow hedges. The effective portion of the gain or loss on these instruments is reported as a component of other comprehensive income and reclassified into earnings in the same period in which the hedged items affect earnings. The Company's cash flow hedges are 100% effective and are not material to the financial statements.

The Company owns fixed maturity securities that may have call, put or conversion options embedded. These derivatives are not related to hedging and are not material to the Company's financial statements.

Net Investment Hedge Instruments

The Company has designated non-derivative foreign-currency denominated long-term debt and the related accrued interest as hedges of its net investment in certain foreign operations. Accordingly, the foreign currency translation of the debt instrument and accrued interest is recorded in accumulated other comprehensive income, offsetting the foreign currency translation adjustment of the related net investment that is also recorded in accumulated other comprehensive income. As of December 31, 2016 the Company had €750 million of outstanding long-term debt and

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approximately €14 million of accrued interest designated as non-derivative hedges of its net investment in certain foreign operations. The foreign currency translation of the debt instrument and accrued interest recorded in accumulated other comprehensive income were immaterial. (See Note 7 for further discussion.)

Securities Lending

The Company participates in a securities lending program to generate additional income, whereby certain domestic fixed maturity securities and equity 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 permitted securities as outlined in the securities lending agreement. 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 is tested for impairment at least annually using either a qualitative or a quantitative process. Election of the approach can be made at the reporting unit level. The Company has determined that each of its SBUs is a reporting unit. The reporting unit has the option to skip the qualitative test and move directly to completion of the quantitative process. The qualitative approach can be used to evaluate if there are any indicators of impairment. Through this process, the reporting unit must determine if there is indication that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill. If it is determined that there is an indication of potential impairment, the reporting unit must complete the quantitative process. The quantitative approach is 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 by acquisitions, dispositions, and foreign currency translation adjustments. In 2016, goodwill increased by \$92 driven primarily by the acquisition of Compañía de Seguros Generales Penta Security S.A.

In 2016, the Company utilized a qualitative test in accordance with its accounting policy for all reporting units. There were no goodwill impairments recognized in 2016 or 2015.

Indefinite-lived intangible assets held by the Company are reviewed for impairment on at least an annual basis using a qualitative process. The classification of the asset as indefinite-lived is reassessed, and an impairment is recognized if the carrying amount of the asset exceeds its fair value.

Intangible assets that have finite useful lives are amortized over their useful lives. The carrying amounts of intangible assets with finite useful lives are reviewed regularly for indicators of impairment in value. Impairment is recognized only if the carrying amount of the intangible asset is not recoverable from its undiscounted cash flows and is measured as the difference between the carrying amount and the fair value of the asset.

The Company has intangible assets included in other assets on the accompanying consolidated balance sheets primarily related to the Safeco and Ohio Casualty Corporation ("Ohio Casualty") acquisitions that occurred in 2008 and 2007, respectively. As of December 31, 2016, intangible assets related to these acquisitions were as follows: Safeco agency relationship of \$275, Ohio Casualty agency relationship of \$80, trademarks of \$229, state licenses of \$82, and other intangibles of \$1. As of December 31, 2015, intangible assets related to these acquisitions were as follows: Safeco agency relationship of \$316, Ohio Casualty agency relationship of \$87, trademarks of \$229, state licenses of \$82, and other intangibles of \$4. The amortization applied to the Safeco agency relationship, Ohio Casualty agency relationship, and other intangible assets is 15 years on the straight-line method, 20 years on the straight-line method, and 10 years using the present value mid-year convention, respectively. The intangible assets above are net of accumulated amortization of \$426 and \$375 as of December 31, 2016 and 2015, respectively. All other intangible assets are not subject to amortization.

The Company recognized \$51, \$52 and \$52 of amortization expense on intangible assets related to these acquisitions for the years ended December 31, 2016, 2015, and 2014, respectively. Amortization expense is reflected in operating costs and expenses on the accompanying consolidated statements of income. The Company did not recognize impairments on intangible assets related to these acquisitions for the years ended December 31, 2016, 2015 and 2014, respectively. Estimated amortization expense is expected to be \$50, \$50, \$49, \$49 and \$49 for the years ended December 31, 2017 through 2021, respectively.

Deferred Acquisition Costs

Costs that are directly related to the successful acquisition or renewal of insurance contracts are deferred and amortized over the respective policy terms. All other acquisition related costs, including market research, training, administration, unsuccessful acquisition or renewal efforts, and product development are charged to expense as incurred. 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 and underwriting expenses. Deferred acquisition costs are reviewed annually for recoverability. Investment income is considered in the recoverability assessment.

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 and investment products, acquisition costs are amortized in relation to expected gross profits.

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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 impact on unamortized deferred acquisition costs is recorded net of tax as a change in unrealized 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 3-5 years for equipment). Expenditures for maintenance and repairs are charged to income as incurred while expenditures for improvements are capitalized and depreciated.

Oil and Gas Properties

Oil and gas properties are accounted for using the successful efforts method whereby only costs (including lease acquisition and intangible drilling costs) associated with exploration efforts that result in the discovery of proved reserves are capitalized. Costs of acquiring and exploring unproved oil and gas leases are initially capitalized pending the results of exploration activities. Capitalized costs of producing oil and gas properties are depreciated and depleted on a field-by-field basis. The Company uses the unit-of-production method to deplete its properties and the calculation is based on units of proved developed reserves as estimated by independent petroleum engineers. Significant processing and pipeline assets are depreciated over a fixed period using the straight line method.

The Company records impairment losses on proved oil and gas properties when events and circumstances indicate the properties are impaired and the estimated undiscounted cash flows expected to be generated by those properties are less than the carrying amounts of those assets. Unproved properties are assessed at least annually to determine whether impairment has occurred. Appropriate adjustments to the costs of unproved properties are made when necessary and are included in realized gains (losses) on the consolidated statement of income. Impairment is assessed on a field-by-field basis. (See Note 10 for further discussion.)

Separate Account Assets and Liabilities

Separate 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 accompanying consolidated statements of income. The fees earned for administrative and contract holder maintenance performed for these separate accounts are included in fee and other revenues. Separate account assets and liabilities are reflected in other assets and other liabilities on the accompanying consolidated balance sheet.

Insurance Liabilities and Reserves

For short-duration contracts, the Company establishes reserves for unpaid claims and claim adjustment expenses covering events that occurred in 2016 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 discounting on the long-term indemnity portion of workers compensation settled claims, the long-term disability portion of group accident and health claims as permitted by insurance regulations in certain states, the long-term portion of certain workers compensation claims of foreign subsidiaries, reserves related to periodic payment orders on certain automobile policies and specific asbestos structured settlements. Reserves are reduced for estimated amounts of salvage and subrogation and deductibles recoverable from policyholders. The Company discounts the long-term indemnity portion of workers compensation claims at risk-free discount rates determined by reference to the U.S. Treasury yield curve. The weighted average discount rates were 5.1%, 5.2% and 5.4% for 2016, 2015, and 2014, respectively. The held discounted reserves on these unpaid workers compensation claims, net of all reinsurance, as of December 31, 2016, 2015 and 2014 were \$1,718, \$1,763 and \$1,842, respectively.

The discounting of disability claims is based on the 1987 Commissioners Group Disability Table modified for company experience in the first four years of claim duration, at annual discount rates varying from 2.5% to 7.0% in 2016 and 2015. Unpaid disability claims and claim adjustment expenses as of December 31, 2016 and 2015 include liabilities at discounted values of \$1,972 and \$1,765, respectively.

For long-duration contracts, measurement of liabilities is based on generally accepted actuarial techniques and 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. The average implied credited interest rates for domestic structured settlement contracts in force were 4.7%, 4.8% and 5.0% for 2016, 2015 and 2014, respectively. Implied credited interest rates for foreign structured settlement contracts in force were between 1.0% and 6.0% for each of the years ending December 31, 2016 and 2015. Credited rates for domestic universal life contracts in force were between 3.0% and 5.0% in 2016 and 2015. Credited rates for foreign universal life contracts in force were between 0.04% and 6.0% in 2016 and 2015. 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 2016 and 2015), mortality assumptions (based on the Company's experience relative to standard industry mortality tables) and withdrawal assumptions (based on the Company's experience).

Policyholder Dividends

Policyholder dividends are accrued using an estimate of the ultimate amount to be paid in relation to premiums earned based on the related insurance policies.

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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 0.3%, 0.4%, and 0.4% of domestic property-casualty insurance premiums written for the years ended December 31, 2016, 2015, and 2014, respectively. 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. 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 consolidated net income and total equity.

Guaranty Funds

Liabilities for guaranty funds 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. The liabilities for guaranty fund assessments are based on preceding year premium or multiple year's premiums depending upon the state law. Additionally, for those states that have loss-based assessments, liabilities for workers compensation loss based assessments are reserved based on workers compensation loss reserves and workers compensation paid losses. Liabilities for guaranty funds and other insurance-related assessments are not discounted and are included as part of other liabilities in the accompanying consolidated balance sheets. As of December 31, 2016 and 2015, the liability balance was \$135 and \$135, respectively. As of December 31, 2016 and 2015, included in other assets were \$3 and \$4, 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 over one year while loss-based assessments are expected to be paid over a period ranging from one year to the life expectancy of certain workers compensation claimants and the recoveries are expected to occur over the same period of time. Premium tax offsets are expected to be realized within one year.

Long-Term Incentive and Performance Based Incentive Plans

The Company maintains short-term and long-term incentive compensation plans. Long-term plans vest over the requisite service period, are based upon notional units and are accounted for under ASC 718, *Compensation – Stock Compensation*, using the intrinsic value method. Additionally, the Company provides 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 loss portfolio transfers, premiums are fully recognized as written and earned at contract inception. 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 accompanying consolidated balance sheets. Prospective reinsurance premiums, claims, and claim adjustment expenses are accounted for on a basis consistent with the terms of the reinsured contracts. The accompanying 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 benefits, claims and claim adjustment expenses. In transactions where the consideration paid exceeds the estimated liabilities for claims and claim costs a loss is recognized. If the adverse development net of experience adjustments exceeds the original loss, deferred gains are recorded. The deferred gains are subsequently recognized into earnings over the expected settlement period of the reserves.

Amounts recoverable from reinsurers include unpaid losses estimated in a manner consistent with the claim liabilities associated with the reinsured business. The Company evaluates reinsurance collectability, and a provision for uncollectible reinsurance is recorded.

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 that operation 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. Translation adjustments are recorded as a separate component of accumulated other comprehensive income, net of tax, to the extent applicable. Foreign currency amounts are re-measured to the functional currency, and the resulting foreign exchange gains or losses are reflected in earnings.

Income Taxes

The income tax provision is calculated under the liability method. The Company recognizes deferred income tax assets and liabilities for the expected future tax effects attributable to temporary differences between the financial statement and tax return basis of assets and liabilities based on enacted

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tax rates and other provisions of the tax law. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized. Deferred tax positions are not established for adjustments arising from foreign operations whose earnings are considered to be permanently reinvested.

Fee and Other Revenues

Fee and other revenues primarily consist of revenues from the Company's energy production operations, universal life cost of insurance and administrative fees, group life administrative service contract fees, and service fees generated from processing business for involuntary assigned risk pools, self-insured customers, and risk retention groups. Service fees are earned on a pro-rata basis over the term of the related policies. The Company accounts for oil and gas sales from its interests in producing wells under the sales method. The sales method requires that the Company recognize revenue based on the amount of natural gas and oil sold to purchasers on its behalf, which may be different from the Company's entitled production based on its interest in the properties.

Discontinued Operations

Disposal of businesses that are considered strategic shifts in the Company's operations are reflected as discontinued operations in the accompanying consolidated financial statements.

Accumulated Other Comprehensive (Loss) Income

Accumulated other comprehensive (loss) income consists principally of unrealized gains and losses on certain investments in debt and equity securities, foreign currency translation adjustments, and pension and postretirement liability adjustments.

The components of accumulated other comprehensive (loss) income, net of related deferred acquisition costs and taxes, for the years ended December 31, 2016, 2015 and 2014 are as follows:

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2016 | 2015 | 2014 |
| Unrealized gains on securities | \$962 | \$819 | \$2,097 |
| Foreign currency translation and other adjustments | (708) | (825) | (371) |
| Pension and post retirement liability funded status | (1,558) | (1,515) | (1,669) |
| Accumulated other comprehensive (loss) income | \$(1,304) | \$(1,521) | \$57 |

The following table presents the consolidated other comprehensive income (loss) reclassification adjustments for the years ended December 31, 2016, 2015, and 2014, respectively.

| | Unrealized gains on securities⁽¹⁾ | Change in pension and post retirement plans funded status | Foreign currency translation and other adjustments⁽²⁾ | Total |
|--|---|--|---|--------------|
| Year ended December 31, 2016 | | | | |
| Unrealized change arising during the period | \$256 | \$(222) | \$131 | \$165 |
| Less: Reclassification adjustments included in consolidated net income | 29 | (156) | - | (127) |
| Total other comprehensive income (loss), before income tax expense (benefit) | 227 | (66) | 131 | 292 |
| Less: Income tax expense (benefit) | 82 | (23) | 5 | 64 |
| Total other comprehensive income (loss), net of income tax expense (benefit) | \$145 | \$(43) | \$126 | \$228 |

⁽¹⁾ Includes \$2 of non-controlling interest.

⁽²⁾ Includes \$9 of non-controlling interest.

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| | Unrealized (losses) gains on securities | Change in pension and post retirement plans funded status | Foreign currency translation and other adjustments⁽¹⁾ | Total |
|--|--|--|---|-------------------|
| Year ended December 31, 2015 | | | | |
| Unrealized change arising during the period | \$ (1,634) | \$ (2) | \$ (504) | \$ (2,140) |
| Less: Reclassification adjustments included in consolidated net income | 257 | (224) | - | 33 |
| Total other comprehensive (loss) income, before income tax (benefit) expense | (1,891) | 222 | (504) | (2,173) |
| Less: Income tax (benefit) expense | (613) | 68 | (45) | (590) |
| Total other comprehensive (loss) income, net of income tax (benefit) expense | <u>\$ (1,278)</u> | <u>\$ 154</u> | <u>\$ (459)</u> | <u>\$ (1,583)</u> |

⁽¹⁾ Includes \$(5) of non-controlling interest.

| | Unrealized gains on securities | Change in pension and post retirement plans funded status | Foreign currency translation and other adjustments⁽¹⁾ | Total |
|--|---|--|---|-----------------|
| Year ended December 31, 2014 | | | | |
| Unrealized change arising during the period | \$ 1,352 | \$ (1,574) | \$ (473) | \$ (695) |
| Less: Reclassification adjustments included in consolidated net income | 109 | (78) | - | 31 |
| Total other comprehensive income (loss), before income tax expense (benefit) | 1,243 | (1,496) | (473) | (726) |
| Less: Income tax expense (benefit) | 435 | (522) | (51) | (138) |
| Total other comprehensive income (loss), net of income tax expense (benefit) | <u>\$ 808</u> | <u>\$ (974)</u> | <u>\$ (422)</u> | <u>\$ (588)</u> |

⁽¹⁾ Includes \$(5) of non-controlling interest.

(2) ACQUISITIONS AND DISPOSITIONS

ACQUISITIONS

Ironshore Inc.

On December 5, 2016, the Company entered into an agreement to purchase Ironshore Inc. (“Ironshore”) from Fosun International Ltd. Ironshore had approximately \$2,200 of gross written premium in 2015. The transaction is subject to regulatory approval and expected to close in the first half of 2017.

Compañía de Seguros Generales Penta Security S.A.

On January 14, 2016, the Company completed the acquisition of Compañía de Seguros Generales Penta Security S.A., the fourth largest non-life insurer in Chile. Compañía de Seguros Generales Penta Security S.A. had approximately \$160 of net written premium in 2015.

Hughes Insurance

On July 1, 2015, the Company completed the acquisition of Hughes Insurance, an independent insurance broker in Northern Ireland. Hughes Insurance offers motor, van, household, small-to-medium-enterprise commercial insurance and travel insurance. Hughes Insurance has been reflected in the consolidated financial statements since the second quarter of 2014.

DISPOSITIONS

Liberty Ubezpieczenia

On September 30, 2016, the Company completed the sale of substantially all the assets and liabilities of its Polish operation resulting in an immaterial gain. Liberty Ubezpieczenia had approximately \$90 of net written premium in 2015.

HELD FOR SALE

St. James/Arlington Real Estate Limited Partnership

On September 6, 2016, the Company determined to hold for sale and actively market its 10 St. James and 75 Arlington properties. The transaction was completed January 5, 2017. The 10 St. James and 75 Arlington properties had a carrying value of \$366 as of December 31, 2016 which is included in other assets on the Company’s consolidated balance sheets. (See note 13 for further discussion.)

Liberty Insurance (China)

On August 16, 2016, the Company entered into an agreement to sell a 51% interest of its Chinese operations to Sanpower Group. The transaction is subject to regulatory approval. A gain is expected on the sale.

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DISCONTINUED OPERATIONS

Venezuela Operations

Effective as of September 30, 2015, the Company deconsolidated the Venezuelan subsidiaries and made the Venezuelan operations available for sale. The evolving conditions in Venezuela, including the increasingly restrictive exchange control regulations and other factors, significantly impacted our control over the Venezuelan operations. As a result of these factors, which we believe to be other-than-temporary, we concluded that effective September 30, 2015, we do not meet the accounting criteria for control over the Venezuelan operations, and deconsolidated these operations in the accompanying financial statements. As a result of deconsolidating, the Company recognized an impairment charge of approximately \$690 which includes the write down of the investment in the previously consolidated Venezuelan operations to fair value and the write-off of related intercompany balances. The Company's Venezuelan operations and the related impairment charge are classified as discontinued operations in the consolidated financial statements. Subsequent to deconsolidation, the Company accounts for its ongoing investment in the Venezuelan operation on the cost basis.

The following table summarizes the amounts related to discontinued operations in the consolidated statements of income:

| | Years Ended December 31, | | |
|--|---------------------------------|----------------|----------------|
| | 2016 | 2015 | 2014 |
| Revenues: | | | |
| Premiums earned | \$ - | \$1,949 | \$1,946 |
| Net investment income | - | 95 | 93 |
| Fee and other revenues | - | - | 85 |
| Net realized losses | - | (211) | (317) |
| Total revenues | <u>\$ -</u> | <u>\$1,833</u> | <u>\$1,807</u> |
| Claims, Benefits and Expenses: | | | |
| Benefits, claims and claim adjustment expense | \$ - | \$1,351 | \$915 |
| Operating costs and expenses | - | 373 | 505 |
| Amortization of deferred policy acquisition costs | - | 303 | 284 |
| Total claims, benefits and expenses | <u>\$ -</u> | <u>\$2,027</u> | <u>\$1,704</u> |
| (Loss) income before income tax expense | \$ - | \$(194) | \$103 |
| Income tax expense | - | 25 | 57 |
| Net (loss) income | <u>\$ -</u> | <u>\$(219)</u> | <u>\$46</u> |
| Net loss on deconsolidation, net of tax | <u>\$ -</u> | <u>\$(662)</u> | <u>\$ -</u> |
| Impairment of intercompany receivables, net of tax | - | (28) | - |
| (Loss) income on discontinued operations, net of tax | <u>\$ -</u> | <u>\$(909)</u> | <u>\$46</u> |

(3) INVESTMENTS

Components of Net Investment Income

| | Years Ended December 31, | | |
|--|---------------------------------|----------------|----------------|
| | 2016 | 2015 | 2014 |
| Taxable interest income | \$2,088 | \$2,080 | \$2,109 |
| Tax-exempt interest income | 306 | 374 | 399 |
| Dividends | 55 | 65 | 74 |
| Limited partnerships, limited liability companies and other equity method investments | 143 | 153 | 574 |
| Commercial mortgage loans | 118 | 112 | 93 |
| Other investments | 22 | 26 | 12 |
| Gross investment income | <u>2,732</u> | <u>2,810</u> | <u>3,261</u> |
| Investment expenses ⁽¹⁾ | <u>(169)</u> | <u>(160)</u> | <u>(148)</u> |
| Net investment income ⁽²⁾ | <u>\$2,563</u> | <u>\$2,650</u> | <u>\$3,113</u> |

⁽¹⁾ Fees paid to external managers are included within the components of gross investment income.

⁽²⁾ The above table contains net investment income attributable to discontinued operations related to Summit and Argentina operations of \$0, \$0, and \$14 for the years ended December 31, 2016, 2015, and 2014, respectively.

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Components of Net Realized Losses

| | Years Ended December 31, | | |
|-----------------------|---------------------------------|----------------|-----------------|
| | 2016 | 2015 | 2014 |
| Fixed maturities | | | |
| Gross realized gains | \$238 | \$180 | \$153 |
| Gross realized losses | (146) | (135) | (95) |
| Equities | | | |
| Gross realized gains | 193 | 342 | 138 |
| Gross realized losses | (257) | (131) | (80) |
| Other | | | |
| Gross realized gains | 126 | 67 | 48 |
| Gross realized losses | (281) | (347) | (264) |
| Net realized losses | <u>\$ (127)</u> | <u>\$ (24)</u> | <u>\$ (100)</u> |

During the years ended December 31, 2016, 2015, and 2014, the Company recorded \$(368), \$(410), and \$(252) of impairment losses, respectively. As of December 31, 2016 and 2015, other-than-temporary impairment losses recognized through accumulated other comprehensive income were \$(30) and \$(31), respectively.

During the years ended December 31, 2016, 2015, and 2014, proceeds from sales of fixed maturities available for sale were \$7,123, \$4,466 and \$4,550, respectively. The gross realized gains (losses) on sales of fixed maturities available for sale totaled \$178 and \$(110) in 2016, \$152 and \$(73) in 2015 and \$123 and \$(45) in 2014. During the years ended December 31, 2016, 2015, and 2014, proceeds from sales of equities available for sale were \$1,237, \$1,396, and \$1,310, respectively. The gross realized gains (losses) on sales of equities available for sale totaled \$146 and \$(112) in 2016, \$316 and \$(70) in 2015, and \$110 and \$(54) in 2014.

Components of Change in Net Unrealized Investment Gains (Losses)

| | Years Ended December 31, | | |
|--|---------------------------------|------------------|--------------|
| | 2016 | 2015 | 2014 |
| Fixed maturities | \$113 | \$(1,861) | \$1,449 |
| Equities | 115 | (238) | 62 |
| Other | 71 | (44) | 71 |
| Adjustments to deferred acquisition costs | (72) | 252 | (339) |
| Net change in unrealized investment gains (losses) | <u>227</u> | <u>(1,891)</u> | <u>1,243</u> |
| Deferred income tax (expense) benefit | (82) | 613 | (435) |
| Net change in unrealized investment gains (losses), net of tax | <u>\$145</u> | <u>\$(1,278)</u> | <u>\$808</u> |

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Available for Sale Investments

The amortized cost, gross unrealized gains and losses and fair values of available for sale investments as of December 31, 2016 and 2015, are as follows:

| December 31, 2016 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|---------------------------|---------------------------------------|--|-----------------------|
| U.S. government and agency securities | \$3,141 | \$118 | \$(29) | \$3,230 |
| Residential MBS ⁽¹⁾ | 6,554 | 147 | (50) | 6,651 |
| Commercial MBS | 1,659 | 25 | (6) | 1,678 |
| Other MBS and ABS ⁽²⁾ | 2,966 | 37 | (23) | 2,980 |
| U.S. state and municipal | 14,014 | 462 | (194) | 14,282 |
| Corporate and other | 29,935 | 1,123 | (233) | 30,825 |
| Foreign government securities | 4,900 | 188 | (34) | 5,054 |
| Total fixed maturities | 63,169 | 2,100 | (569) | 64,700 |
| Common stock | 1,801 | 469 | (31) | 2,239 |
| Preferred stock | 363 | 15 | (41) | 337 |
| Total equity securities | 2,164 | 484 | (72) | 2,576 |
| Total securities available for sale | \$65,333 | \$2,584 | \$(641) | \$67,276 |

⁽¹⁾ Mortgage-backed securities ("MBS")

⁽²⁾ Asset-backed securities ("ABS")

| December 31, 2015 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|---------------------------|---------------------------------------|--|-----------------------|
| U.S. government and agency securities | \$3,182 | \$142 | \$(12) | \$3,312 |
| Residential MBS | 7,224 | 185 | (29) | 7,380 |
| Commercial MBS | 1,592 | 20 | (16) | 1,596 |
| Other MBS and ABS | 3,051 | 57 | (15) | 3,093 |
| U.S. state and municipal | 13,553 | 666 | (54) | 14,165 |
| Corporate and other | 28,749 | 991 | (694) | 29,046 |
| Foreign government securities | 4,042 | 197 | (37) | 4,202 |
| Total fixed maturities | 61,393 | 2,258 | (857) | 62,794 |
| Common stock | 2,193 | 488 | (110) | 2,571 |
| Preferred stock | 378 | 14 | (54) | 338 |
| Total equity securities | 2,571 | 502 | (164) | 2,909 |
| Total securities available for sale | \$63,964 | \$2,760 | \$(1,021) | \$65,703 |

Approximately 74% of the Company's securitized portfolio is explicitly backed by the U.S. government (Government National Mortgage Association "GNMA" and Small Business Association "SBA") or by government-sponsored entities (Federal Home Loan Mortgage Corporation "FHLMC" and Federal National Mortgage Association "FNMA"). Approximately 93% of the mortgage and asset-backed holdings are rated AAA. The commercial MBS portfolio is well diversified and of high quality with approximately 94% rated AAA.

As of December 31, 2016, no single issuer, excluding U.S. Treasuries, agency securities and MBS, accounted for more than 0.9% of invested assets.

Of the \$2,239 and \$2,571 of common stock as of December 31, 2016 and 2015, respectively, \$538 and \$483, respectively, related to securities associated with non-guaranteed unit linked products where the policyholder bears the investment risk.

As of December 31, 2016 and 2015, securities carried at \$3,006 and \$3,019, respectively, were on deposit with state regulatory authorities as required by law.

As of December 31, 2016 and 2015, the fair values of fixed maturity securities and equity securities loaned were approximately \$1,115 and \$1,495, respectively. Cash and short-term investments received as collateral in connection with the loaned securities were approximately \$898 and \$1,065

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as of December 31, 2016 and 2015, respectively. Investments other than cash and short-term investments received as collateral in connection with the loaned securities were approximately \$250 and \$487 as of December 31, 2016 and 2015, respectively.

The amortized cost and fair value of fixed maturities as of December 31, 2016, by contractual maturity are as follows:

| | Amortized Cost | Fair Value |
|--|---------------------------|-----------------------|
| Due to mature: | | |
| One year or less | \$3,298 | \$3,323 |
| Over one year through five years | 17,298 | 17,696 |
| Over five years through ten years | 16,995 | 17,341 |
| Over ten years | 14,399 | 15,031 |
| MBS and ABS of government and corporate agencies | 11,179 | 11,309 |
| Total fixed maturities | \$63,169 | \$64,700 |

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 tables summarize the gross unrealized losses and fair value of fixed maturity securities and equity securities by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2016 and 2015 and that are not deemed to be other-than-temporarily impaired.

| December 31, 2016 | Less Than 12 Months | | 12 Months or Longer | |
|---------------------------------------|------------------------------|--|------------------------------|--|
| | Unrealized Losses | Fair Value of Investments with Unrealized | Unrealized Losses | Fair Value of Investments with Unrealized |
| | | Losses | | Losses |
| U.S. government and agency securities | \$(28) | \$1,774 | \$(1) | \$6 |
| Residential MBS | (49) | 3,135 | (1) | 34 |
| Commercial MBS | (6) | 639 | - | 8 |
| Other MBS and ABS | (18) | 1,499 | (5) | 155 |
| U.S. state and municipal | (188) | 4,491 | (6) | 66 |
| Corporate and other | (178) | 7,878 | (55) | 840 |
| Foreign government securities | (30) | 1,425 | (4) | 263 |
| Total fixed maturities | (497) | 20,841 | (72) | 1,372 |
| Common stock | (14) | 187 | (17) | 164 |
| Preferred stock | (1) | 17 | (40) | 241 |
| Total equities | (15) | 204 | (57) | 405 |
| Total | \$(512) | \$21,045 | \$(129) | \$1,777 |

| December 31, 2015 | Less Than 12 Months | | 12 Months or Longer | |
|---------------------------------------|------------------------------|--|------------------------------|--|
| | Unrealized Losses | Fair Value of Investments with Unrealized | Unrealized Losses | Fair Value of Investments with Unrealized |
| | | Losses | | Losses |
| U.S. government and agency securities | \$(8) | \$1,304 | \$(4) | \$245 |
| Residential MBS | (21) | 2,445 | (8) | 364 |
| Commercial MBS | (13) | 737 | (3) | 122 |
| Other MBS and ABS | (11) | 1,280 | (4) | 166 |
| U.S. state and municipal | (47) | 1,647 | (7) | 142 |
| Corporate and other | (510) | 10,543 | (184) | 1,027 |
| Foreign government securities | (22) | 911 | (15) | 298 |
| Total fixed maturities | (632) | 18,867 | (225) | 2,364 |
| Common stock | (98) | 653 | (12) | 33 |
| Preferred stock | (1) | 4 | (53) | 254 |
| Total equities | (99) | 657 | (65) | 287 |
| Total | \$(731) | \$19,524 | \$(290) | \$2,651 |

Unrealized losses decreased from \$1,021 as of December 31, 2015 to \$641 as of December 31, 2016 primarily due to tightening credit spreads. As of December 31, 2016, there were 985 securities that were in an unrealized loss position for 12 months or longer. The Company monitors the difference between the amortized cost and estimated fair value of fixed maturity securities to ascertain whether declines in value are temporary in nature. In addition, the Company also monitors its intent and ability to hold certain equity securities for a period of time that is sufficient to allow

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for any anticipated recovery in fair value. The Company currently does not have the intent to sell and has determined it is not more likely than not that it would be required to sell these fixed maturity securities before recovery. For equity securities the Company has the intent and ability to hold these securities until recovery.

Variable Interest Entities

The Company invests in limited partnerships and other entities subject to VIE analysis under the VIE subsections of ASC 810, *Consolidation*. The Company analyzes each investment to determine whether it is a VIE, and if so, whether the Company is the primary beneficiary or a significant interest holder based on a qualitative and quantitative assessment. The Company evaluates the design of the entity, the risks to which the entity was designed to expose the variable interest holder and the extent of the Company's control of and variable interest in the VIE. As of December 31, 2016 and 2015, respectively, the Company has determined that it was not the primary beneficiary of any of its VIEs except for the Company's investment in its India joint venture which is deemed immaterial.

The Company has variable interests in VIEs for which it is not the primary beneficiary and accounts for these VIEs under the equity method in accordance with ASC 323, *Investments – Equity Method and Joint Ventures*. The VIEs are principally private equity limited partnerships in which the Company has invested as a passive limited partner. The partnerships were deemed to be VIEs because the equity holders as a group lack the power to direct the activities that most significantly impact the respective entity's economic performance. The VIEs generate variability primarily from investment portfolio performance and that variability is passed to equity holders. The net carrying value of non-consolidated VIEs in which the Company has a variable interest was \$4,675 and \$1,719 as of December 31, 2016 and 2015, respectively and the Company's maximum exposure to loss was \$7,477 and \$2,487 as of December 31, 2016 and 2015, respectively. The assets are included in other investments in the accompanying consolidated balance sheets. Maximum exposure to loss includes the carrying value and unfunded commitment of the VIE. There is no recourse provision to the general credit of the Company for any VIE beyond the full amount of the Company's loss exposure.

LPs, LLCs and Other Equity Method Investments

As of December 31, 2016 and 2015, the carrying values of LP, LLC and other equity method investments were \$5,316 and \$5,023, respectively. These investments consist of traditional private equity partnerships, natural resources partnerships (primarily energy and metals and mining), real estate partnerships, and other partnership funds and equity method investments. The Company's investments in LPs, LLCs and other equity method investments are long-term in nature. The Company believes these investments offer the potential for superior long-term returns and are appropriate in the overall context of a diversified portfolio.

Investments in Commercial Mortgage Loans

As of December 31, 2016 and 2015, the carrying values of commercial mortgage loans were \$2,582 and \$2,317, respectively. The carrying values reflect allowances for loan losses of \$8 and \$11 as of December 31, 2016 and 2015, respectively. The number of loans in the portfolio increased from 4,763 as of December 31, 2015, to 4,856 as of December 31, 2016.

(4) DEFERRED ACQUISITION COSTS

The following reflects the policy acquisition costs deferred for amortization against future income and related amortization charged to income:

| | Years Ended December 31, | | |
|---|--------------------------|---------|---------|
| | 2016 | 2015 | 2014 |
| Balance at beginning of year | \$3,164 | \$3,001 | \$2,978 |
| Balance attributable to dispositions ⁽¹⁾ | (8) | - | (17) |
| Acquisition costs deferred and other | 5,114 | 4,838 | 4,721 |
| Amortization charged to income ⁽²⁾ | (4,922) | (4,675) | (4,681) |
| Balance at end of year | \$3,348 | \$3,164 | \$3,001 |

⁽¹⁾ The balance attributable to dispositions primarily represents the disposition of Liberty Ubezpieczenia during the year ended 2016 and the dispositions of Argentina operations and Summit during the year ended 2014. (See Note 2 for further discussion.)

⁽²⁾ The above table contains amortization attributable to discontinued operations of \$0, \$0 and \$21 for the years ended December 31, 2016, 2015, and 2014 respectively.

(5) 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.

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

| P&C | 2016 | | 2015 | | 2014 | |
|--------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | Written | Earned | Written | Earned | Written | Earned |
| Direct | \$37,208 | \$36,348 | \$35,719 | \$35,151 | \$35,920 | \$35,175 |
| Assumed | 1,358 | 1,541 | 1,687 | 1,821 | 1,927 | 1,945 |
| Ceded | 4,754 | 4,945 | 4,619 | 4,827 | 5,129 | 5,308 |
| Net premiums | <u>\$33,812</u> | <u>\$32,944</u> | <u>\$32,787</u> | <u>\$32,145</u> | <u>\$32,718</u> | <u>\$31,812</u> |

| Life & Annuity | 2016 | | 2015 | | 2014 | |
|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | Written | Earned | Written | Earned | Written | Earned |
| Direct | \$1,997 | \$1,986 | \$1,838 | \$1,831 | \$1,704 | \$1,726 |
| Assumed | 3 | 3 | 2 | 2 | 2 | 2 |
| Ceded | 98 | 98 | 94 | 94 | 92 | 92 |
| Net premiums | <u>\$1,902</u> | <u>\$1,891</u> | <u>\$1,746</u> | <u>\$1,739</u> | <u>\$1,614</u> | <u>\$1,636</u> |

The Company reported reinsurance recoverables of \$13,820 and \$13,575 as of December 31, 2016 and 2015, respectively, net of allowance for doubtful accounts of \$235 and \$131, respectively. 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, 2016:

| S&P Rating | Reinsurance Recoverables | Collateral Held | Net Recoverables ⁽¹⁾ |
|-----------------------------------|--------------------------|-----------------|---------------------------------|
| AAA | \$ - | \$ - | \$ - |
| AA+, AA, AA- | 5,481 | 3,567 | 2,216 |
| A+, A, A- | 3,460 | 288 | 3,194 |
| BBB+, BBB, BBB- | 3 | - | 3 |
| BB+ or below | 1 | - | 1 |
| Involuntary pools | 2,927 | - | 2,929 |
| Voluntary pools | 271 | 103 | 239 |
| Other ⁽²⁾ | 1,912 | 2,409 | 494 |
| Gross recoverables ⁽³⁾ | <u>\$14,055</u> | <u>\$6,367</u> | <u>\$9,076</u> |
| Less: allowance | 235 | | |
| Net recoverables | <u>\$13,820</u> | | |

⁽¹⁾ Net recoverables represent gross recoverables less applicable collateral that can be specifically applied against recoverable balances.

⁽²⁾ Includes \$433 and \$1,479 of reinsurance recoverables from non-rated reinsurers and captive and program business, respectively.

⁽³⁾ Includes \$564 and \$13,491 of paid and unpaid reinsurance recoverables, 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.

The reinsurance recoverables from state mandated involuntary pools and associations primarily 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.

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

On July 17, 2014, Liberty Mutual Insurance Company ("LMIC") entered into a reinsurance agreement with National Indemnity Company ("NICO"), a subsidiary of Berkshire Hathaway Inc., on a combined aggregate excess of loss agreement for substantially all of the Company's U.S. workers compensation, asbestos and environmental liabilities (the "NICO Reinsurance Transaction"), attaching at \$12,522 of combined aggregate reserves, with an aggregate limit of \$6,500 and sublimits of \$3,100 for asbestos and environmental liabilities and \$4,507 for certain workers compensation liabilities. At the closing of the NICO Reinsurance Transaction, but effective as of January 1, 2014, the Company ceded \$3,320 of existing undiscounted liabilities under this retroactive reinsurance agreement. NICO will provide \$3,180 of additional aggregate adverse development cover ("ADC"). The Company paid NICO total consideration of \$3,046, and recorded a pre-tax loss of \$128 in the third quarter of 2014. With respect to

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the ceded asbestos and environmental business, NICO has been given authority to handle claims, subject to the Company's oversight and control. With respect to the ceded workers compensation business, the Company handles claims.

In general terms, the covered business includes post December 31, 2013 development on: (1) asbestos and environmental liabilities arising under policies of insurance and reinsurance with effective dates prior to January 1, 2005; and (2) workers compensation liabilities as respects injuries or accidents occurring prior to January 1, 2014.

The following table displays the impact of the NICO Reinsurance Transaction subsequent to transaction date in the accompanying consolidated statements of income:

| | Years Ended December 31, | | |
|---|--------------------------|------|-------|
| | 2016 | 2015 | 2014 |
| Amounts ceded under NICO Reinsurance Transaction | | | |
| Unrecognized reinsurance benefit related to original transaction loss at the beginning of the year | \$59 | \$43 | \$128 |
| Asbestos and environmental unfavorable loss development | 141 | 5 | 111 |
| Workers compensation favorable loss development | (7) | (21) | (26) |
| Total amounts ceded under NICO Reinsurance Transaction | 134 | (16) | 85 |
| Retroactive reinsurance (benefits) reductions related to original transaction loss recognized into income | (59) | 16 | (85) |
| Deferred gain amortization | (13) | - | - |
| Pre-tax impact of unrecognized deferred retroactive reinsurance benefit | 62 | - | - |
| Unrecognized reinsurance benefit related to original transaction loss at the end of the year | \$- | \$59 | \$43 |

As the aggregate of workers compensation and asbestos and environmental development has exceeded the original pre-tax loss of \$128, deferred gains are now being recorded. Deferred gains are amortized into earnings over the period when underlying claims are settled. For the years ended December 31, 2016, 2015 and 2014 deferred gain amortization was \$13, \$0 and \$0 respectively. As of December 31, 2016, and 2015, deferred gains were \$62 and \$0, respectively, and are included in other liabilities within the accompanying consolidated balance sheets.

In addition, the Company has an aggregate reinsurance recoverable from Nationwide Indemnity Company in the amount of \$1,541 and \$1,590 as of December 31, 2016 and 2015, respectively. The reinsurance recoverable is guaranteed by Nationwide Mutual Insurance Company, which has a financial strength rating of A+ from S&P. Additionally, the Company has significant reinsurance recoverable concentrations with Swiss Re Group, Munich Re Group, Berkshire Hathaway Insurance Group, and Everest Re Group totaling \$920, \$415, \$278, and \$258, respectively, as of December 31, 2016, net of offsetting collateral under the contracts.

Catastrophe Exposure

The Company writes insurance and reinsurance contracts that cover catastrophic events, both natural and man-made. 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.

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 ("the Terrorism Act") was enacted into Federal law and established the Terrorism Risk Insurance Program ("the Program"), a temporary Federal program in the Department of the Treasury, that provided for a system of shared public and private compensation for certain insured losses resulting from acts of terrorism or war committed by or on behalf of a foreign interest. The Program was scheduled to terminate on December 31, 2005. In December 2005, the Terrorism Risk Insurance Extension Act of 2005 ("the Terrorism Extension Act") was enacted into Federal law, reauthorizing the prior program through December 31, 2007, while reducing the Federal role under the Program. In December 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 was enacted into Federal law, extending coverage to include domestic acts of terrorism and reauthorizing the Program through December 31, 2014. In January 2015, the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("the 2015 Reauthorization") extends the effectiveness of the Terrorism Act through December 31, 2020, while further reducing the Federal role under the program. The four acts are hereinafter collectively referred to as "the Acts."

For a loss to be covered under the Program (subject losses), the loss must meet certain aggregate industry loss minimums and must be the result of an event that is certified as an act of terrorism by the U.S. Secretary of the Treasury. The annual aggregate industry loss minimum is \$100 through 2015. The original Program excluded from participation certain of the following types of insurance: Federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, and reinsurance. The Terrorism Extension Act exempted from coverage certain additional types of insurance, including commercial automobile, professional liability (other than directors and officers), surety, burglary and theft, and farm-owners multi-peril. In the case of a war declared by Congress, only workers compensation losses are covered by the Acts. The Acts generally require that all commercial property casualty insurers licensed in the United States participate in the Program. The 2015 Reauthorization increases the loss minimum by \$20 annually starting in 2016 until it reaches \$200 in 2020. Under the Program, a participating insurer was entitled through 2015 to be reimbursed by the Federal Government for 85% of subject losses, after an insurer deductible, subject to an annual cap. Under the 2015 Reauthorization, the Federal reimbursement percentage decreases by 1% a year starting in 2016 from the current 85% to 80% in 2020. The 2015 Reauthorization did not change the program cap of \$100,000 or the Company's deductible which remains at 20% of the Company's prior year earned premium for the covered lines.

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The deductible for any calendar year is equal to 20% of the insurer's direct earned premiums for covered lines for the preceding calendar year. The Company's estimated deductible under the Program is \$1,487 for 2017. The annual cap limits the amount of aggregate subject losses for all participating insurers to \$100,000. Once subject losses have reached the \$100,000 aggregate during a program year, participating insurers will not be liable under the Program for additional covered terrorism losses for that program year. The Company has had no terrorism-related losses since the Program was established. Because the interpretation of the Acts is untested, there is substantial uncertainty as to how they will be applied to specific circumstances. It is also possible that future legislative action could change the Acts. Further, given the unpredictable frequency and severity of terrorism losses, as well as the limited terrorism coverage in the Company's own reinsurance program, future losses from acts of terrorism, particularly "unconventional" acts of terrorism involving nuclear, biological, chemical or radiological events, could be material to the Company's operating results, financial position and/or liquidity in future periods. The Company will continue to manage this type of catastrophic risk by monitoring and controlling terrorism risk aggregations to the best of its ability.

Catastrophes

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. Catastrophe losses are severe losses resulting from natural and man-made events, including risks such as fire, earthquake, windstorm, explosion, terrorism, and other similar events. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in an area affected by the event and the severity of the event. 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.

(6) 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); incurred but not reported claims reserves ("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 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.

In order to establish a reserve for IBNR claims, the actuarial teams within each of the SBUs use their experience and knowledge of the lines of business to estimate the potential future development of the incurred claims. The Company uses a number of actuarial methods and assumptions to develop an estimate of ultimate claim liabilities. Generally, these are a combination of exposure and experience based actuarial methods and review of other pertinent and available information from claims, underwriting, product and finance. Exposure based actuarial methods consider historical loss ratios and adjust for rate changes, premium and loss trends, industry trends and other information. These methods are typically used when developing an actuarial central estimate for more recent policy periods when claims data is insufficient to produce a reliable indication. As claims data becomes more reliable for a given policy period, more consideration is given to experience methods which review and monitor actual paid and reported development.

A comprehensive actuarial reserve review is performed for each product line at least once a year. The process and methods used for each product line vary depending on the circumstances and include input from claims, underwriting, product and finance. Each quarter the actuarial central estimate for each product line is reviewed and updated based upon development and presented to the reserving committee to conclude on the Company's best estimate of ultimate claim liabilities.

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

| | 2016 | 2015 | 2014 |
|--|----------|----------|----------|
| Balance as of January 1 | \$49,323 | \$49,970 | \$52,207 |
| Less: unpaid reinsurance recoverables ⁽¹⁾ | 9,891 | 10,256 | 10,957 |
| Net balance as of January 1 | 39,432 | 39,714 | 41,250 |
| Balance attributable to acquisitions and dispositions ⁽²⁾ | (28) | (67) | (900) |
| Incurred attributable to: | | | |
| Current year | 22,184 | 21,454 | 21,203 |
| Prior years ⁽³⁾ | (73) | (162) | 47 |
| Discount accretion attributable to prior years | 61 | 79 | 109 |
| Total incurred | 22,172 | 21,371 | 21,359 |
| Paid attributable to: | | | |
| Current year | 12,015 | 11,559 | 11,491 |
| Prior years | 9,622 | 9,457 | 9,987 |
| Total paid | 21,637 | 21,016 | 21,478 |
| Amortization of deferred retroactive reinsurance gain | 16 | 3 | 4 |
| Net adjustment due to foreign exchange | (250) | (573) | (521) |
| Add: unpaid reinsurance recoverables ⁽¹⁾ | 10,016 | 9,891 | 10,256 |
| Balance as of December 31 | \$49,721 | \$49,323 | \$49,970 |

⁽¹⁾ In addition to the unpaid reinsurance recoverable balances noted above, and as a result of retroactive reinsurance agreements, the Company has recorded retroactive reinsurance recoverable balances of \$3,141, \$3,000, and \$3,015 as of December 31, 2016, 2015, and 2014, respectively.

⁽²⁾ The balance attributable to acquisitions and dispositions primarily represents the disposition of Liberty Ubezpieczenia during the year ended 2016, the disposition of the Venezuelan operations during the year ended 2015 and the dispositions of Argentina operations and Summit, partially offset by the Uni.Asia acquisition during the year ended 2014. (See Note 2 for further discussion.)

⁽³⁾ Does not include increases (decreases) in allowance related to reinsurance recoverables due to prior year development of \$98, \$21, and \$(9) as of December 31, 2016, 2015, and 2014, respectively.

In 2016, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to favorable development in LSM reinsurance due to actuarial reserving adjustments and international personal automobile lines of business, partially offset by unfavorable development on the domestic personal automobile and commercial automobile lines of business due to greater than expected severity. In 2015, favorable incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to favorable development in the reinsurance line of business due to lower than expected loss development. In 2014, incurred attributable to prior years, excluding asbestos and environmental and amortization of deferred retroactive gain, is primarily attributable to favorable development across various lines of business, partially offset by unfavorable development on the surety line of business due to greater than expected severity in prior year claims.

For certain commercial lines of insurance, the Company offers experience-rated insurance contracts whereby the ultimate premium is dependent upon the claims incurred. As of December 31, 2016 and 2015, the Company held \$3,585 and \$3,613, respectively, of unpaid claims and claim adjustment expenses related to experience-rated contracts. Premiums receivable included accrued retrospective and unbilled audit premiums of \$446 and \$448 as of December 31, 2016 and 2015, respectively. For the years ended December 31, 2016, 2015, and 2014, the Company recognized a (decrease) increase of premium income of \$(13), \$40 and \$(2), respectively, relating to prior years.

Unpaid claims and claim adjustment expenses are recorded net of anticipated salvage and subrogation of \$1,362 and \$1,286 as of December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015, the reserve for unpaid claim reserves was reduced by \$5,406 and \$5,564, respectively, for large dollar deductibles. Large dollar deductibles billed and recoverable were \$163 and \$163 as of December 31, 2016 and 2015, respectively.

In order to establish a reserve for IBNR claims, the actuarial teams within each of the SBUs use their experience and knowledge of the lines of business to estimate the potential future development of the incurred claims. The Company uses a number of actuarial methods and assumptions to develop an estimate of ultimate claim liabilities. Generally, these are a combination of exposure and experience based actuarial methods and review of other pertinent and available information from claims, underwriting, product and finance. Exposure based actuarial methods consider historical loss ratios and adjust for rate changes, premium and loss trends, industry trends and other information. These methods are typically used when developing an actuarial central estimate for more recent policy periods when claims data is insufficient to produce a reliable indication. As claims data becomes more reliable for a given policy period, more consideration is given to experience methods which review and monitor actual paid and reported development.

A comprehensive actuarial reserve review is performed for each product line at least once a year. The process and methods used for each product line vary depending on the circumstances and include input from claims, underwriting, product and finance. Each quarter the actuarial central estimate for each product line is reviewed and updated based upon development and presented to the reserving committee to conclude on the Company's best estimate of ultimate claim liabilities.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

The following is information about incurred and paid claims development as of December 31, 2016, net of reinsurance, as well as cumulative claim frequency and the total of incurred-but-not-reported liabilities plus expected development on reported claims included within the net incurred claims amounts.

Supplementary information provided includes information about incurred and paid claims development for the years ended December 31, 2007, to 2015, and information about average historical claims duration as of December 31, 2016. Due to the composition of the Company, comprising organically grown and acquired business, there is a mixture of claim count definitions. However, these definitions have been consistently applied throughout the history shown. We have disclosed our claim count methodologies below, unless it is impracticable to do so.

Disclosures about claim development by accident year are presented for the number of years for which claims incurred typically remain outstanding, up to 10 years.

The impact of current and prior year acquisitions and dispositions are presented on a retrospective basis.

Commercial Multiple-Peril (“CMP”)

(Claim counts in whole numbers)

Incurred claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | Total of incurred but not reported liabilities plus expected development on reported claims | Cumulative number of reported claims ⁽¹⁾ |
|-------------------------|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|---|---|
| AY | -----Supplemental and unaudited----- | | | | | | | | | 2016 | | |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| 2007 | 1,279 | 1,234 | 1,165 | 1,176 | 1,162 | 1,164 | 1,167 | 1,179 | 1,181 | 1,178 | 6 | 91,933 |
| 2008 | | 1,632 | 1,562 | 1,563 | 1,541 | 1,550 | 1,553 | 1,567 | 1,562 | 1,563 | 12 | 102,103 |
| 2009 | | | 1,300 | 1,272 | 1,254 | 1,241 | 1,245 | 1,241 | 1,237 | 1,238 | 40 | 92,325 |
| 2010 | | | | 1,408 | 1,377 | 1,365 | 1,371 | 1,365 | 1,355 | 1,355 | 55 | 97,844 |
| 2011 | | | | | 1,668 | 1,537 | 1,528 | 1,502 | 1,487 | 1,491 | 31 | 107,452 |
| 2012 | | | | | | 1,419 | 1,373 | 1,363 | 1,340 | 1,341 | 102 | 92,768 |
| 2013 | | | | | | | 1,151 | 1,144 | 1,112 | 1,109 | 144 | 62,645 |
| 2014 | | | | | | | | 1,134 | 1,086 | 1,090 | 151 | 52,864 |
| 2015 | | | | | | | | | 1,039 | 1,040 | 283 | 45,880 |
| 2016 | | | | | | | | | | 1,057 | 487 | 37,757 |
| | | | | | | | | | | Total | \$12,462 | |

⁽¹⁾Note that approximately 85% of claim count information is disclosed on a per occurrence basis, while approximately 15% is disclosed on a per claimant basis.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | | |
|-------------------------|--------------------------------------|------|-------|-------|-------|-------|-------|-------|-------|--------------|--|----------------|
| AY | -----Supplemental and unaudited----- | | | | | | | | | | | |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| 2007 | 427 | 683 | 814 | 938 | 1,033 | 1,097 | 1,120 | 1,141 | 1,151 | 1,162 | | |
| 2008 | | 653 | 1,052 | 1,192 | 1,333 | 1,435 | 1,483 | 1,514 | 1,534 | 1,542 | | |
| 2009 | | | 487 | 771 | 901 | 1,018 | 1,100 | 1,142 | 1,168 | 1,185 | | |
| 2010 | | | | 519 | 829 | 974 | 1,106 | 1,196 | 1,248 | 1,274 | | |
| 2011 | | | | | 640 | 975 | 1,136 | 1,269 | 1,366 | 1,421 | | |
| 2012 | | | | | | 504 | 812 | 969 | 1,095 | 1,175 | | |
| 2013 | | | | | | | 353 | 622 | 757 | 870 | | |
| 2014 | | | | | | | | 415 | 677 | 798 | | |
| 2015 | | | | | | | | | 374 | 610 | | |
| 2016 | | | | | | | | | | 369 | | |
| | | | | | | | | | | Total | \$10,406 | |
| | | | | | | | | | | | 191 | |
| | | | | | | | | | | | Liabilities for claims and claim adjustment expense | \$2,247 |

All net outstanding liabilities prior to 2007, net of reinsurance

Liabilities for claims and claim adjustment expense

Average annual percentage payout of incurred claims (Supplemental and unaudited)

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| 37.7% | 23.3% | 10.9% | 9.6% | 6.7% | 3.9% | 2.0% | 1.5% | 0.7% | 1.0% |

General Liability

(Claim counts in whole numbers)

Incurring claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | Total of incurred but not reported liabilities plus expected development on reported claims | Cumulative number of reported ⁽¹⁾ claims | |
|-------------------------|--------------------------------------|------|------|------|------|------|------|------|------|------|---|---|----------------|
| AY | -----Supplemental and unaudited----- | | | | | | | | | | | | |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | | | |
| 2007 | 825 | 714 | 590 | 620 | 619 | 630 | 628 | 633 | 641 | 645 | 44 | 87,747 | |
| 2008 | | 852 | 614 | 630 | 655 | 670 | 674 | 679 | 679 | 680 | 47 | 80,601 | |
| 2009 | | | 738 | 660 | 634 | 600 | 593 | 584 | 591 | 600 | 59 | 65,356 | |
| 2010 | | | | 699 | 643 | 640 | 614 | 618 | 623 | 627 | 83 | 69,192 | |
| 2011 | | | | | 787 | 733 | 686 | 718 | 720 | 733 | 110 | 65,701 | |
| 2012 | | | | | | 755 | 672 | 744 | 726 | 721 | 179 | 67,264 | |
| 2013 | | | | | | | 746 | 726 | 715 | 708 | 265 | 70,773 | |
| 2014 | | | | | | | | 765 | 748 | 738 | 345 | 68,628 | |
| 2015 | | | | | | | | | 775 | 766 | 504 | 56,161 | |
| 2016 | | | | | | | | | | 705 | 570 | 42,328 | |
| | | | | | | | | | | | | Total | \$6,923 |

⁽¹⁾Note that approximately 91% of claim count information is disclosed on a per claimant basis, while approximately 9% is disclosed on a per occurrence basis.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | | |
|--------------------------------------|------|------|------|------|------|------|------|------|------|--------------|--|----------------|
| -----Supplemental and unaudited----- | | | | | | | | | | | | |
| AY | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| 2007 | 28 | 113 | 217 | 321 | 408 | 468 | 504 | 532 | 558 | 569 | | |
| 2008 | | 39 | 109 | 230 | 342 | 452 | 524 | 561 | 580 | 595 | | |
| 2009 | | | 32 | 100 | 194 | 311 | 401 | 448 | 477 | 507 | | |
| 2010 | | | | 27 | 90 | 194 | 300 | 393 | 444 | 483 | | |
| 2011 | | | | | 25 | 104 | 225 | 340 | 443 | 538 | | |
| 2012 | | | | | | 24 | 114 | 236 | 364 | 462 | | |
| 2013 | | | | | | | 22 | 85 | 174 | 313 | | |
| 2014 | | | | | | | | 26 | 112 | 225 | | |
| 2015 | | | | | | | | | 27 | 113 | | |
| 2016 | | | | | | | | | | 27 | | |
| | | | | | | | | | | Total | \$3,832 | |
| | | | | | | | | | | | 394 | |
| | | | | | | | | | | | Liabilities for claims and claim adjustment expense | \$3,484 |

Average annual percentage payout of incurred claims (Supplemental and unaudited)

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| 4.0% | 11.1% | 15.9% | 17.5% | 14.5% | 9.7% | 5.6% | 4.0% | 3.1% | 1.6% |

Workers Compensation

(Claim counts in whole numbers)

Incurred claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | | | | |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------------------|----------------|---|---|
| -----Supplemental and unaudited----- | | | | | | | | | | | | | | |
| AY | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Gross ADC ⁽¹⁾ | Net of ADC | Total of incurred but not reported liabilities plus expected development on reported claims | Cumulative number of reported claims ⁽²⁾ |
| 2007 | 3,258 | 3,270 | 3,180 | 3,196 | 3,201 | 3,243 | 3,257 | 3,216 | 3,212 | 3,208 | 218 | 2,990 | 371 | 565,989 |
| 2008 | | 3,383 | 3,372 | 3,412 | 3,486 | 3,548 | 3,693 | 3,622 | 3,611 | 3,607 | 265 | 3,342 | 543 | 546,952 |
| 2009 | | | 2,948 | 2,999 | 3,047 | 3,140 | 3,164 | 3,088 | 3,082 | 3,078 | 253 | 2,825 | 464 | 433,858 |
| 2010 | | | | 2,894 | 2,980 | 3,092 | 3,106 | 2,998 | 2,987 | 2,976 | 264 | 2,712 | 439 | 414,117 |
| 2011 | | | | | 2,665 | 2,722 | 2,747 | 2,676 | 2,670 | 2,661 | 286 | 2,375 | 604 | 381,048 |
| 2012 | | | | | | 2,823 | 2,775 | 2,700 | 2,691 | 2,680 | 297 | 2,383 | 806 | 339,603 |
| 2013 | | | | | | | 2,130 | 2,080 | 2,071 | 2,059 | 233 | 1,826 | 751 | 267,513 |
| 2014 | | | | | | | | 1,571 | 1,544 | 1,522 | - | 1,522 | 580 | 221,300 |
| 2015 | | | | | | | | | 1,374 | 1,377 | - | 1,377 | 670 | 191,342 |
| 2016 | | | | | | | | | | 1,263 | - | 1,263 | 794 | 169,055 |
| | | | | | | | | | | Total | \$24,431 | \$1,816 | \$22,615 | |

⁽¹⁾ Amount relates to workers compensation activity only and does not reflect the asbestos and environmental portion of the ADC. (See Note 5 for further discussion.)

⁽²⁾ Note that approximately 82% of claim count information is disclosed on a per claimant basis, while approximately 18% is disclosed on a per occurrence basis.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| AY | As of December 31, 2016 | | | | | | | | | |
|------|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|--------------|---|
| | -----Supplemental and unaudited----- | | | | | | | | | |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| 2007 | 560 | 1,267 | 1,692 | 1,983 | 2,172 | 2,304 | 2,412 | 2,495 | 2,543 | 2,582 |
| 2008 | | 611 | 1,361 | 1,844 | 2,156 | 2,358 | 2,514 | 2,626 | 2,686 | 2,727 |
| 2009 | | | 532 | 1,179 | 1,596 | 1,852 | 2,043 | 2,162 | 2,240 | 2,292 |
| 2010 | | | | 553 | 1,230 | 1,613 | 1,870 | 2,043 | 2,137 | 2,202 |
| 2011 | | | | | 530 | 906 | 1,263 | 1,495 | 1,624 | 1,713 |
| 2012 | | | | | | 441 | 949 | 1,258 | 1,417 | 1,524 |
| 2013 | | | | | | | 300 | 652 | 825 | 929 |
| 2014 | | | | | | | | 230 | 504 | 666 |
| 2015 | | | | | | | | | 192 | 435 |
| 2016 | | | | | | | | | | 184 |
| | | | | | | | | | Total | \$15,254 |
| | | | | | | | | | | All net outstanding liabilities prior to 2007, net of reinsurance |
| | | | | | | | | | | <u>3,395</u> |
| | | | | | | | | | | Liabilities for claims and claim adjustment expense |
| | | | | | | | | | | <u>\$10,756</u> |

Average annual percentage payout of incurred claims (*Supplemental and unaudited*)

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| 16.5% | 19.1% | 12.1% | 7.8% | 5.4% | 3.8% | 2.8% | 2.0% | 1.3% | 1.2% |

The aggregate amount of discount related to the time value of money deducted to derive the liabilities as of December 31, 2016 and 2015 were \$1,164 and \$1,207 respectively.

The amounts of interest accretion recognized for the years ended December 31, 2016, 2015 and 2014 were \$53, \$63 and \$68, respectively. These amounts are included in the financial statement line item Benefits, claims and claim adjustment expenses.

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Global Specialty- General Liability

(Claim counts in whole numbers)

Incurred claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | Total of incurred but not reported liabilities plus expected development on reported claims | Cumulative number of reported claims ⁽¹⁾ |
|-------------------------|--------------------------------------|------|------|------|------|------|------|------|-------|--------------|---|---|
| AY | -----Supplemental and unaudited----- | | | | | | | | | 2016 | | |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | | |
| 2007 | 294 | 305 | 295 | 296 | 288 | 310 | 302 | 314 | 314 | 302 | 7 | 9,929 |
| 2008 | | 481 | 457 | 394 | 408 | 435 | 433 | 445 | 457 | 451 | 24 | 11,042 |
| 2009 | | | 524 | 615 | 567 | 490 | 505 | 476 | 490 | 479 | 25 | 13,106 |
| 2010 | | | | 388 | 467 | 478 | 499 | 461 | 445 | 446 | 17 | 15,109 |
| 2011 | | | | | 369 | 512 | 515 | 553 | 536 | 532 | 37 | 16,552 |
| 2012 | | | | | | 671 | 775 | 769 | 801 | 790 | 98 | 19,372 |
| 2013 | | | | | | | 922 | 977 | 980 | 972 | 166 | 21,232 |
| 2014 | | | | | | | | 965 | 952 | 985 | 397 | 20,677 |
| 2015 | | | | | | | | | 1,113 | 1,218 | 566 | 17,520 |
| 2016 | | | | | | | | | | 1,124 | 755 | 12,178 |
| | | | | | | | | | | Total | \$7,298 | |

⁽¹⁾Approximately 75% of claim count information is disclosed on a per occurrence basis, while approximately 25% is disclosed on a per claimant basis. General Liability Proportional Reinsurance claim count is not disclosed due to a lack of available information.

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| As of December 31, 2016 | | | | | | | | | | | |
|-------------------------|--------------------------------------|------|------|------|------|------|------|------|------|--|----------------|
| AY | -----Supplemental and unaudited----- | | | | | | | | | | 2016 |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | |
| 2007 | 11 | 48 | 91 | 150 | 185 | 237 | 254 | 268 | 274 | 283 | 283 |
| 2008 | | 7 | 42 | 111 | 184 | 229 | 288 | 316 | 332 | 354 | 354 |
| 2009 | | | 14 | 63 | 117 | 197 | 254 | 313 | 347 | 382 | 382 |
| 2010 | | | | 15 | 70 | 145 | 221 | 288 | 334 | 373 | 373 |
| 2011 | | | | | 24 | 85 | 162 | 272 | 364 | 417 | 417 |
| 2012 | | | | | | 66 | 233 | 303 | 426 | 515 | 515 |
| 2013 | | | | | | | 161 | 324 | 476 | 627 | 627 |
| 2014 | | | | | | | | 81 | 220 | 375 | 375 |
| 2015 | | | | | | | | | 123 | 296 | 296 |
| 2016 | | | | | | | | | | 137 | 137 |
| | | | | | | | | | | Total | \$3,759 |
| | | | | | | | | | | All net outstanding liabilities prior to 2007, net of reinsurance | 137 |
| | | | | | | | | | | Liabilities for claims and claim adjustment expense | \$3,676 |

Average annual percentage payout of incurred claims (Supplemental and unaudited)

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| 7.2% | 13.3% | 14.0% | 17.3% | 12.9% | 12.6% | 6.9% | 5.2% | 3.4% | 2.7% |

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Global Specialty- Reinsurance

(Claim counts in whole numbers)

Incurred claims and allocated claim adjustment expenses, net of reinsurance

| AY | As of December 31, 2016 | | | | | | | | | | Total of incurred but not reported liabilities plus expected development on reported claims ⁽¹⁾ | |
|------|-------------------------|------|------|----------------------------|------|------|------|------|------|------|--|----------------|
| | 2007 | 2008 | 2009 | Supplemental and unaudited | | | | | | | | 2016 |
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | |
| 2007 | 558 | 634 | 608 | 598 | 597 | 597 | 596 | 583 | 582 | 574 | 34 | |
| 2008 | | 651 | 735 | 722 | 728 | 748 | 738 | 733 | 714 | 700 | 55 | |
| 2009 | | | 589 | 680 | 698 | 724 | 720 | 707 | 690 | 672 | 68 | |
| 2010 | | | | 600 | 784 | 770 | 787 | 780 | 772 | 752 | 118 | |
| 2011 | | | | | 591 | 701 | 715 | 691 | 667 | 658 | 147 | |
| 2012 | | | | | | 391 | 496 | 498 | 483 | 462 | 143 | |
| 2013 | | | | | | | 370 | 497 | 466 | 438 | 136 | |
| 2014 | | | | | | | | 331 | 419 | 429 | 170 | |
| 2015 | | | | | | | | | 324 | 426 | 225 | |
| 2016 | | | | | | | | | | 337 | 326 | |
| | | | | | | | | | | | Total | \$5,448 |

⁽¹⁾Claims count is unavailable for the line of business since underlying claim count information is not maintained by cedants and not included in cession statements.

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| AY | As of December 31, 2016 | | | | | | | | | | | | |
|------|-------------------------|------|------|----------------------------|------|------|------|------|------|------|--------------|---|----------------|
| | 2007 | 2008 | 2009 | Supplemental and unaudited | | | | | | | 2016 | | |
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | | | |
| 2007 | 280 | 311 | 343 | 359 | 380 | 399 | 415 | 428 | 435 | 443 | | | |
| 2008 | | 32 | 277 | 331 | 387 | 428 | 465 | 497 | 509 | 518 | | | |
| 2009 | | | 267 | 381 | 427 | 462 | 496 | 530 | 547 | 555 | | | |
| 2010 | | | | 187 | 339 | 434 | 500 | 569 | 614 | 634 | | | |
| 2011 | | | | | 142 | 266 | 392 | 481 | 535 | 561 | | | |
| 2012 | | | | | | 54 | 161 | 257 | 307 | 335 | | | |
| 2013 | | | | | | | 38 | 142 | 222 | 264 | | | |
| 2014 | | | | | | | | 42 | 154 | 238 | | | |
| 2015 | | | | | | | | | 46 | 136 | | | |
| 2016 | | | | | | | | | | 41 | | | |
| | | | | | | | | | | | Total | \$3,725 | |
| | | | | | | | | | | | | All net outstanding liabilities prior to 2007, net of reinsurance | 333 |
| | | | | | | | | | | | | Liabilities for claims and claim adjustment expense | \$2,056 |

Average annual percentage payout of incurred claims (Supplemental and unaudited)

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| 19.2% | 21.2% | 13.8% | 8.4% | 6.3% | 4.7% | 3.1% | 1.8% | 1.3% | 1.4% |

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Private Passenger Auto
(Claim counts in whole numbers)

Incurring claims and allocated claim adjustment expenses, net of reinsurance

As of December 31, 2016

| AY | <i>Supplemental and unaudited</i> | | | 2016 | Total of incurred but not reported liabilities plus expected development on reported claims | Cumulative number of reported claims ⁽¹⁾ |
|--------------|-----------------------------------|-------|-------|-----------------|---|---|
| | 2013 | 2014 | 2015 | | | |
| 2013 | 6,591 | 6,622 | 6,623 | 6,624 | 114 | 3,867,107 |
| 2014 | | 7,137 | 7,138 | 7,135 | 346 | 3,991,710 |
| 2015 | | | 7,546 | 7,591 | 671 | 3,953,824 |
| 2016 | | | | 8,336 | 1,686 | 3,784,148 |
| Total | | | | \$29,686 | | |

⁽¹⁾Note that approximately 84% of claim count information is disclosed on a per claimant basis, while approximately 16% is disclosed on a per occurrence basis.

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

| AY | As of December 31, 2016 | | | |
|---|---|-------|-------|-----------------|
| | ----- <i>Supplemental and unaudited</i> ----- | | | 2016 |
| | 2013 | 2014 | 2015 | |
| 2013 | 4,023 | 5,269 | 5,821 | 6,218 |
| 2014 | | 4,286 | 5,627 | 6,257 |
| 2015 | | | 4,557 | 6,070 |
| 2016 | | | | 5,107 |
| Total | | | | \$23,652 |
| All net outstanding liabilities prior to 2013, net of reinsurance | | | | 465 |
| Liabilities for claims and claim adjustment expense | | | | \$6,499 |

Average annual percentage payout of incurred claims (*Supplemental and unaudited*)

| Year 1 | Year 2 | Year 3 | Year 4 |
|--------|--------|--------|--------|
| 59.8% | 18.4% | 9.4% | 6.7% |

LIBERTY MUTUAL HOLDING COMPANY INC.

Notes to Consolidated Financial Statements

(dollars in millions)

Reconciliation of the Disclosure of Incurred and Paid Claims Development to the Liability for Unpaid Claims and Claim Adjustment Expenses (“CAE”)

| Net outstanding liabilities for unpaid claims and CAE | December 31, 2016 |
|--|-------------------|
| Private Passenger Auto | \$6,499 |
| CMP | 2,247 |
| General Liability | 3,484 |
| Workers Compensation | 10,756 |
| GS- Reinsurance | 2,056 |
| GS- General Liability | 3,676 |
| Other Insurance Lines | 10,561 |
| Liabilities for unpaid claims and allocated CAE, net of reinsurance | \$39,279 |
| Reinsurance recoverable on unpaid claims | |
| Private Passenger Auto | 796 |
| CMP | 21 |
| General Liability | 779 |
| Workers Compensation | 3,726 |
| GS- Reinsurance | 114 |
| GS- General Liability | 519 |
| Other Insurance Lines | 4,061 |
| Total reinsurance recoverable on unpaid claims | \$10,016 |
| Unallocated claims adjustment expenses | 1,590 |
| Impact of discounting | (1,164) |
| Total gross liability for unpaid claims and CAE | \$49,721 |

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-1980s. In establishing the Company's asbestos and environmental reserves, the Company estimates case reserves for anticipated losses and bulk reserves for claim adjustment expenses and IBNR. The Company maintained casualty excess of loss reinsurance during the relevant periods. The reserves, including cessions reported by ceding reinsurers on assumed reinsurance contracts, are reported in unpaid claims and claim adjustment expenses, and ceded reserves are included in reinsurance recoverables on the accompanying consolidated balance sheets.

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 collectability of reinsurance.

The uncertainties associated with establishing reserves for asbestos and environmental claims and claim 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

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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 2016, the Company completed asbestos ground-up and aggregate environmental reserve studies. These studies were completed by a multi-disciplinary team of internal claims, legal, reinsurance and actuarial personnel, and included all major business segments of the Company's direct, assumed, and ceded asbestos and environmental unpaid claim liabilities. As part of the internal review, policyholders with the largest direct asbestos unpaid claim liabilities were individually evaluated using the Company's proprietary stochastic ground-up model, which is consistent with published actuarial methods of asbestos reserving. Among the factors reviewed in depth by the team of specialists were the type of business, level of exposure, coverage limits, geographic distribution of products, injury type, jurisdiction and legal defenses. Reinsurance recoveries for these policyholders were then separately evaluated by the Company's reinsurance and actuarial personnel. Asbestos and environmental unpaid claim liabilities for all other policyholders were evaluated using aggregate methods that utilized information and experience specific to these policyholders. The studies resulted in an increase to reserves of \$150 including: \$100 of asbestos reserves and \$50 of pollution reserves.

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 and would be covered under the NICO Reinsurance Transaction.

As of December 31, 2016 and 2015, the Company's unpaid claims and claim adjustment expense reserves, net of associated reinsurance recoverables, included \$936 and \$952 respectively, for asbestos and environmental-related claims before consideration of the NICO Reinsurance Transaction.

Net asbestos losses paid in 2016, 2015, and 2014 were \$72, \$243, and \$169, respectively. The Company incurred \$62, \$7, and \$89 of asbestos reserves before consideration of the NICO Reinsurance Transaction, net of change in allowance for doubtful accounts during the years ended December 31, 2016, 2015, and 2014, respectively.

Net environmental losses paid in 2016, 2015, and 2014 were \$55, \$37, and \$52, respectively. The Company incurred \$49, \$0, and \$28 of environmental reserves before consideration of the NICO Reinsurance Transaction, net of change in allowance for doubtful accounts during the years ended December 31, 2016, 2015, and 2014, respectively.

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(7) DEBT OUTSTANDING

Debt outstanding as of December 31, 2016 and 2015 includes the following:

Current maturities of long-term debt:

| | 2016 | 2015 |
|--------------------------------------|-------------|-------------|
| Current maturities of long-term debt | \$ - | \$ 249 |

Long-term debt:

| | 2016 | 2015 |
|--|-------------|-------------|
| 7.00% Junior Subordinated Notes, due 2067 ⁽¹⁾ | \$300 | \$300 |
| 5.00% Notes, due 2021 | 600 | 600 |
| 4.95% Notes, due 2022 | 750 | 750 |
| 4.25% Notes, due 2023 | 1,000 | 1,000 |
| 8.50% Surplus Notes, due 2025 | 140 | 140 |
| 2.75% €750 Notes, due 2026 | 791 | - |
| 7.875% Surplus Notes, due 2026 | 227 | 227 |
| 7.625% Notes, due 2028 | 3 | 3 |
| 3.91% - 4.25% Federal Home Loan Bank Borrowings due 2032 | 300 | 300 |
| 7.00% Notes, due 2034 | 231 | 231 |
| 6.50% Notes, due 2035 | 471 | 471 |
| 7.50% Notes, due 2036 | 19 | 19 |
| 7.80% Junior Subordinated Notes, due 2087 ⁽²⁾ | 700 | 700 |
| 10.75% Junior Subordinated Notes, due 2088 ⁽³⁾ | 68 | 193 |
| 6.50% Notes, due 2042 | 750 | 750 |
| 4.85% Notes, due 2044 | 1,050 | 1,050 |
| 7.697% Surplus Notes, due 2097 | 260 | 260 |
| | 7,660 | 6,994 |
| Unamortized discount | (15) | (12) |
| Total long-term debt excluding unamortized debt issuance costs | 7,645 | 6,982 |
| Unamortized debt issuance costs | (42) | (42) |
| Total long-term debt | \$7,603 | \$6,940 |

⁽¹⁾ The par value call date and final fixed rate interest payment date is March 15, 2017, subject to certain requirements.

⁽²⁾ The par value call date and final fixed rate interest payment date is March 15, 2037, subject to certain requirements.

⁽³⁾ The par value call date and final fixed rate interest payment date is June 15, 2038, subject to certain requirements.

Debt Transactions and In-Force Credit Facilities

For the year ended December 31, 2016, the Company repurchased \$125 of the 10.75% Junior Subordinated notes due 2088 compared to repurchases of \$3 in 2015. Pre-tax losses of \$76 were recorded on these transactions for the year ended December 31, 2016 compared to pre-tax losses of \$1 in 2015 and are included in loss on extinguishment of debt in the accompanying consolidated statements of income.

On May 5, 2016, LMIC extended the termination date of a \$1,000 repurchase agreement from July 3, 2017 to July 3, 2018, unless extended. To date, no funds have been borrowed under the facility.

On May 4, 2016, Liberty Mutual Group Inc. ("LMGI") issued €750 par value of the 2026 Notes. Interest is payable annually at a fixed rate of 2.75%. The 2026 Notes mature on May 4, 2026.

On December 21, 2015, LMIC renewed its \$1,000 repurchase agreement for a two-year period, which terminates December 21, 2017. To date, no funds have been borrowed under the facility.

The Company places commercial paper through a program issued by LMGI and guaranteed by LMIC. On April 8, 2015, LMGI increased its commercial paper program from \$750 to \$1,000. As of December 31, 2016, there was no commercial paper outstanding.

On March 5, 2015, LMGI amended and restated its unsecured revolving credit facility from \$750 to \$1,000 with an expiration date of March 5, 2020. This facility backs the Company's commercial paper program. To date, no funds have been borrowed under the facility.

LMIC, Peerless Insurance Company ("PIC"), Liberty Life Assurance Company of Boston ("LLAC"), Liberty Mutual Fire Insurance Company ("LMFIC"), and Employers Insurance Company of Wausau ("EICOW") are members of the Federal Home Loan Bank. On March 21, 2012, LMFIC borrowed \$150 at a rate of 3.91% with a maturity date of March 22, 2032. On March 23, 2012 and April 2, 2012, LMIC borrowed \$127 at a rate of 4.24% with a maturity date of March 23, 2032 and \$23 at a rate of 4.25% with a maturity date of April 2, 2032, respectively. As of December 31, 2016, all of the outstanding Federal Home Loan Bank borrowings are fully collateralized.

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On January 20, 2012, LMGI entered into two interest rate swap transactions having a notional amount of \$300 with respect to LMGI's \$300 7.00% Junior Subordinated Notes due 2067. Pursuant to the terms of the swap agreements, commencing on March 15, 2017 and effective through March 15, 2037, LMGI has agreed with the counterparties to pay a fixed rate of interest on the notional amount and the counterparties have agreed to pay a floating rate of interest on the notional amount.

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.

Interest

The Company paid \$431, \$434, \$400 of interest in 2016, 2015, and 2014, respectively.

(8) INCOME TAXES

The components of U.S. Federal, state and foreign income tax expense are:

| Years ended December 31, | 2016 | 2015 | 2014 |
|---|--------------|--------------|--------------|
| Current tax expense (benefit): | | | |
| U.S. Federal | \$(210) | \$374 | \$320 |
| U.S. Federal net operating losses | 62 | (385) | (401) |
| State | 2 | 3 | 3 |
| Foreign | 150 | 167 | 112 |
| Total current tax expense | 4 | 159 | 34 |
| Deferred tax expense (benefit): | | | |
| U.S. Federal | 296 | 395 | 706 |
| Foreign | 29 | (30) | 4 |
| Total deferred tax expense | 325 | 365 | 710 |
| Total U.S. Federal, state and foreign income tax expense | <u>\$329</u> | <u>\$524</u> | <u>\$744</u> |

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 is as follows:

| Years ended December 31, | 2016 | 2015 | 2014 |
|--|--------------|--------------|--------------|
| Expected U.S. Federal income tax expense | \$490 | \$688 | \$899 |
| Tax effect of: | | | |
| Nontaxable investment income | (98) | (107) | (122) |
| Change in valuation allowance | (7) | (6) | (2) |
| Revision to estimates | (16) | (6) | 7 |
| General business credits | (24) | (18) | (5) |
| Audit Settlement | (31) | (40) | (60) |
| State | 2 | 3 | 3 |
| Foreign | 42 | 20 | 22 |
| Other | (29) | (10) | 2 |
| Actual income tax expense | <u>\$329</u> | <u>\$524</u> | <u>\$744</u> |

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

| | <u>2016</u> | <u>2015</u> |
|--------------------------------|--------------|--------------|
| Deferred tax assets: | | |
| Unpaid claims discount | \$238 | \$302 |
| Unearned premium reserves | 1,031 | 979 |
| Net operating losses | 362 | 319 |
| Employee benefits | 527 | 775 |
| Credits | 521 | 439 |
| Other accrued expenses | 164 | 114 |
| Other | 260 | 479 |
| | <u>3,103</u> | <u>3,407</u> |
| Less: valuation allowance | (91) | (106) |
| Total deferred tax assets | <u>3,012</u> | <u>3,301</u> |
| Deferred tax liabilities: | | |
| Deferred acquisition costs | 910 | 842 |
| Net unrealized gains | 696 | 653 |
| Intangibles | 352 | 364 |
| Depreciation/amortization | 455 | 343 |
| Other | 197 | 304 |
| Total deferred tax liabilities | <u>2,610</u> | <u>2,506</u> |
| Net deferred tax assets | <u>\$402</u> | <u>\$795</u> |

The decrease in the valuation allowance is primarily due to the sale of foreign assets and revised income projections for certain foreign subsidiaries. Management believes it is more likely than not that the Company's net deferred income tax assets will be realized based upon the Company's ability and the likelihood of generating future taxable income.

The Company's subsidiaries have foreign tax credit carry forwards of \$219, general business credit carry forwards of \$167, alternative minimum tax credit carry forwards of \$135, and net operating loss carry forwards of \$1,121 as of December 31, 2016. The foreign tax credits will begin to expire, if not utilized, in 2019, the general business credits will begin to expire, if not utilized, in 2031, and the alternative minimum tax credits do not expire. 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:

| <u>Year</u> | <u>Total</u> |
|--------------|-----------------------|
| 2017 | 35 |
| 2018 | 42 |
| 2019 | 29 |
| 2020 | 26 |
| Thereafter | <u>989</u> |
| Total | <u>\$1,121</u> |

The Company has not provided for deferred taxes on unremitted earnings of subsidiaries outside the U.S. where such earnings are permanently reinvested. As of December 31, 2016, unremitted earnings of foreign subsidiaries were \$2,664. 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 determination of the amount of unrecognized deferred tax liability related to the undistributed earnings is not practicable.

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | |
|--|-------|
| Balance as of December 31, 2014 | \$182 |
| Additions based on tax positions related to current year | 42 |
| Additions for tax positions of prior years | 191 |
| Reductions for tax positions of prior years | (152) |
| Settlements | (3) |
| Translation | (11) |
| Balance as of December 31, 2015 | \$249 |
| Additions based on tax positions related to current year | 13 |
| Additions for tax positions of prior years | 46 |
| Reductions for tax positions of prior years | (231) |
| Settlements | 17 |
| Translation | 5 |
| Balance as of December 31, 2016 | \$99 |

Included in the tabular roll forward of unrecognized tax benefits are interest and penalties in the amount of \$6 and \$34 as of December 31, 2016 and 2015, respectively.

Included in the balance at December 31, 2016 is \$40 related to tax positions that would impact the effective tax rate.

The Company recognizes interest and penalties related to unrecognized tax benefits in U.S. Federal, state, and foreign income tax expense. For the years ended December 31, 2016, 2015, and 2014, the Company recognized approximately \$(28), \$(30), and \$(36) in interest and penalties, respectively. The Company had approximately \$6 and \$31 of interest and penalties accrued as of December 31, 2016 and 2015, respectively.

The IRS has completed its review of the Company's U.S. Federal income tax returns through the 2009 tax year and is currently reviewing income tax returns for the 2010 through 2014 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.

The Company believes that the range of reasonably possible changes to the balance of unrecognized tax benefits could decrease by \$0 to \$20 within the next twelve months as a result of potential settlements with the IRS for prior years.

(9) BENEFIT PLANS

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 final average compensation, as more fully described in the Plans. Some foreign subsidiaries also sponsor defined benefit pension plans. In 2014, the Company added a new cash balance benefit formula for all eligible U.S. employees and froze credited service under the plan's final average pay formula. In 2016, the Company announced changes to the U.S. pension plan which included freezing the final average pay formula effective December 31, 2020, and increasing pay credits under the cash balance formula from 4.5% to 5.0% of eligible pay effective January 1, 2018. The benefits obligation table below reflects the impact of the freeze (see "Amendments") as well as the impact of a Lump Sum payment window made available in 2016 to terminated employees with a vested benefit in the U.S. pension plan (see "Benefits paid").

The Company sponsors non-qualified supplemental pension plans for selected highly compensated employees to restore the pension benefits they would be entitled to under the Company's U.S. tax qualified, defined benefit pension plan had it not been for limits imposed by the Internal Revenue Code. The supplemental plans are unfunded.

The Company also provides certain postretirement healthcare and life insurance benefits ("Postretirement") covering substantially all U.S. and Canadian employees. In 2014, the Company's U.S. postretirement medical and dental cost sharing arrangement changed to a defined contribution model with an annual dollar contribution amount based on age and years of eligible credited service. Life insurance benefits are based on a participant's final compensation subject to the plan maximum. The postretirement plan is unfunded. In 2016, the Company announced employees hired on or after January 1, 2018, will not be eligible for coverage under the U.S. postretirement health and life insurance plans.

Assets of the U.S. tax-qualified, defined benefit pension plans consist primarily of investments held in a master trust with The Bank of New York Mellon. Assets of the plan are invested primarily in fixed income securities and in diversified public equities. As of December 31, 2016 and 2015, no assets of the plans were held in separate accounts of the Company.

The Company sponsors defined contribution plans for substantially all U.S. (401(k) plan) and Canadian (Retirement Savings Plan and Deferred Profit Sharing Plan) employees who meet eligibility requirements. During 2016, 2015, and 2014, employees could contribute a percentage of their annual compensation on a before and after-tax basis, subject to Federal limitations. Company contributions, a portion of which reflect Company performance, are based on the employee's contribution amount. In 2016, 2015, and 2014, the Company incurred matching contributions of \$105, \$138 and \$128, respectively, including the supplemental defined contribution plans.

Compensation expense related to the Company's long-term and short-term incentive compensation plans was \$614, \$636, and \$653 for the years ended December 31, 2016, 2015, and 2014, respectively.

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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, 2016 and 2015, and accompanying consolidated statements of income for the years ended December 31, 2016, 2015, and 2014.

| | Pension | | Supplemental Pension | | Postretirement | |
|---|----------------|----------------|----------------------|----------------|----------------|----------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Change in benefit obligations: | | | | | | |
| Benefit obligation at beginning of year | \$7,093 | \$7,216 | \$394 | \$400 | \$791 | \$844 |
| Service costs | 138 | 133 | 5 | 4 | 17 | 19 |
| Interest costs | 308 | 341 | 16 | 19 | 34 | 39 |
| Amendments | (233) | 1 | (25) | - | - | - |
| Actuarial losses (gains) | 354 | (316) | 51 | 9 | 49 | (77) |
| Currency exchange rate change | (11) | (21) | 1 | (1) | - | (1) |
| Benefits paid | (593) | (262) | (19) | (38) | (26) | (33) |
| Employee contributions | 1 | 1 | 1 | 1 | - | - |
| Benefit obligations at end of year | \$7,057 | \$7,093 | \$423 | \$394 | \$865 | \$791 |
| Accumulated benefit obligations | \$6,913 | \$6,713 | \$396 | \$344 | \$865 | \$791 |
| Change in plan assets: | | | | | | |
| Fair value of plan assets at beginning of year | \$6,169 | \$6,091 | \$- | \$- | \$- | \$- |
| Actual return on plan assets | 433 | 42 | - | - | - | - |
| Currency exchange rate change | (11) | (17) | - | - | - | - |
| Employer contribution | 805 | 313 | - | - | - | - |
| Benefits paid | (593) | (262) | - | - | - | - |
| Other | 1 | 2 | - | - | - | - |
| Fair value of plan assets at end of year | \$6,804 | \$6,169 | \$- | \$- | \$- | \$- |
| Funded status of Plan | \$(253) | \$(924) | \$(423) | \$(394) | \$(865) | \$(791) |

| | Pension | | Supplemental Pension | | Postretirement | |
|--|----------------|----------------|----------------------|----------------|----------------|----------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Amounts recognized in the Balance Sheets: | | | | | | |
| Assets | \$10 | \$10 | \$- | \$- | \$- | \$- |
| Liabilities | (263) | (934) | (423) | (394) | (865) | (791) |
| Net liability at end of year | \$(253) | \$(924) | \$(423) | \$(394) | \$(865) | \$(791) |

| | | | | | | |
|---|----------------|----------------|--------------|--------------|---------------|----------------|
| Amounts recognized in Accumulated Other Comprehensive Loss (Income): | | | | | | |
| Net loss (gain) | \$2,609 | \$2,375 | \$242 | \$213 | \$(21) | \$(69) |
| Prior service costs | (245) | (11) | (34) | (11) | (66) | (77) |
| Net transition asset | - | (1) | - | - | - | - |
| Total | \$2,364 | \$2,363 | \$208 | \$202 | \$(87) | \$(146) |

| | | | | | | |
|---|------------|----------------|------------|---------------|-------------|---------------|
| Other changes in Plan assets and projected benefit obligation recognized in Other Comprehensive Loss (Income): | | | | | | |
| Net actuarial loss (gain) | \$381 | \$71 | \$51 | \$8 | \$49 | \$(77) |
| Currency exchange rate change | 2 | (5) | - | - | - | - |
| Amortization of net actuarial loss | (148) | (200) | (22) | (23) | (1) | (4) |
| Prior service costs | (233) | 1 | (25) | - | - | - |
| Amortization of prior service cost | (1) | 2 | 2 | 2 | 11 | 10 |
| Total | \$1 | \$(131) | \$6 | \$(13) | \$59 | \$(71) |

The estimated net actuarial loss, prior service cost, and transition obligation for the pension, supplemental pension and postretirement plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2017 fiscal year are \$179, \$(27), and \$0 for pension plans, \$24, \$(5), and \$0 for supplemental pension plans, and \$3, \$(10), and \$0 for postretirement plans.

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The net benefit costs for the years ended December 31, 2016, 2015 and 2014, include the following components:

| December 31, 2016 | Pension | Supplemental Pension | Postretirement |
|---|----------------|---------------------------------|-----------------------|
| Components of net periodic benefit costs: | | | |
| Service costs | \$138 | \$5 | \$17 |
| Interest costs | 308 | 16 | 34 |
| Expected return on plan assets | (459) | - | - |
| Amortization of unrecognized: | | | |
| Net loss | 148 | 22 | 1 |
| Prior service cost | 1 | (2) | (11) |
| Net periodic benefit costs | \$136 | \$41 | \$41 |

| December 31, 2015 | Pension | Supplemental Pension | Postretirement |
|---|----------------|---------------------------------|-----------------------|
| Components of net periodic benefit costs: | | | |
| Service costs | \$133 | \$4 | \$19 |
| Interest costs | 341 | 19 | 39 |
| Expected return on plan assets | (428) | - | - |
| Settlement / curtailment loss | 2 | - | - |
| Amortization of unrecognized: | | | |
| Net loss | 198 | 23 | 4 |
| Prior service cost | (2) | (2) | (10) |
| Net periodic benefit costs | \$244 | \$44 | \$52 |

| December 31, 2014 | Pension | Supplemental Pension | Postretirement |
|---|----------------|---------------------------------|-----------------------|
| Components of net periodic benefit costs: | | | |
| Service costs | \$104 | \$3 | \$17 |
| Interest costs | 312 | 19 | 40 |
| Expected return on plan assets | (386) | - | - |
| Amortization of unrecognized: | | | |
| Net loss (gain) | 77 | 16 | (1) |
| Prior service cost | (2) | (2) | (10) |
| Net periodic benefit costs | \$105 | \$36 | \$46 |

The measurement date used to determine pension and other postretirement is December 31, 2016.

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

| December 31, | 2016 | 2015 |
|-------------------------------|-------------|-------------|
| Pension | | |
| Discount rate | 4.78% | 5.12% |
| Rate of compensation increase | 3.90% | 3.80% |
| Supplemental Pension | | |
| Discount rate | 4.61% | 4.95% |
| Rate of compensation increase | 5.13% | 5.02% |
| Postretirement | | |
| Discount rate | 4.78% | 5.09% |

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

| December 31, | 2016 | 2015 | 2014 |
|---------------------------------------|-------------|-------------|-------------|
| Pension | | | |
| Discount rate | 5.12% | 4.85% | 5.60% |
| Interest cost effective interest rate | 4.46% | 4.85% | 5.60% |
| Service cost discount rate | 5.28% | 4.85% | 5.60% |
| Expected return on plan assets | 6.75% | 7.00% | 6.75% |
| Rate of compensation increase | 3.80% | 4.00% | 3.70% |
| Supplemental Pension | | | |
| Discount rate | 4.97% | 4.85% | 5.60% |
| Interest cost effective interest rate | 4.11% | 4.85% | 5.60% |
| Service cost discount rate | 4.98% | 4.85% | 5.60% |
| Rate of compensation increase | 5.02% | 5.29% | 3.90% |
| Postretirement | | | |
| Discount rate | 5.09% | 4.85% | 5.60% |
| Interest cost effective interest rate | 4.41% | 4.85% | 5.60% |
| Service cost discount rate | 5.31% | 4.85% | 5.60% |

On an annual basis, the Company reviews the discount rate assumption used to determine the benefit obligations and the composition of various yield curves to ensure that the assumed discount rate reflects the Company's best estimate of the rate of return inherent in a portfolio of high-quality debt instruments that would provide the cash flows necessary to settle the Company's projected benefit payments.

The discount rate assumption used to determine the benefit obligations was based on a yield curve approach where the cash flows related to the benefit plans' liability stream were discounted at an interest rate specifically applicable to the timing of the cash flows. Prior to December 31, 2015, the process calculated the present value of these cash flows and determined the weighted average discount rate that produced the same present value of the future cash flows. The single effective discount rate was also used to determine the Service cost and Interest cost components of net periodic benefit cost. Effective December 31, 2015, the discount rate assumption used to determine the benefit obligations is based on the yield curve where the cash flows related to each of the benefit plans' liability stream is discounted using spot rates specifically applicable to the timing of the cash flows of each plan. Effective January 1, 2016, service cost is calculated by discounting the future cash flows attributable to the current year of service using spot rates specifically applicable to the timing of the cash flows. Interest cost is determined by multiplying each benefit obligation cash flow by the spot rate applicable to that timing of the cash flow. The spot rate change, which is accounted for as a change in estimate, had a \$57 impact on the net periodic benefit cost reported for 2016. There was no impact on the benefit obligation.

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

The Company adopted the RP-2014 Mortality table for Annuitants and Non-Annuitants with White Collar adjustment, projected generationally with Scale MP-2016 at December 31, 2016 and Scale MP-2015 at December 31, 2015.

The weighted-average healthcare cost trend rates are expected to be 9.6% in 2017 graded down to 5.0% in 2028. 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 | \$29 | \$(24) |
| Effect on total service and interest costs | \$1 | \$(1) |

Plan Assets

The assets of the U.S. pension plan represent approximately 98% of the total Plans' assets as of December 31, 2016 and 2015 respectively. The Company's overall investment strategy for the U.S. pension plan's assets is to achieve a mix of approximately 50% of investments for near-term benefit payments and 50% for long-term growth with a wide diversification of asset types, fund strategies, and fund managers. The U.S. pension plan's goal is to achieve a total return in the range of 6%-8% annually with sufficient liquidity to meet the benefit needs of the U.S. pension plan.

The U.S. pension plan's assets are held in a trust and managed by LMIC, a wholly owned subsidiary of the Company and by its subadvisor, Liberty Mutual Group Asset Management, Inc., which is also a wholly owned subsidiary of the Company.

The target allocation for the U.S. pension plan's assets are 47% bonds, 40% diversified public equities, 10% private equity and real estate investments, and 3% cash and short-term investments.

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Fixed maturities include investment grade and high yield bonds and bank loans of companies from diversified industries, residential and commercial mortgage backed securities (“RMBS” and “CMBS”), asset backed securities (“ABS”) and collateralized mortgage obligations (“CMO”), U.S. Treasuries and Agencies, U.S. Municipals and Foreign Government securities. Public equities are broadly diversified by geography (U.S. vs International) and capitalization (large cap vs mid and small cap). Limited partnerships include investments in private equity, real estate and other funds.

The investment strategy for each category of the U.S. pension plan’s assets is as follows:

Fixed maturities - Achieve superior performance against the Bloomberg Barclays Aggregate Bond Index, Bank of America Merrill Lynch High Yield Bond Index, S&P/LSTA Performing Loan Index, and J.P. Morgan Government Bond Index-Emerging Markets Global Diversified over a three to five year period.

Public equities – Achieve superior performance against the MSCI All Country World Index over a three to five year period.

Limited partnerships – Achieve long-term returns in excess of liquid equity securities and provide diversification to the U.S. pension plan’s assets. Exposures are diversified by geography, manager, industry, stage and vintage year.

The U.S. pension plan’s assets are administered by the Liberty Mutual Retirement Committee, which has the fiduciary responsibility for management of the U.S. pension plan’s assets in accordance with the Liberty Mutual Retirement Benefit Plan Investment Policy Statement. This policy has been approved by the Liberty Mutual Retirement Committee.

The other assets represent currency hedges, and real estate assets that support foreign pension plans and an insurance company separate account that supports the domestic pension plan.

The following tables sets forth by level, within the fair value hierarchy, the Plans’ assets at fair value as of December 31, 2016 and 2015.

Fair Value Measurements as of December 31, 2016

| Asset Category | Total | Quoted Prices in | Significant | Significant |
|--|----------------|---|--|--|
| | | Active Markets for Identical Assets Level 1 ⁽¹⁾ | Observable Inputs Level 2 ⁽¹⁾ | Unobservable Inputs Level 3 ⁽¹⁾ |
| Cash, cash equivalents and short-term investments ⁽²⁾ | \$155 | \$98 | \$57 | \$- |
| Fixed maturities: | | | | |
| U.S. government and agency securities | 213 | 210 | 3 | - |
| U.S. state and municipal | 116 | - | 116 | - |
| RMBS/CMO/ABS/CMBS | 734 | - | 734 | - |
| Corporate and other | 2,000 | 102 | 1,891 | 7 |
| Foreign government securities | 52 | - | 52 | - |
| U.S. large cap equities | 1,044 | 1,044 | - | - |
| U.S. mid and small cap equities | 467 | 467 | - | - |
| European equities | 678 | 678 | - | - |
| Asian equities | 448 | 448 | - | - |
| Other equities | 87 | 79 | 8 | - |
| Limited partnerships | 581 | - | - | 581 |
| Other assets | 229 | - | 11 | 218 |
| Total | \$6,804 | \$3,126 | \$2,872 | \$806 |

⁽¹⁾ See Note 10 for descriptions of the three levels of fair value presentation.

⁽²⁾ Cash equivalents in Level 2 are net of investment payables of \$(81).

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Fair Value Measurements as of December 31, 2015

| Asset Category | Total | Quoted Prices in | Significant | Significant |
|--|----------------|---|--|--|
| | | Active Markets for Identical Assets Level 1 ⁽¹⁾ | Observable Inputs Level 2 ⁽¹⁾ | Unobservable Inputs Level 3 ⁽¹⁾ |
| Cash, cash equivalents and short-term investments ⁽²⁾ | \$42 | \$84 | \$(42) | \$- |
| Fixed maturities: | | | | |
| U.S. government and agency securities | 180 | 89 | 91 | - |
| U.S. state and municipal | 138 | - | 138 | - |
| RMBS/CMO/ABS/CMBS | 726 | - | 726 | - |
| Corporate and other | 1,994 | - | 1,992 | 2 |
| Foreign government securities | 47 | - | 47 | - |
| U.S. large cap equities | 747 | 747 | - | - |
| U.S. mid and small cap equities | 525 | 525 | - | - |
| European equities | 648 | 648 | - | - |
| Asian equities | 470 | 470 | - | - |
| Other equities | 41 | 41 | - | - |
| Limited partnerships | 436 | - | - | 436 |
| Other assets | 175 | - | 12 | 163 |
| Total | \$6,169 | \$2,604 | \$2,964 | \$601 |

⁽¹⁾ See Note 10 for descriptions of the three levels of fair value presentation.

⁽²⁾ Cash equivalents in Level 2 are net of investment payables of \$(53).

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

| | Balance January 1, 2016 | Actual Return on Plan Assets Still Held | Actual Return on Plan Assets Sold | Purchases, Sales, & Settlements | Transfers In/(Out) of Level 3 | Balance December 31, 2016 |
|----------------------|----------------------------|---|---|---------------------------------------|-------------------------------------|---------------------------------|
| Limited partnerships | \$436 | \$11 | \$35 | \$99 | \$- | \$581 |
| Fixed maturities | 2 | - | - | 5 | - | 7 |
| Other assets | 163 | 19 | (8) | 44 | - | 218 |
| Total | \$601 | \$30 | \$27 | \$148 | \$- | \$806 |

| | Balance January 1, 2015 | Actual Return on Plan Assets Still Held | Actual Return on Plan Assets Sold | Purchases, Sales, & Settlements | Transfers In/(Out) of Level 3 | Balance December 31, 2015 |
|----------------------|----------------------------|---|---|---------------------------------------|-------------------------------------|---------------------------------|
| Limited partnerships | \$281 | \$22 | \$16 | \$117 | \$- | \$436 |
| Fixed maturities | 1 | - | - | 1 | - | 2 |
| Other assets | 90 | (2) | 8 | 67 | - | 163 |
| Total | \$372 | \$20 | \$24 | \$185 | \$- | \$601 |

The Plans' investments in limited partnerships are recorded at the carrying value as reported by the external fund managers, which is believed to approximate the fair value of the investments.

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Cash Flows

Contributions - The Company contributed \$805 to the qualified plans, and directly funded \$19 to retirees in the supplemental pension plans in 2016. In addition, the Company directly funded \$26 to retirees in the postretirement benefit plans in 2016.

The Company expects to contribute approximately \$628 to the qualified plans, to directly fund \$37 to retirees in the supplemental pension plans, and to directly fund \$38 to the postretirement benefit plans in 2017.

Expected Future Benefit Payments - The following benefit payments, which reflect expected future service as appropriate, are expected to be paid:

| | Pension | Supplemental Pension | Postretirement Plans |
|-----------|----------------|---------------------------------|---------------------------------|
| 2017 | 314 | 37 | 38 |
| 2018 | 321 | 49 | 39 |
| 2019 | 342 | 23 | 42 |
| 2020 | 362 | 23 | 44 |
| 2021 | 382 | 25 | 46 |
| 2022-2026 | 2,179 | 128 | 252 |

(10) FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses the market approach, which generally utilizes market transaction data for identical or similar instruments.

The hierarchy level assigned to each security in the Company's available for sale portfolio is based on the Company's assessment of the transparency and reliability of the inputs used in the valuation of each instrument at the measurement date. The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified based on the lowest level of input that is significant to the fair value measurement. The Company recognizes transfers between levels at the end of each reporting period. The three hierarchy levels are defined as follows:

- Level 1 — Valuations based on unadjusted quoted market prices in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2 — Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets or liabilities at the measurement date, quoted prices in markets that are not active, or other inputs that are observable, either directly or indirectly.
- Level 3 — Valuations based on inputs that are unobservable and significant to the overall fair value measurement and involve management judgment. The unobservable inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the assets and liabilities.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorized in Level 3.

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance on the overall reasonableness and consistent application of valuation methodologies and inputs and compliance with accounting standards through the execution of various processes and controls designed to ensure that the Company's assets and liabilities are appropriately valued. For fair values received from third parties or internally estimated, the Company's processes are designed to determine that the valuation methodologies and inputs are appropriate and consistently applied, the assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities.

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The Company used the following methods and assumptions in estimating the fair value of its financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy:

Fixed Maturities

At each valuation date, the Company uses various valuation techniques to estimate the fair value of its fixed maturities portfolio. The primary method for valuing the Company's securities is through independent third-party valuation service providers. For positions where valuations are not available from independent third-party valuation service providers, the Company utilizes broker quotes and internal pricing methods to determine fair values. The Company obtains a single non-binding price quote from a broker familiar with the security who, similar to the Company's valuation service providers, may consider transactions or activity in similar securities, as applicable, among other information. The brokers providing price quotes are generally from the brokerage divisions of leading financial institutions with market making, underwriting and distribution expertise regarding the security subject to valuation. The evaluation and prioritization of these valuation sources is systematic and predetermined resulting in a single quote or price for each financial instrument. The following describes the techniques generally used to determine the fair value of the Company's fixed maturities by asset class:

U.S. Government and Agency Securities

U.S. government and agency securities consist primarily of bonds issued by the U.S. Treasury and mortgage pass-through agencies such as the Federal Home Loan Bank, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. As the fair values of the Company's U.S. Treasury securities are based on active markets and unadjusted market prices, they are classified within Level 1. The fair value of U.S. government agency securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, reported trades, bids, offers and credit spreads. Accordingly, the fair value of U.S. government agency securities is classified within Level 2.

Mortgage-Backed Securities

The Company's portfolio of residential and commercial MBS is originated by both agencies and non-agencies, the majority of which are pass-through securities issued by U.S. government agencies. The fair value of MBS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of MBS is primarily classified within Level 2.

Asset-Backed Securities

ABS include mostly investment-grade bonds backed by pools of loans with a variety of underlying collateral, including automobile loan receivables, credit card receivables, and collateralized loan obligation securities originated by a variety of financial institutions. The fair value of ABS is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, contractual cash flows, prepayment speeds, collateral performance and credit spreads. Accordingly, the fair value of ABS is primarily classified within Level 2.

Municipal Securities

The Company's municipal portfolio is comprised of bonds issued by U.S. domiciled state and municipal entities. The fair value of municipal securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades and credit spreads. Accordingly, the fair value of municipal securities is primarily classified within Level 2.

Corporate Debt and Other Securities

Corporate debt securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair value of corporate and other securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of corporate and other securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

Foreign Government Securities

Foreign government securities include bonds issued or guaranteed by foreign governments. The fair value of foreign government securities is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, binding broker quotes, issuer ratings, reported trades of identical or comparable securities and credit spreads. Accordingly, the fair value of foreign government securities is primarily classified within Level 2. In the event third-party vendor valuation is not available, prices are determined using non-binding price quotes from a broker familiar with the security. In this instance, the valuation inputs are generally unobservable and the fair value is classified within Level 3.

Equity Securities

Equity securities include common and preferred stocks. Common stocks with fair values based on quoted market prices in active markets are classified within Level 1. Common stocks with fair values determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active are classified within Level 2. The fair value of preferred stock is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active. Accordingly, the fair value of preferred stock is primarily classified within Level 2.

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Short-Term Investments

The fair value of short-term investments is generally determined using observable market inputs that include quoted prices for identical or similar assets in markets that are not active, benchmark yields, new issuances, issuer ratings, reported trades of identical or comparable securities, bids, offers and credit spreads. Accordingly, the fair value of short-term investments is primarily classified within Level 2 of the fair value hierarchy.

Other Investments

Other investments include primarily foreign cash deposits and equity investments in privately held businesses. Cash deposits are primarily valued using quoted prices for similar instruments in active markets; these assets are categorized within Level 2 of the fair value hierarchy. Equity investments in privately held businesses are valued using internal management estimates; they are categorized within Level 3 of the hierarchy. Loans, limited partnership and other alternative investments, which represent the remainder of the other investment balance on the accompanying consolidated balance sheet are not subject to these disclosures and therefore are excluded from the table in this note.

Separate Account Assets

Separate account assets, which primarily consist of other limited partnerships and equity securities, are measured based on the methodologies discussed above. The activity in separate account assets is offset by an equal amount for separate account liabilities, which results in a net zero impact for the Company. Separate account assets within Level 3 include other limited partnership interests. Other limited partnership interests are valued giving consideration to the value of the underlying holdings of the partnerships.

Other Assets and Other Liabilities

Other assets primarily consist of fixed maturities, short-term investments, and equity securities of captive companies sponsored by the Company. These assets are measured based on the methodology for individual securities as discussed above.

Additionally, other assets and other liabilities classified within Level 2 represent the Company's derivatives which can be exchange-traded or traded over-the-counter ("OTC"). OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. When models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of, and specific risks inherent in the instrument, as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be corroborated by observable market data by correlation or other means, and model selection does not involve significant management judgment.

Life Insurance Obligations

Life insurance obligations include certain variable annuity contracts that provide guaranteed minimum income benefits. These benefits are accounted for as embedded derivatives and are bifurcated from the host contract and carried at fair value. The fair value of these embedded derivatives are computed on a recurring basis using assumptions predominately classified as Level 3 (significant unobservable) inputs. While some inputs are observable in the market, such as risk free rates, volatility and historical equity returns, the underlying future policyholder behavior inputs are highly unobservable. The significant policyholder behavior assumptions include lapse and the underlying annuitization rate.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables summarize the Company's assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2016 and 2015:

| | As of December 31, 2016 | | | |
|---|--------------------------------|-----------------|----------------|-----------------|
| Assets, at Fair Value | Level 1 | Level 2 | Level 3 | Total |
| U.S. government and agency securities | \$2,562 | \$668 | \$ - | \$3,230 |
| Residential MBS | - | 6,651 | - | 6,651 |
| Commercial MBS | - | 1,634 | 44 | 1,678 |
| Other MBS and ABS | - | 2,932 | 48 | 2,980 |
| U.S. state and municipal | - | 14,102 | 180 | 14,282 |
| Corporate and other | - | 30,725 | 100 | 30,825 |
| Foreign government securities | - | 5,054 | - | 5,054 |
| Total fixed maturities, available for sale | <u>2,562</u> | <u>61,766</u> | <u>372</u> | <u>64,700</u> |
| Common stock | 2,201 | - | 38 | 2,239 |
| Preferred stock | - | 333 | 4 | 337 |
| Total equity securities, available for sale | <u>2,201</u> | <u>333</u> | <u>42</u> | <u>2,576</u> |
| Short-term investments | 5 | 1,137 | 5 | 1,147 |
| Other investments | - | 77 | 526 | 603 |
| Separate account assets | 39 | - | 65 | 104 |
| Other assets | - | 1 | 21 | 22 |
| Total assets | <u>\$4,807</u> | <u>\$63,314</u> | <u>\$1,031</u> | <u>\$69,152</u> |
| | | | | |
| Liabilities, at Fair Value | | | | |
| Life insurance obligations | \$ - | \$ - | \$(136) | \$(136) |
| Other liabilities | - | (46) | (1) | (47) |
| Total liabilities | <u>\$ -</u> | <u>\$(46)</u> | <u>\$(137)</u> | <u>\$(183)</u> |

| | As of December 31, 2015 | | | |
|---|--------------------------------|-----------------|----------------|-----------------|
| Assets, at Fair Value | Level 1 | Level 2 | Level 3 | Total |
| U.S. government and agency securities | \$2,627 | \$685 | \$ - | \$3,312 |
| Residential MBS | - | 7,379 | 1 | 7,380 |
| Commercial MBS | - | 1,521 | 75 | 1,596 |
| Other MBS and ABS | - | 3,013 | 80 | 3,093 |
| U.S. state and municipal | - | 13,921 | 244 | 14,165 |
| Corporate and other | - | 28,811 | 235 | 29,046 |
| Foreign government securities | - | 4,192 | 10 | 4,202 |
| Total fixed maturities, available for sale | <u>2,627</u> | <u>59,522</u> | <u>645</u> | <u>62,794</u> |
| Common stock | 2,529 | - | 42 | 2,571 |
| Preferred stock | - | 334 | 4 | 338 |
| Total equity securities, available for sale | <u>2,529</u> | <u>334</u> | <u>46</u> | <u>2,909</u> |
| Short-term investments | 1 | 271 | - | 272 |
| Other investments | - | 133 | 479 | 612 |
| Separate account assets | 38 | - | 64 | 102 |
| Other assets | 6 | 32 | 25 | 63 |
| Total assets | <u>\$5,201</u> | <u>\$60,292</u> | <u>\$1,259</u> | <u>\$66,752</u> |
| | | | | |
| Liabilities, at Fair Value | | | | |
| Life insurance obligations | \$ - | \$ - | \$(154) | \$(154) |
| Other liabilities | - | (34) | - | (34) |
| Total liabilities | <u>\$ -</u> | <u>\$(34)</u> | <u>\$(154)</u> | <u>\$(188)</u> |

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The Company did not have significant transfers between Levels 1 and 2 during the years ended December 31, 2016 and 2015.

Changes in Level 3 Recurring Fair Value Measurements

The following tables summarize the fair values of assets on a recurring basis classified as Level 3 within the fair value hierarchy:

| | Balance January 1, 2016 | Net Realized Gains (Losses) | Net Unrealized (Losses) Gains | Purchases | Settlements | Sales and Maturities | Transfer in to Level 3 | Transfer out of Level 3 | Balance December 31, 2016 |
|---------------------------------------|-------------------------------|--------------------------------------|--|-----------|-------------|-------------------------|------------------------------|-------------------------------|---------------------------------|
| Assets, at Fair Value | | | | | | | | | |
| U.S. government and agency securities | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Residential MBS | 1 | - | - | 4 | - | - | - | (5) | - |
| Commercial MBS | 75 | - | - | 17 | - | - | 1 | (49) | 44 |
| Other MBS and ABS | 80 | - | (1) | - | - | (1) | 29 | (59) | 48 |
| U.S. state and municipal | 244 | - | 5 | 152 | - | (25) | 8 | (204) | 180 |
| Corporate and other | 235 | 3 | 1 | 37 | - | (144) | 1 | (33) | 100 |
| Foreign government securities | 10 | - | - | - | - | (1) | - | (9) | - |
| Total fixed maturities | 645 | 3 | 5 | 210 | - | (171) | 39 | (359) | 372 |
| Common stock | 42 | - | 1 | - | - | (5) | - | - | 38 |
| Preferred stock | 4 | - | - | - | - | - | - | - | 4 |
| Total equity securities | 46 | - | 1 | - | - | (5) | - | - | 42 |
| Short-term investments | - | - | - | 6 | - | - | - | (1) | 5 |
| Other investments | 479 | - | 28 | 25 | - | (6) | - | - | 526 |
| Separate account assets | 64 | 5 | - | - | - | (4) | - | - | 65 |
| Other assets | 25 | (1) | - | (3) | - | - | - | - | 21 |
| Total assets | \$1,259 | \$7 | \$34 | \$238 | \$ - | \$(186) | \$39 | \$(360) | \$1,031 |
| Liabilities, at Fair Value | | | | | | | | | |
| Life insurance obligations | \$(154) | \$- | \$ - | \$18 | \$ - | \$ - | \$ - | \$ - | \$(136) |
| Other liabilities | - | - | (1) | - | - | - | - | - | (1) |
| Total liabilities | \$(154) | \$- | \$(1) | \$18 | \$ - | \$ - | \$ - | \$ - | \$(137) |

| | Balance January 1, 2015 | Net Realized Gains (Losses) | Net Unrealized Gains (Losses) | Purchases | Settlements | Sales and Maturities | Transfer in to Level 3 | Transfer out of Level 3 | Balance December 31, 2015 |
|---------------------------------------|-------------------------------|--------------------------------------|--|-----------|-------------|-------------------------|------------------------------|-------------------------------|---------------------------------|
| Assets, at Fair Value | | | | | | | | | |
| U.S. government and agency securities | \$22 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$(22) | \$ - |
| Residential MBS | 1 | - | 1 | 156 | - | - | - | (157) | 1 |
| Commercial MBS | 84 | - | 2 | 52 | - | (28) | - | (35) | 75 |
| Other MBS and ABS | 70 | - | (3) | 100 | - | (4) | - | (83) | 80 |
| U.S. state and municipal | 176 | - | (15) | 180 | - | (6) | 47 | (138) | 244 |
| Corporate and other | 251 | (4) | (6) | 155 | - | (156) | 6 | (11) | 235 |
| Foreign government securities | 11 | (1) | - | 1 | - | (1) | - | - | 10 |
| Total fixed maturities | 615 | (5) | (21) | 644 | - | (195) | 53 | (446) | 645 |
| Common stock | 44 | 27 | (4) | 21 | - | (36) | 1 | (11) | 42 |
| Preferred stock | 2 | - | - | 2 | - | - | - | - | 4 |
| Total equity securities | 46 | 27 | (4) | 23 | - | (36) | 1 | (11) | 46 |
| Short-term investments | 1 | - | - | - | - | (1) | - | - | - |
| Other investments | 440 | (1) | 48 | 26 | - | (34) | - | - | 479 |
| Separate account assets | 60 | 6 | - | - | - | (2) | - | - | 64 |
| Other assets | 27 | 1 | - | (3) | - | - | - | - | 25 |
| Total assets | \$1,189 | \$28 | \$23 | \$690 | \$ - | \$(268) | \$54 | \$(457) | \$1,259 |
| Liabilities, at Fair Value | | | | | | | | | |
| Life insurance obligations | \$(163) | \$(4) | \$ - | \$13 | \$ - | \$ - | \$ - | \$ - | \$(154) |
| Total liabilities | \$(163) | \$(4) | \$ - | \$13 | \$ - | \$ - | \$ - | \$ - | \$(154) |

Transfers into and out of Level 3 were primarily due to changes in the observability of pricing inputs.

There were no material unrealized gains (losses) for the period included in earnings attributable to the fair value relating to assets and liabilities classified as Level 3 that are still held as of December 31, 2016 and 2015.

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Quantitative Information about Level 3 Fair Value Measurements

The following table provides information about the significant unobservable inputs used for recurring fair value measurements for certain material Level 3 assets and liabilities and includes only those instruments for which information about the inputs is reasonably available to the Company. As the input information with respect to certain Level 3 instruments may not be reasonably available to the Company, balances shown below may not equal total amounts reported for such Level 3 assets and liabilities.

| | Fair Value at December 31, 2016 | Valuation Technique(s) | Unobservable Input ^(a) | Range (Weighted Average) |
|-----------------------------------|------------------------------------|--------------------------------------|-----------------------------------|-----------------------------|
| Assets, at Fair Value | | | | |
| State and Municipal | \$95 | Comparative Valuation | Discount Margin (a) | 191-191 (191 bps) |
| | | | Credit Spread (c) | 137-137 (137 bps) |
| | | Discounted Cash Flow Spread Model | Discount Rate (a) | 8.6%-12.0% (10.0%) |
| | | | Credit Spread (c) | 998-998 (998 bps) |
| Corporate and other | \$95 | Spread Model | Credit Spread (c) | 93-699 (458 bps) |
| | | Comparative Valuation | Credit Spread (c) | 164-657 (438 bps) |
| | | | Illiquidity Premium (b) | 149-292 (262 bps) |
| Other invested assets | \$396 | Discounted Cash Flow | Discount Rate (a) | 10.0%-22.5% (16.6%) |
| Liabilities, at Fair Value | | | | |
| Life insurance obligations | \$136 | Discounted Cash Flow | Discount rate (a) | 0.15%-5.13% |
| | | | Lapse rates (d) | 2.0%-12.0% |
| | | | Annuitization take-up rate (e) | 0%-19.2% |

(a) An increase in the discount rate will lead to a decrease in fair value and vice versa.

(b) An increase in the illiquidity premium will lead to a decrease in fair value and vice versa

(c) An increase in the credit spread will lead to a decrease in fair value and vice versa.

(d) An increase in the lapse rates will lead to a decrease in fair value and vice versa.

(e) An increase in the take-up rate will lead to an increase in fair value and vice versa.

| | Fair Value at December 31, 2015 | Valuation Technique(s) | Unobservable Input ^(a) | Range (Weighted Average) |
|-----------------------------------|------------------------------------|--------------------------------------|-----------------------------------|-----------------------------|
| Assets, at Fair Value | | | | |
| Corporate and other | \$167 | Discounted Cash Flow Spread Model | Discount Rate (a) | 22.5% |
| | | | Credit Spread (c) | 94-699 (502 bps) |
| | | Comparative Valuation | Credit Spread(c) | 150-277 (259 bps) |
| | | | Illiquidity Premium(d) | 152-211 (201 bps) |
| | | | Index Yield(b) | 4.4% |
| | | Matrix Pricing | Credit Spread (c) | 120-200 (166 bps) |
| Other invested assets | \$360 | Discounted Cash Flow | Discount Rate (a) | 10.0%-20.0% (16.0%) |
| Liabilities, at Fair Value | | | | |
| Life insurance obligations | \$154 | Discounted Cash Flow | Discount rate (a) | 0.14%-5.14% |
| | | | Lapse rates (e) | 1.0%-12.0% |
| | | | Annuitization take-up rate (f) | 0%-21.0% |

(a) An increase in the discount rate will lead to a decrease in fair value and vice versa.

(b) An increase in yield will lead to a decrease in fair value and vice versa.

(c) An increase in the credit spread will lead to a decrease in fair value and vice versa.

(d) An increase in the illiquidity premium will lead to a decrease in fair value and vice versa.

(e) An increase in the lapse rates will lead to a decrease in fair value and vice versa.

(f) An increase in the take-up rate will lead to an increase in fair value and vice versa.

Fair Value Measurements on a Non-Recurring Basis

The Company's assets measured on a non-recurring basis are primarily related to equity investments in metals and mining projects, direct investments in oil and gas production ventures (Natural Resources), real estate and software. These assets are measured at fair value on a non-recurring basis at time of impairment and are not included in the tables presented above. The Company's assets classified as Level 3 were \$78 and \$314 as of December 31, 2016 and 2015, respectively.

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The following table summarizes the Company's impairment charges for assets measured at fair value on a non-recurring basis for the years ended December 31, 2016, 2015, and 2014.

| | Years ended December 31, | | |
|----------------------|--------------------------|-------|-------|
| | 2016 | 2015 | 2014 |
| Natural resources | \$195 | \$343 | \$155 |
| Real Estate | 34 | - | - |
| Software | 5 | 41 | 3 |
| Limited Partnerships | - | - | 68 |
| Total | \$234 | \$384 | \$226 |

The Company tests for impairment on its natural resource investments by comparing the undiscounted cash flows expected to be generated by a project to the property's carrying value. When a property's carrying value is greater than the expected future cash flows, impairment expense is recognized to the extent that the carrying value of the property exceeds its discounted expected cash flows.

In employing the discounted cash flow method described above, key inputs regarding natural resource investments are commodity prices, locational basis difference, production, project development costs and the discount rate which are based on management's expectations about outcomes with respect to these variables. Specifically, the Company uses a long term forward price curve and applies a discount rate to the projected future cash flows. Regarding the sensitivity of the key inputs, an increase in the locational basis difference, project development costs or discount rate will lead to a decrease in fair value, and an increase in prices or production will lead to an increase in fair value.

Fair Value Option

The Company has elected to apply the fair value option to certain financial instruments in limited circumstances. The fair value option election is made on an instrument by instrument basis. All periodic changes in the fair value of the elected instruments are reflected in the accompanying consolidated statements of income. The impact of the fair value option elections is immaterial to the Company.

Financial Instruments Not Carried at Fair Value

The fair values and carrying values of the Company's financial instruments excluded from ASC 820, *Fair Value Measurement*, as of December 31, 2016 and 2015, are as follows:

| | 2016 | | 2015 | |
|--------------------------------|----------------|------------|----------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Other investments | \$5,422 | \$5,457 | \$5,040 | \$5,040 |
| Commercial mortgage loans | 2,582 | 2,636 | 2,317 | 2,368 |
| Cash and cash equivalents | 4,608 | 4,608 | 4,227 | 4,227 |
| Individual and group annuities | 3,973 | 4,143 | 3,418 | 3,553 |
| Debt | 7,603 | 8,362 | 7,189 | 7,807 |

Other investments - Fair values, classified as Level 3, represent the Company's investment in loans as well as its equity in limited partnerships and other alternative investments. The fair value of loans was estimated using discounted cash flows; key inputs include interest and principle payments as well as the discount rate which are based on management's expectations about outcomes with respect to these variables. Carrying value of limited partnerships and other alternative investments approximates fair value.

Commercial mortgage loans - The fair values of commercial mortgage loans, classified as Level 3, were estimated using option adjusted valuation discount rates or carrying value for newly acquired loans.

Cash and cash equivalents - The carrying amounts reported in the accompanying consolidated balance sheets for these instruments approximate fair values and are classified as Level 1.

Individual and group annuities - Fair values of liabilities under fixed investment-type insurance contracts, classified as Level 3, are estimated using discounted cash flow calculations at pricing rates as of December 31, 2016 and 2015. Also included are variable investment-type insurance contracts, for which carrying value approximates fair value, classified as Level 3, as of December 31, 2016 and 2015.

Debt - Fair values, classified as Level 2, of commercial paper and short-term borrowings approximate carrying value. Fair values of long-term debt were based upon a tiered approach using the following sources in order of availability (1) quoted prices from Morgan Markets, (2) quoted prices from Bloomberg, or (3) a yield to maturity calculation utilizing Bloomberg prices as of December 31, 2016 and 2015.

The Company has not applied ASC 820 to non-financial assets and liabilities.

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(11) 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 leases certain office facilities and equipment under operating leases expiring in various years through 2031. In addition, the Company is party to two land leases expiring in 2025 and 2101. Rental expense was \$207, \$206 and \$223 for the years ended December 31, 2016, 2015 and 2014, respectively. The Company also owns certain office facilities and receives rental income from tenants under operating leases expiring in various years through 2043. Rental income was \$29, \$32, and \$40 for the years ended December 31, 2016, 2015, and 2014, 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 | Net Lease Obligations |
|-------------|---------------------|--------------|--------------------------|
| 2017 | \$181 | \$1 | \$182 |
| 2018 | 144 | 1 | 145 |
| 2019 | 105 | 1 | 106 |
| 2020 | 84 | 1 | 85 |
| 2021 | 91 | 1 | 92 |
| 2022 – 2041 | 319 | 20 | 339 |
| 2042 – 2061 | - | 22 | 22 |
| 2062 – 2101 | - | 86 | 86 |
| Total | <u>\$924</u> | <u>\$133</u> | <u>\$1,057</u> |

As of December 31, 2016, the Company had unfunded commitments in traditional private equity partnerships, natural resources, real estate, and other investments of \$1,698, \$653, \$746, and \$541, respectively. For the year ended December 31, 2016 energy unfunded commitments have declined \$2,358.

As of December 31, 2016, the Company had commitments to purchase various residential MBS at a cost and fair value of \$302, and various corporate and municipal securities at a cost of \$17 and fair value of \$18.

As of December 31, 2016, the Company had \$635 of undrawn letters of credit outstanding secured by assets of \$753.

(12) POLICYHOLDERS' EQUITY

Statutory Surplus

The statutory surplus of the Company's domestic insurance companies was \$19,582 and \$18,687 as of December 31, 2016 and 2015, respectively. The Company's domestic insurance subsidiaries prepare 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 and may only be paid from unassigned surplus. 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, is adequate to its financial needs and does not exceed the insurer's unassigned surplus. However, no insurer may pay an extraordinary dividend without the approval or non-disapproval of the domiciliary insurance regulatory authority. Insurance subsidiaries owned directly by LMGI are LMIC, Liberty Mutual Personal Insurance Company ("LMPICO"), LMFIC and EICOW. Under the insurance laws of Massachusetts, the domiciliary state of LMIC and LMPICO, 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 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 with regard to policyholders as of the preceding December 31, or (b) the greater of (1) the insurer's net income for the calendar year preceding the date of the dividend, minus realized capital gains for that calendar year, or (2) the aggregate of the insurer's net income for the three calendar years preceding the date of the dividend, 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, LMPICO, LMFIC, and EICOW could negatively affect LMGI's ability to pay principal and interest on the notes held at LMGI, as could a redomestication or merger of LMIC, LMPICO, LMFIC, or EICOW to a different domiciliary state. The maximum dividend payout in 2017 that may be made prior to regulatory approval is \$1,959.

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(13) SUBSEQUENT EVENTS

On February 27, 2017, the United Kingdom's Ministry of Justice announced a reduction in the discount rate utilized for certain lump sum personal injury compensation claims from 2.5% to (.75%) effective March 20, 2017. The Company's reserve estimation process provided for the impact of a range of events such as this.

On January 5, 2017, the Company completed the sale of its 10 St. James and 75 Arlington properties. The sale resulted in a gain of \$302, of which \$188 was deferred over the terms of the lease and \$114 was recognized in the consolidated statement of income. The Company has entered into a sale lease back agreement which extends over 15 years resulting in a net lease obligation of \$258.

Management has assessed material subsequent events through March 1, 2017, the date the financial statements were available to be issued.