

TRAVELERS COMPANIES, INC.  
Form 10-K/A  
March 01, 2013

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Table of Contents](#)

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K/A**

(Amendment No. 1)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2012

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to

Commission file number 001-10898

**The Travelers Companies, Inc.**

(Exact name of registrant as specified in its charter)

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**Minnesota**  
(State or other jurisdiction of  
incorporation or organization)

**41-0518860**  
(I.R.S. Employer  
Identification No.)

**485 Lexington Avenue,  
New York, NY 10017**  
(Address of principal executive offices) (Zip Code)

**(917) 778-6000**  
(Registrant's telephone number, including area code)

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**Securities registered pursuant to Section 12(b) of the Act:**

| <b>Title of each class</b>   | <b>Name of each exchange on which registered</b> |
|--|--|
| Common stock, without par value                                    | New York Stock Exchange                          |
| <b>Securities registered pursuant to Section 12(g) of the Act:</b> | <b>None</b>                                      |

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of June 30, 2012, the aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates was \$24,560,884,330.

As of February 11, 2013, 377,954,687 shares of the registrant's common stock (without par value) were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement relating to the 2013 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

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Table of Contents

**Explanatory Note**

The Travelers Companies, Inc. is filing this Amendment No. 1 on Form 10-K/A ("Form 10-K/A") to its Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the Securities and Exchange Commission on February 19, 2013 (the "Original Filing"), to reflect a correction of a clerical error of one number contained in "Item 1. Business". In particular, the "Claims and Claim Adjustment Expense Development Table" contained in "Item 1. Business" has been revised to change the "cumulative amounts paid as of five years later" in the 2007 column to be \$20.244 billion instead of \$19.744 billion. That table, as revised, is included on page 24 of this Form 10-K/A.

Except as described above, no other changes have been made to the Original Filing, and this Form 10-K/A does not modify, amend or update in any way any of the financial or other information contained in the Original Filing. This Form 10-K/A does not reflect events that may have occurred subsequent to the filing date of the Original Filing.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, this Form 10-K/A also contains certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, which are attached hereto. Because no financial statements have been included in this Form 10-K/A and this Form 10-K/A does not contain or amend any disclosure with respect to Items 307 and 308 of Regulation S-K, paragraphs 3, 4, and 5 of the certifications have been omitted.

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Table of Contents

**The Travelers Companies, Inc.**  
**Annual Report on Form 10-K/A**  
**For Fiscal Year Ended December 31, 2012**

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**TABLE OF CONTENTS**

| <b>Item Number</b> |   | <b>Page</b> |
|--------------------|---|-------------|
| <u>1.</u>          | <b><u>Part I</u></b><br><u>Business</u>           | <u>1</u>    |
|                    | <b><u>Part IV</u></b>                             |             |
| <u>15.</u>         | <u>Exhibits and Financial Statement Schedules</u> | <u>48</u>   |
|                    | <u>Signatures</u>                                 | <u>49</u>   |

---

Table of Contents

**PART I**

**Item 1. BUSINESS**

The Travelers Companies, Inc. (together with its consolidated subsidiaries, the Company) is a holding company principally engaged, through its subsidiaries, in providing a wide range of commercial and personal property and casualty insurance products and services to businesses, government units, associations and individuals. The Company is incorporated as a general business corporation under the laws of the state of Minnesota and is one of the oldest insurance organizations in the United States, dating back to 1853. The principal executive offices of the Company are located at 485 Lexington Avenue, New York, New York 10017, and its telephone number is (917) 778-6000. The Company also maintains executive offices in Hartford, Connecticut, and St. Paul, Minnesota. The term "TRV" in this document refers to The Travelers Companies, Inc., the parent holding company excluding subsidiaries.

For a summary of the Company's revenues, operating income and total assets by reportable business segments, see note 2 of notes to the Company's consolidated financial statements.

**PROPERTY AND CASUALTY INSURANCE OPERATIONS**

The property and casualty insurance industry is highly competitive in the areas of price, service, product offerings, agent relationships and methods of distribution. Distribution methods include the use of independent agents, exclusive agents, direct marketing (including use of toll-free numbers and the internet) and/or salaried employees. According to A.M. Best, there are approximately 1,326 property and casualty groups in the United States, comprising approximately 2,778 property and casualty companies. Of those groups, the top 150 accounted for approximately 92% of the consolidated industry's total net written premiums in 2011. The Company competes with both foreign and domestic insurers. In addition, several property and casualty insurers writing commercial lines of business, including the Company, offer products for alternative forms of risk protection in addition to traditional insurance products. These products include large deductible programs and various forms of self-insurance, some of which utilize captive insurance companies and risk retention groups. The Company's competitive position in the marketplace is based on many factors, including the following:

- premiums charged;
- contract terms and conditions;
- products and services offered;
- claim service;
- agent, broker and client relationships;
- local presence;
- geographic scope of business;
- overall financial strength;
- ratings assigned by independent rating agencies;

experience and qualifications of employees; and

technology and information systems.

In addition, the marketplace is affected by available capacity of the insurance industry, as measured by policyholders' surplus, and the availability of reinsurance. Industry capacity as measured by policyholders' surplus expands and contracts primarily in conjunction with profit levels generated by the industry, less amounts returned to shareholders through dividends and share repurchases. Capital raised by debt and equity offerings may also increase policyholders' surplus.

Table of Contents**Pricing and Underwriting**

Pricing of the Company's property and casualty insurance products is generally developed based upon an estimation of expected losses, the expenses associated with producing, issuing and servicing business and managing claims, the time value of money related to the expected loss and expense cash flows, and a reasonable allowance for profit that considers the capital needed to support the Company's business. The Company has a disciplined approach to underwriting and risk management that over the long-term emphasizes product returns and profitable growth rather than premium volume or market share. The Company's insurance subsidiaries are subject to state laws and regulations regarding rate and policy form approvals. The applicable state laws and regulations establish standards in certain lines of business to ensure that rates are not excessive, inadequate, unfairly discriminatory, or used to engage in unfair price competition. The Company's ability to increase rates and the relative timing of the process are dependent upon each respective state's requirements, as well as the competitive market environment.

**Geographic Distribution**

The following table shows the geographic distribution of the Company's consolidated direct written premiums for the year ended December 31, 2012:

| State                     | % of Total    |
|---------------------------|---------------|
| California                | 10.1%         |
| New York                  | 9.8           |
| Texas                     | 7.3           |
| Pennsylvania              | 5.1           |
| Florida                   | 4.5           |
| Illinois                  | 4.0           |
| New Jersey                | 3.9           |
| Massachusetts             | 3.4           |
| Georgia                   | 3.1           |
| All other domestic(1)     | 44.8          |
| <b>Total domestic</b>     | <b>96.0</b>   |
| International             | 4.0           |
| <b>Consolidated total</b> | <b>100.0%</b> |

(1)

No other single state accounted for 3.0% or more of the total direct written premiums written in 2012 by the Company's domestic operations.

**Catastrophe Exposure**

The wide geographic distribution of the Company's property and casualty insurance operations exposes it to claims arising out of catastrophes. The Company uses various analyses and methods, including proprietary and third-party computer modeling processes, to continually monitor and analyze underwriting risks of business in natural catastrophe-prone areas and target risk areas for conventional terrorist attacks (defined as attacks other than nuclear, biological, chemical or radiological events). The Company relies, in part, upon this analysis to make underwriting decisions designed to manage its exposure on catastrophe-exposed business. For example, the Company has limited the writing of new property and homeowners business in some markets and has selectively taken underwriting actions on new and existing business. These underwriting actions on new and existing business include tightened underwriting standards, selective price increases and changes to deductibles specific to hurricane-, tornado-, wind- and hail-prone areas. See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Catastrophe Modeling" and " Changing Climate Conditions."



Table of Contents

The Company also utilizes reinsurance to manage its aggregate exposures to catastrophes. See " Reinsurance."

The Company is organized into three reportable business segments: Business Insurance; Financial, Professional & International Insurance; and Personal Insurance.

**BUSINESS INSURANCE**

The Business Insurance segment offers a broad array of property and casualty insurance and insurance-related services to its clients primarily in the United States. Business Insurance is organized into the following six groups, which collectively comprise Business Insurance Core operations:

*Select Accounts* provides small businesses with property and casualty products, including commercial multi-peril, commercial property, general liability, commercial auto and workers' compensation insurance.

*Commercial Accounts* provides mid-sized businesses with property and casualty products, including commercial multi-peril, commercial property, general liability, commercial auto and workers' compensation insurance.

*National Accounts* provides large companies with casualty products and services, including workers' compensation, general liability and automobile liability, generally utilizing loss-sensitive products, on both a bundled and unbundled basis. National Accounts also includes the Company's commercial residual market business, which primarily offers workers' compensation products and services to the involuntary market.

*Industry-Focused Underwriting.* The following units provide targeted industries with differentiated combinations of insurance coverage, risk management, claims handling and other services:

*Construction* serves a broad range of construction businesses, offering guaranteed cost products for small to mid-sized policyholders and loss-sensitive programs for larger accounts. For the larger accounts, the customer and the Company work together in actively managing and controlling exposure and claims, and they share risk through policy features such as deductibles or retrospective rating. Products offered include workers' compensation, general liability, umbrella and commercial auto coverages, and other risk management solutions.

*Technology* serves small to large companies involved in telecommunications, information technology, medical technology and electronics manufacturing, offering a comprehensive portfolio of products and services. Products offered include commercial property, commercial auto, general liability, workers' compensation, umbrella, internet liability, technology errors and omissions coverages and global companion products.

*Public Sector Services* provides insurance products and services to public entities including municipalities, counties, Indian Nation gaming organizations and selected special government districts such as water and sewer utilities. The policies written by this unit typically cover commercial property, commercial auto, general liability, professional liability and workers' compensation exposures.

*Oil & Gas* provides specialized property and liability products and services for customers involved in the exploration and production of oil and natural gas, including operators and drilling contractors, as well as various service and supply companies and manufacturers that support upstream operations. The policies written by this business group cover risks including physical damage, liability, business interruption and workers' compensation.

Table of Contents

*Agribusiness* serves small to medium-sized agricultural businesses, including farms, ranches, wineries and related operations, offering property and liability coverages other than workers' compensation.

*Target Risk Underwriting.* The following units serve commercial businesses requiring specialized product underwriting, claims handling and risk management services:

*National Property* provides traditional and customized property insurance programs to large and mid-sized customers, including office building owners, manufacturers, municipalities and schools, retailers and service businesses. These insurance programs cover losses on buildings, business personal property and business interruption exposures.

*Inland Marine* provides insurance for goods in transit and movable objects for customers such as jewelers, museums, contractors and the transportation industry. Builders' risk insurance is also offered to customers during the construction, renovation or repair of buildings and other structures.

*Ocean Marine* serves the marine transportation industry and related services, as well as other businesses involved in international trade. The Company's product offerings in this unit fall under six main coverage categories: marine liability, cargo, hull and machinery, protection and indemnity, pleasure craft, and marine property and liability.

*Excess Casualty* serves small to mid-sized commercial businesses, offering mono-line umbrella and excess coverage where the Company typically does not write the primary casualty coverage, or where other business units within the Company prefer to access the underwriting expertise and/or limit capacity of the Excess Casualty business unit.

*Boiler & Machinery* serves small to large companies, offering comprehensive breakdown coverages for equipment, including property and business interruption coverages. Through the BoilerRe unit, Boiler & Machinery also serves other property and casualty carriers that do not have in-house expertise with reinsurance, underwriting, engineering, claim handling and risk management services for this type of coverage.

*Global Partner Services* provides insurance to foreign organizations with property and liability exposures located in the United States (reverse-flow) as part of a global program.

*Specialized Distribution.* The following units market and underwrite their products to customers predominantly through licensed wholesale, general and program agents that manage customers' unique insurance requirements:

*Northland* provides insurance coverage for the commercial transportation industry, as well as commercial liability and package policies for small, difficult to place specialty classes of commercial business on an admitted or excess and surplus lines basis.

*National Programs* offers tailored property and casualty programs on an admitted basis for customers with common risk characteristics or coverage requirements. Programs available include those for entertainment, architects and engineers, equipment rental, golf services and owners of franchised businesses.

Business Insurance also includes the Special Liability Group (which manages the Company's asbestos and environmental liabilities) and the assumed reinsurance and certain other runoff operations, which are collectively referred to as Business Insurance Other.



Table of Contents**Selected Market and Product Information**

The following table sets forth Business Insurance net written premiums by market and product line for the periods indicated. For a description of the markets and product lines referred to in the table, see "Principal Markets and Methods of Distribution" and "Product Lines," respectively.

| (for the year ended December 31, in millions)   | 2012             | 2011      | 2010      | % of Total<br>2012 |
|---|------------------|-----------|-----------|--------------------|
| <b>By market:</b>                               |                  |           |           |                    |
| Select Accounts                                 | \$ 2,775         | \$ 2,784  | \$ 2,718  | 23.4%              |
| Commercial Accounts                             | 3,101            | 2,890     | 2,576     | 26.1               |
| National Accounts                               | 907              | 782       | 806       | 7.7                |
| Industry-Focused Underwriting                   | 2,554            | 2,407     | 2,299     | 21.5               |
| Target Risk Underwriting                        | 1,666            | 1,587     | 1,573     | 14.0               |
| Specialized Distribution                        | 870              | 880       | 872       | 7.3                |
| <b>Total Business Insurance Core</b>            | <b>11,873</b>    | 11,330    | 10,844    | <b>100.0</b>       |
| Business Insurance Other                        | (1)              | 10        | 13        |                    |
| <b>Total Business Insurance by market</b>       | <b>\$ 11,872</b> | \$ 11,340 | \$ 10,857 | <b>100.0%</b>      |
| <b>By product line:</b>                         |                  |           |           |                    |
| Workers' compensation                           | \$ 3,400         | \$ 2,959  | \$ 2,586  | 28.6%              |
| Commercial automobile                           | 1,924            | 1,955     | 1,910     | 16.2               |
| Commercial property                             | 1,647            | 1,595     | 1,641     | 13.9               |
| General liability                               | 1,765            | 1,705     | 1,726     | 14.9               |
| Commercial multi-peril                          | 3,100            | 3,096     | 2,995     | 26.1               |
| Other   | 36               | 30        | (1)       | 0.3                |
| <b>Total Business Insurance by product line</b> | <b>\$ 11,872</b> | \$ 11,340 | \$ 10,857 | <b>100.0%</b>      |

**Principal Markets and Methods of Distribution**

Business Insurance distributes its products through approximately 10,500 independent agencies and brokers located throughout the United States that are serviced by 118 field offices and three customer service centers. Business Insurance continues to make significant investments in enhanced technology utilizing internet-based applications to provide real-time interface capabilities with independent agencies and brokers. Business Insurance builds relationships with well-established, independent insurance agencies and brokers. In selecting new independent agencies and brokers to distribute its products, Business Insurance considers, among other attributes, each agency's or broker's financial strength, staff experience and strategic fit with the Company's operating and marketing plans. Once an agency or broker is appointed, Business Insurance carefully monitors its performance. The majority of products offered by the Select Accounts, Commercial Accounts, Industry-Focused Underwriting and Target-Risk Underwriting groups are distributed through a common base of independent agents and brokers, many of whom also sell the Company's Personal Insurance products. Additionally, the Industry-Focused Underwriting and Target Risk Underwriting groups may underwrite business with agents that specialize in servicing the needs of certain of the industries served by these groups.

**Select Accounts** is a leading provider of commercial property and casualty insurance products to small businesses, generally with fewer than 50 employees. Products offered by Select Accounts are guaranteed-cost policies, including packaged products covering property and liability exposures. Each small business risk is independently evaluated via an automated underwriting platform which in turn enables agents to quote, bind and issue a substantial amount of new small business risks at their desktop. Risks with more complex characteristics are underwritten with the assistance of Company personnel. The automated underwriting platform has significantly streamlined the agent desktop underwriting process.

Table of Contents

**Commercial Accounts** sells a broad range of commercial property and casualty insurance products through a large network of independent agents and brokers, primarily targeting mid-sized businesses with 50 to 1,000 employees. The Company offers a full line of products to its Commercial Accounts customers with an emphasis on guaranteed cost programs. Each account is underwritten based on the unique risk characteristics, loss history and coverage needs of the account. The ability to underwrite at this detailed level allows Commercial Accounts to have a broad risk appetite and a diversified customer base.

**National Accounts** sells a variety of casualty products and services to large companies through a network of national and regional brokers, primarily utilizing loss-sensitive products in connection with a large deductible or self-insured program and, to a lesser extent, a retrospectively rated or a guaranteed cost insurance policy. National Accounts also provides casualty products and services through retail brokers on an unbundled basis, using third-party administrators for insureds who utilize programs such as collateralized deductibles, captive reinsurers and self-insurance. National Accounts provides insurance-related services, such as risk management services, claims administration, loss control and risk management information services, either in addition to, or in lieu of, pure risk coverage, and generated \$193 million of fee income in 2012, excluding commercial residual market business. The commercial residual market business of National Accounts sells claims and policy management services to workers' compensation pools throughout the United States, and generated \$82 million in fee income in 2012.

Workers' compensation accounted for approximately 73% of sales to National Accounts customers during 2012, based on direct written premiums and fees.

**Industry-Focused Underwriting** markets commercial property and casualty insurance products and services through a large network of agents and brokers. These products and services are tailored to targeted industry segments of significant size and complexity that require unique underwriting, claim, risk management or other insurance-related products and services.

**Target Risk Underwriting** markets commercial property and casualty insurance products and services through a large network of agents and brokers to a wide customer base having specialized property and casualty coverage requirements.

**Specialized Distribution** distributes admitted and excess and surplus lines property and casualty products predominantly through selected wholesale agents, both on a brokerage and managing general underwriting basis, and through selected program agents. These brokers, general agents and program agents operate in certain markets that are not typically served by the Company's appointed retail agents, or they maintain certain affinity arrangements in specialized market segments. The wholesale excess and surplus lines market, which is characterized by the absence of rate and form regulation, allows for more flexibility to write certain classes of business. In working with wholesale or program agents on a brokerage basis, Specialized Distribution underwrites the business and sets the premium level. In working with wholesale or program agents on a managing general underwriting or program manager basis, the agents produce and underwrite business subject to underwriting guidelines that have been specifically designed for each facility or program.

**Pricing and Underwriting**

Business Insurance has developed an underwriting and pricing methodology that incorporates underwriting, claims, engineering, actuarial and product development disciplines for particular industries, and enables Business Insurance to facilitate its risk selection process and develop pricing parameters. This approach is designed to maintain high-quality underwriting and pricing discipline utilizing proprietary data gathered and analyzed with respect to business over many years. The underwriters and engineers use this information, which provides specialized knowledge about specific industry segments, to assess and evaluate risks. The Company utilizes both standard industry forms and proprietary forms for the insurance policies it issues.

Table of Contents

For smaller businesses meeting pre-determined exposure characteristics and thresholds, Select Accounts utilizes an automated underwriting system that enables agents to issue a significant number of new policies at their desktop.

A portion of business in this segment, particularly in National Accounts and Construction, is written with large deductible insurance policies. Under workers' compensation insurance contracts with deductible features, the Company is obligated to pay the claimant the full amount of the claim. The Company is subsequently reimbursed by the contractholder for the deductible amount and is subject to credit risk until such reimbursement is made. At December 31, 2012, contractholder payables on unpaid losses within the deductible layer of large deductible policies and the associated receivables were each approximately \$4.78 billion. Retrospectively rated policies are primarily used for workers' compensation coverage. Although the retrospectively rated feature of the policy substantially reduces insurance risk for the Company, it introduces additional credit risk to the Company. Premium receivables from holders of retrospectively rated policies totaled approximately \$116 million at December 31, 2012. Significant collateral, primarily letters of credit and, to a lesser extent, cash collateral or trusts, is generally requested for large deductible plans and/or retrospectively rated policies that provide for deferred collection of deductible recoveries and/or ultimate premiums. The amount of collateral requested is predicated upon the creditworthiness of the customer and the nature of the insured risks. Business Insurance continually monitors the credit exposure on individual accounts and the adequacy of collateral.

**Product Lines**

The Business Insurance segment writes the following types of coverages:

**Workers' Compensation.** Provides coverage for employers for specified benefits payable under state or federal law for workplace injuries to employees. There are typically four types of benefits payable under workers' compensation policies: medical benefits, disability benefits, death benefits and vocational rehabilitation benefits. The Company emphasizes managed care cost containment strategies, which involve employers, employees and care providers in a cooperative effort that focuses on the injured employee's early return to work and cost-effective quality care. The Company offers the following types of workers' compensation products:

guaranteed-cost insurance products, in which policy premium charges are fixed for the period of coverage and do not vary as a result of the insured's loss experience;

loss-sensitive insurance products, including large deductible and retrospectively rated policies, in which fees or premiums are adjusted based on actual loss experience of the insured during the policy period; and

service programs, which are generally sold to the Company's National Accounts customers, where the Company receives fees rather than premiums for providing loss prevention, risk management, and claim and benefit administration services to organizations under service agreements.

The Company also participates in state assigned risk pools as a servicing carrier and pool participant.

**Commercial Automobile.** Provides coverage for businesses against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured's vehicle and property damage to other vehicles and other property resulting from the ownership, maintenance or use of automobiles and trucks in a business.

**Commercial Property.** Provides coverage for loss of or damage to buildings, inventory and equipment from a variety of events, including, among others, hurricanes and other windstorms, earthquakes, hail, wildfires, severe winter weather, floods, volcanic eruptions, tsunamis, theft,

Table of Contents

vandalism, fires, explosions, terrorism and financial loss due to business interruption resulting from covered property damage. For additional information on terrorism coverages, see "Reinsurance Catastrophe Reinsurance Terrorism Risk Insurance Program." Property also includes specialized equipment insurance, which provides coverage for loss or damage resulting from the mechanical breakdown of boilers and machinery, and ocean and inland marine insurance, which provides coverage for goods in transit and unique, one-of-a-kind exposures.

**General Liability.** Insures businesses against third-party claims arising from accidents occurring on their premises or arising out of their operations, including as a result of injuries sustained from products sold. Specialized liability policies may also include coverage for directors' and officers' liability arising in their official capacities, employment practices liability insurance, fiduciary liability for trustees and sponsors of pension, health and welfare, and other employee benefit plans, errors and omissions insurance for employees, agents, professionals and others arising from acts or failures to act under specified circumstances, as well as umbrella and excess insurance.

**Commercial Multi-Peril.** Provides a combination of the property and liability coverages described in the foregoing product line descriptions.

**Net Retention Policy**

The following discussion reflects the Company's retention policy with respect to the Business Insurance segment as of January 1, 2013. For third-party liability, Business Insurance generally limits its net retention, through the use of reinsurance, to a maximum of \$18.8 million per insured, per occurrence. The net retained amount per risk for property exposures is generally limited to \$18.0 million per occurrence, after reinsurance. The Company generally retains its workers' compensation exposures. Reinsurance treaties often have aggregate limits or caps which may result in larger net per-risk retentions if the aggregate limits or caps are reached. The Company utilizes facultative reinsurance to provide additional limits capacity or to reduce retentions on an individual risk basis. The Company may also retain amounts greater than those described herein based upon the individual characteristics of the risk.

**Geographic Distribution**

The following table shows the geographic distribution of Business Insurance's direct written premiums for the states that accounted for the majority of premium volume for the year ended December 31, 2012:

| State         | % of Total |
|---------------|------------|
| California    | 13.3%      |
| New York      | 7.7        |
| Texas         | 7.5        |
| Illinois      | 5.0        |
| Florida       | 4.2        |
| Pennsylvania  | 4.1        |
| New Jersey    | 3.7        |
| Massachusetts | 3.5        |
| All others(1) | 51.0       |
| Total         | 100.0%     |

(1) No other single state accounted for 3.0% or more of the total direct written premiums written in 2012 by the Business Insurance segment.

Table of Contents

**Competition**

The insurance industry is represented in the commercial marketplace by many insurance companies of varying size as well as other entities offering risk alternatives, such as self-insured retentions or captive programs. Market competition works within the insurance regulatory framework to set the price charged for insurance products and the levels of coverage and service provided. A company's success in the competitive commercial insurance landscape is largely measured by its ability to provide insurance and services, including claims handling and risk control services, at a price and on terms that are reasonable and acceptable to the customer, as well as its ability to retain existing customers and to attract new customers.

Select Accounts business is typically written through independent agents and, to a lesser extent, regional brokers and direct writers. Both national and regional property and casualty insurance companies compete in the Select Accounts market which generally comprises lower-hazard, "Main Street" business customers. Risks are underwritten and priced using standard industry practices and a combination of proprietary and standard industry product offerings. Competition in this market is primarily based on product offerings, service levels, ease of doing business and price. Select Accounts has established a strong marketing relationship with its distribution network and has provided this network with defined underwriting policies, a broad array of products, competitive prices and a highly efficient, automated platform that significantly reduces the time period between quoting a price on a new policy and issuing that policy. In addition, the Company has established centralized service centers to help agents perform many service functions, in return for a fee.

Commercial Accounts business has historically been principally written through independent agents and brokers. Competitors in this market are primarily national property and casualty insurance companies that write most classes of business using traditional products and pricing, and regional insurance companies. Companies compete based on product offerings, service levels, price and claim and loss prevention services. Efficiency through automation and rapid response time to customer needs is one key to success in this market.

In the National Accounts market, competition is based on price, product offerings, claim and loss prevention services, managed care cost containment, risk management information systems and collateral requirements. National Accounts primarily competes with national property and casualty insurance companies, as well as with other underwriters of property and casualty insurance in the alternative risk transfer market, such as self-insurance plans, captives managed by others, and a variety of other risk-financing vehicles and mechanisms. The residual market division competes for state contracts to provide claims and policy management services. National Accounts services approximately 33% of the total workers' compensation assigned risk market, making the Company one of the largest servicing carriers in the industry.

There are several other business groups in Business Insurance that compete in focused target markets. Each of these markets is different and requires unique combinations of industry knowledge, customized coverage, specialized risk control and loss handling services, along with partnerships with agents and brokers that also focus on these markets. Some of these business groups compete with national carriers with similarly dedicated underwriting and marketing groups, whereas others compete with smaller regional companies. Each of these business groups has regional structures that allow them to deliver personalized service and local knowledge to their customer base. Specialized agents and brokers, including managing general agents and wholesale agents, supplement this strategy. In all of these business groups, the competitive strategy typically is the application of focused industry knowledge to insurance and risk needs.

Table of Contents

**FINANCIAL, PROFESSIONAL & INTERNATIONAL INSURANCE**

The Financial, Professional & International Insurance segment includes surety and financial liability coverages, which primarily use credit-based underwriting processes, as well as property and casualty products that are primarily marketed on a domestic basis in the United Kingdom, Canada and the Republic of Ireland, and on an international basis as a corporate member of Lloyd's. The segment includes the following groups:

*Bond & Financial Products* provides a wide range of customers with bond and insurance products and risk management services. The range of coverages includes performance, payment and commercial surety and fidelity bonds for construction and general commercial enterprises; management liability coverages for losses caused by the actual or alleged negligence or misconduct of directors and officers or employee dishonesty; employment practices liability coverages and fiduciary coverages for public corporations, private companies and not-for-profit organizations; professional liability coverage for actual or alleged errors and omissions committed in the course of professional conduct or practice for a variety of professionals including, among others, lawyers, design professionals and real estate agents; and professional and management liability, property, workers' compensation, auto and general liability and fidelity insurance for financial institutions.

*International*, through its operations in the United Kingdom, Canada and the Republic of Ireland, offers specialized insurance and risk management services to several customer groups, including, among others, those in the technology, public services, and financial and professional services industry sectors. International, through its Lloyd's syndicate (Syndicate 5000), for which the Company provides 100% of the capital, underwrites through five principal business units marine, global property, accident & special risks, power & utilities and aviation.

In addition, the Company owns 49.5% of the common stock of J. Malucelli Participações em Seguros e Resseguros S.A. (JMalucelli), its joint venture in Brazil. JMalucelli is currently the market leader in surety in Brazil based on market share, and commenced writing other property and casualty insurance business in 2012. The Company's investment in JMalucelli is accounted for using the equity method and is included in "other investments" on the consolidated balance sheet.

**Selected Market and Product Information**

The following table sets forth Financial, Professional & International Insurance net written premiums by market and product line for the periods indicated. For a description of the markets and product lines referred to in the table, see " Principal Markets and Methods of Distribution" and " Product Lines," respectively.

Table of Contents

| (for the year ended December 31, in millions)                                      | 2012            | 2011            | 2010            | % of Total<br>2012 |
|--|-----------------|-----------------|-----------------|--------------------|
| <b>By market:</b>  |                 |                 |                 |                    |
| Bond & Financial Products  | \$ 1,924        | \$ 1,953        | \$ 1,981        | 64.5%              |
| International  | 1,057           | 1,149           | 1,230           | 35.5               |
| <b>Total Financial, Professional &amp; International Insurance by market</b>       | <b>\$ 2,981</b> | <b>\$ 3,102</b> | <b>\$ 3,211</b> | <b>100.0%</b>      |
| <b>By product line:</b>  |                 |                 |                 |                    |
| Fidelity and surety  | \$ 895          | \$ 957          | \$ 993          | 30.0%              |
| General liability  | 859             | 836             | 834             | 28.8               |
| International  | 1,057           | 1,149           | 1,230           | 35.5               |
| Other  | 170             | 160             | 154             | 5.7                |
| <b>Total Financial, Professional &amp; International Insurance by product line</b> | <b>\$ 2,981</b> | <b>\$ 3,102</b> | <b>\$ 3,211</b> | <b>100.0%</b>      |

**Principal Markets and Methods of Distribution**

Within the Financial, Professional & International Insurance segment, Bond & Financial Products distributes the vast majority of its products in the United States through approximately 6,200 of the same independent agencies and brokers that distribute the Business Insurance segment's products. These independent agencies and brokers are located throughout the United States. Bond & Financial Products, in conjunction with the Business Insurance segment, continues to make investments in enhanced technology utilizing internet-based applications to provide real-time interface capabilities with its independent agencies and brokers. Bond & Financial Products builds relationships with well-established, independent insurance agencies and brokers. In selecting new independent agencies and brokers to distribute its products, Bond & Financial Products considers, among other attributes, each agency's or broker's profitability, financial stability, staff experience and strategic fit with its operating and marketing plans. Once an agency or broker is appointed, its ongoing performance is closely monitored. In addition, Bond & Financial Products sells its surety products through independent brokers in the United Kingdom.

The International market distributes its products principally through brokers in the domestic markets of each of the countries in which it operates. It also writes business at Lloyd's, where its products are distributed through Lloyd's wholesale and retail brokers. By virtue of Lloyd's worldwide licenses, Financial, Professional & International Insurance has access to international markets across the world. In late 2008, the Company commenced an exclusive relationship with a broker in the Republic of Ireland that significantly increased the 2009 volume of personal automobile coverage written and also resulted in the Company writing personal household coverages. The Company ceased writing business through this relationship in the fourth quarter of 2010 and ceased writing all remaining personal insurance business in the Republic of Ireland in the fourth quarter of 2011.

**Pricing and Underwriting**

Financial, Professional & International Insurance has developed underwriting and pricing methodologies that incorporate dedicated underwriting, claims, engineering, actuarial and product development disciplines. This approach is designed to maintain high quality underwriting and pricing discipline, based on an in-depth knowledge of the specific account, industry or country. Underwriters use industry and proprietary data gathered and analyzed over many years to assess and evaluate risks prior to quotation. The Company utilizes both standard industry forms and proprietary forms for the insurance policies it issues. This methodology enables Financial, Professional & International Insurance to facilitate its risk selection process and develop pricing parameters.

Table of Contents

**Product Lines**

The Financial, Professional & International Insurance segment writes the following types of coverages:

**Fidelity and Surety.** Provides fidelity insurance coverage, which protects an insured for loss due to embezzlement or misappropriation of funds by an employee, and surety, which is a three-party agreement whereby the insurer agrees to pay a third party or make complete an obligation in response to the default, acts or omissions of an insured. Surety is generally provided for construction performance, legal matters such as appeals, trustees in bankruptcy and probate and other performance bonds.

**General Liability.** Provides coverage for specialized liability exposures as described above in more detail in the "Business Insurance" section of this report.

**International.** Provides coverage for employers' liability (similar to workers' compensation coverage in the United States), public and product liability (the equivalent of general liability), professional indemnity (similar to professional liability coverage), motor (similar to automobile coverage in the United States), property, surety, marine, aviation, personal accident and kidnap & ransom. Marine provides coverage for ship hulls, cargoes carried, private yachts, marine-related liability, offshore energy, ports and terminals, fine art and terrorism. Aviation provides coverage for worldwide aviation risks including physical damage and liabilities for airline, aerospace, general aviation, aviation war and space risks. Personal accident provides financial protection in the event of death or disablement due to accidental bodily injury, while kidnap & ransom provides financial protection against kidnap, hijack, illegal detention and extortion. While the covered hazards may be similar to those in the U.S. market, the different legal environments can make the product risks and coverage terms potentially very different from those the Company faces in the United States.

**Other.** Coverages include Property, Workers' Compensation, Commercial Automobile and Commercial Multi-Peril, which are described above in more detail in the "Business Insurance" section of this report.

**Net Retention Policy**

The following discussion reflects the Company's retention policy with respect to the Financial, Professional & International Insurance segment as of January 1, 2013. In the U.S. operations for third party liability, including but not limited to umbrella liability, professional liability, directors' and officers' liability, and employment practices liability, Financial, Professional & International Insurance generally limits net retentions, through the use of reinsurance, to up to \$16.6 million per policy after the Company retains an aggregate layer of expected losses. For surety protection, where insured limits are often significant, the Company generally retains up to \$55.0 million probable maximum loss (PML) per principal but may retain higher amounts based on the type of obligation, credit quality and other credit risk factors. In the International operations, per-risk retentions are usually limited up to \$18.8 million, after reinsurance. Reinsurance treaties often have aggregate limits or caps which may result in larger net per risk retentions if the aggregate limits or caps are reached. The Company utilizes facultative reinsurance to provide additional limits capacity or to reduce retentions on an individual risk basis. The Company may also retain amounts greater than those described herein based upon the individual characteristics of the risk.

Table of Contents**Geographic Distribution**

The following table shows the geographic distribution of Financial, Professional & International's direct written premiums for the states that accounted for the majority of premium volume for the year ended December 31, 2012:

| State                 | % of<br>Total |
|-----------------------|---------------|
| California            | 6.8%          |
| New York              | 5.3           |
| Texas                 | 5.0           |
| Florida               | 3.4           |
| Illinois              | 3.1           |
| All other domestic(1) | 45.9          |
| <b>Total domestic</b> | <b>69.5</b>   |
| Total international   | 30.5          |
| <b>Total</b>          | <b>100.0%</b> |

- (1) No other single state within the United States accounted for 3.0% or more of the total direct written premiums written in 2012 by the domestic operations of the Financial, Professional & International Insurance segment.

**Competition**

The competitive landscape in which Bond & Financial Products operates is affected by many of the same factors described previously for the Business Insurance segment. Competitors in this market are primarily national property and casualty insurance companies that write most classes of business using traditional products and pricing and, to a lesser extent, regional insurance companies and companies that have developed niche programs for specific industry segments.

Bond & Financial Products underwrites and markets its products to all sizes of businesses and other organizations, as well as individuals. The Company believes that its reputation for timely and consistent decision making, a nationwide network of local underwriting, claims and industry experts and strong producer and customer relationships, as well as its ability to offer its customers a full range of products, provides Bond & Financial Products an advantage over many of its competitors and enables it to compete effectively in a complex, dynamic marketplace. The Company believes that the ability of Bond & Financial Products to cross-sell its products to customers of the Business Insurance and Personal Insurance segments provides additional competitive advantages for the Company.

International competes with numerous international and domestic insurers in the United Kingdom, Canada and the Republic of Ireland. Companies compete on the basis of price, product offerings and the level of claim and risk management services provided. The Company has developed expertise in various markets in these countries similar to those served in the United States and provides both property and casualty coverage for these markets.

At Lloyd's, International competes with other syndicates operating in the Lloyd's market as well as international and domestic insurers in the various markets where the Lloyd's operation writes business worldwide. Competition is again based on price, product and service. The Company focuses on lines it believes it can underwrite effectively and profitably with an emphasis on short-tail insurance lines.

**PERSONAL INSURANCE**

The Company's Personal Insurance segment writes a broad range of property and casualty insurance covering individuals' personal risks. The primary products of automobile and homeowners insurance are complemented by a broad suite of related coverages.



Table of Contents**Selected Product and Distribution Channel Information**

The following table sets forth net written premiums for the Personal Insurance segment's business by product line for the periods indicated. For a description of the product lines referred to in the following table, see " Product Lines." In addition, see " Principal Markets and Methods of Distribution" for a discussion of distribution channels for Personal Insurance's product lines.

| (for the year ended December 31, in millions) | 2012     | 2011     | 2010     | % of Total<br>2012 |
|---|----------|----------|----------|--------------------|
| <b>By product line:</b>                       |          |          |          |                    |
| Automobile                                    | \$ 3,642 | \$ 3,788 | \$ 3,772 | 48.0%              |
| Homeowners and Other                          | 3,952    | 3,957    | 3,795    | 52.0               |
| Total Personal Insurance                      | \$ 7,594 | \$ 7,745 | \$ 7,567 | 100.0%             |

**Principal Markets and Methods of Distribution**

Personal Insurance products are distributed primarily through approximately 12,000 active independent agents located throughout the United States, supported by personnel in 13 sales regions and seven service centers. While the principal markets for Personal Insurance products continue to be in states along the East Coast, California and Texas, the business continues to expand its geographic presence across the United States.

In selecting new independent agencies to distribute its products, Personal Insurance considers, among other attributes, each agency's profitability, financial stability, staff experience and strategic fit with the segment's operating and marketing plans. Once an agency is appointed, Personal Insurance carefully monitors its performance.

Agents can access the Company's agency service portal for a number of resources including customer service, marketing and claims management. In addition, agencies can choose to shift the ongoing service responsibility for Personal Insurance's customers to one of the Company's five Customer Care Centers, where the Company provides, on behalf of an agency, a comprehensive array of customer service needs, including response to billing and coverage inquiries, and policy changes. Approximately 1,800 agents take advantage of this service alternative.

Personal Insurance also distributes its products through additional channels, including corporations that make the company's product offerings available to their employees primarily through payroll deduction, consumer associations and affinity groups. Personal Insurance handles the sales and service for these programs either through a sponsoring independent agent or through two of the Company's call center locations. In addition, since 1995, the Company has had a marketing agreement with GEICO to underwrite homeowners business for their auto customers.

In 2009, the Company began marketing its insurance products directly to consumers, largely through online channels. The investment in the direct-to-consumer initiative generated modest premium volume for Personal Insurance in recent years, which was consistent with the Company's expectations. However, the direct-to-consumer initiative, while intended to enhance the Company's long-term ability to compete successfully in a consumer-driven marketplace, is expected to remain unprofitable for a number of years as the Company continues to develop, test and evaluate this distribution channel.

**Pricing and Underwriting**

Personal Insurance has developed a product management methodology that integrates the disciplines of underwriting, claim, actuarial and product development. This approach is designed to maintain high quality underwriting discipline and pricing segmentation. Proprietary data accumulated over many years is analyzed and Personal Insurance uses a variety of risk differentiation models to

Table of Contents

facilitate its pricing segmentation. The Company's product management area establishes underwriting guidelines integrated with its filed pricing and rating plans, which enable Personal Insurance to effectively execute its risk selection and pricing processes.

Pricing for personal automobile insurance is driven in large part by changes in the frequency of claims and by inflation in the cost of automobile repairs, medical care and litigation of liability claims. Pricing in the homeowners business is driven in large part by changes in the frequency of claims and by inflation in the cost of building supplies, labor and household possessions. In addition to the normal risks associated with any multiple peril coverage, the profitability and pricing of both homeowners and automobile insurance are affected by the incidence of natural disasters, particularly those related to weather and, for homeowners insurance, earthquakes. Insurers writing personal lines property and casualty policies may be unable to increase prices until some time after the costs associated with coverage have increased, primarily because of state insurance rate regulation. The pace at which an insurer can change rates in response to increased costs depends, in part, on whether the applicable state law requires prior approval of rate increases or notification to the regulator either before or after a rate change is imposed. In states with prior approval laws, rates must be approved by the regulator before being used by the insurer. In states having "file-and-use" laws, the insurer must file rate changes with the regulator, but does not need to wait for approval before using the new rates. A "use-and-file" law requires an insurer to file rates within a period of time after the insurer begins using the new rate. Approximately one-half of the states require prior approval of most rate changes. In addition, changes to methods of marketing and underwriting in some jurisdictions are subject to state-imposed restrictions, which can make it more difficult for an insurer to significantly manage catastrophe exposures.

The Company's ability or willingness to raise prices, modify underwriting terms or reduce exposure to certain geographies may be limited due to considerations of public policy, the evolving political environment, changes in the general economic climate and/or social responsibilities. The Company also may choose to write business it might not otherwise write in some states for strategic purposes, such as improving access to other commercial or personal underwriting opportunities. In choosing to write business in some states, the Company also considers the costs and benefits of those states' residual markets and guaranty funds, as well as other property and casualty business the Company writes in those states.

Personal Insurance utilizes technology intended to maximize independent agents' ease of doing business with the Company. Automated quote transactions can be submitted online by independent agents either through Personal Insurance's proprietary platform, their own agency management platform or comparative raters (discussed in more detail in the "Competition" section that follows). Nearly all new business policies can be issued online either by using the agents' own platform or Personal Insurance's platform, both of which interface with Personal Insurance's underwriting and rating systems to monitor transactions for compliance with the company's underwriting and pricing programs. All online business is subject to consultative review by Personal Insurance's in-house underwriters. Audits of on-line business are conducted by an internal review team using systematic sampling across all of the Company's distribution channels.

**Product Lines**

The primary coverages in Personal Insurance are personal automobile and homeowners and other insurance sold to individuals. Personal Insurance had approximately 7.3 million active policies (e.g., policies-in-force) at December 31, 2012.

The Personal Insurance segment writes the following types of coverages:

**Personal Automobile** provides coverage for liability to others for both bodily injury and property damage, uninsured motorist protection, and for physical damage to an insured's own vehicle

Table of Contents

from collision, fire, flood, hail and theft. In addition, many states require policies to provide first-party personal injury protection, frequently referred to as no-fault coverage.

**Homeowners and Other** provides protection against losses to dwellings and contents from a variety of perils (excluding flooding) as well as coverage for personal liability. The Company writes homeowners insurance for dwellings, condominiums and tenants, and rental properties. The Company writes coverage for boats and yachts and valuable personal items such as jewelry, and also writes coverages for umbrella liability, identity fraud, and weddings and special events.

**Net Retention Policy**

The following describes the Company's retention policy with respect to the Personal Insurance segment as of January 1, 2013. The Company generally retains its primary personal auto exposures in their entirety. For personal property insurance, there is an \$8.0 million maximum retention per risk. Personal Insurance retains the first \$10.0 million of umbrella policies and purchases facultative reinsurance to provide additional limits capacity or to reduce retentions on an individual risk basis. The Company may also retain amounts greater than those described herein based on the individual characteristics of the risk.

**Geographic Distribution**

The following table shows the geographic distribution of Personal Insurance's direct written premiums for the states that accounted for the majority of premium volume for the year ended December 31, 2012:

| State         | % of Total    |
|---------------|---------------|
| New York      | 14.9%         |
| Texas(1)      | 7.8           |
| Pennsylvania  | 7.6           |
| California    | 6.3           |
| Florida       | 5.4           |
| New Jersey    | 5.1           |
| Georgia       | 4.4           |
| Connecticut   | 4.2           |
| Virginia      | 4.1           |
| Massachusetts | 3.7           |
| Maryland      | 3.4           |
| All others(2) | 33.1          |
| <b>Total</b>  | <b>100.0%</b> |

(1) The percentage for Texas includes business written by the Company through a fronting agreement with another insurer.

(2) No other single state accounted for 3.0% or more of the total direct written premiums written in 2012 by the Personal Insurance segment.

**Competition**

Although national companies write the majority of this business, Personal Insurance also faces competition from many regional and hundreds of local companies. Personal Insurance primarily competes based on breadth of product offerings, price, service (including claims handling), ease of doing business, stability of the insurer and name recognition. Personal Insurance competes for business within each independent agency since these agencies also offer policies of competing companies. At the agency level, competition is primarily based on

price, service (including claims handling), the level of

Table of Contents

automation and the development of long-term relationships with individual agents. In recent years, most independent personal insurance agents have begun utilizing price comparison rating technology, sometimes referred to as "comparative raters," as a cost-efficient means of obtaining quotes from multiple companies. Because the use of this technology facilitates the process of generating multiple quotes, the technology has increased price comparison on new business and, increasingly, on renewal business. Personal Insurance also competes with insurance companies that use exclusive agents or salaried employees to sell their products, as well as those that employ direct marketing strategies, including the use of toll-free numbers and the internet. See "Item 1A Risk Factors The intense competition that we face could harm our ability to maintain or increase our business volumes and our profitability."

**CLAIMS MANAGEMENT**

The Company's claim functions are managed through its Claims Services operation, with locations in the United States and in the countries where it does business. With more than 13,000 employees, Claims Services employs a diverse group of professionals, including claim adjusters, appraisers, attorneys, investigators, engineers, accountants, system specialists and training, management and support personnel. Approved external service providers, such as investigators, attorneys and, in the rare circumstances when necessary, independent adjusters and appraisers, are available for use as appropriate.

U.S. field claim management teams located in 21 claim centers and 58 satellite and specialty-only offices in 45 states are organized to maintain focus on the specific claim characteristics unique to the businesses within the Company's business segments. Claim teams with specialized skills, required licenses, resources and workflows are matched to the unique exposures of those businesses, with local claims management dedicated to achieving optimal results within each segment. The Company's home office operations provide additional support in the form of workflow design, quality management, information technology, advanced management information and data analysis, training, financial reporting and control, and human resources strategy. This structure permits the Company to maintain the economies of scale of a large, established company while retaining the agility to respond promptly to the needs of customers, brokers, agents and underwriters. Claims management for International, while generally provided locally by staff in the respective international locations due to local knowledge of applicable laws and regulations, is also managed by the Company's U.S. Claims Services organization to leverage that knowledge base and to share best practices.

An integral part of the Company's strategy to benefit customers and shareholders is its continuing industry leadership in the fight against insurance fraud through its Investigative Services unit. The Company has a nationwide staff of experts who investigate a wide array of insurance fraud schemes using in-house forensic resources and other technological tools. This staff also has specialized expertise in fire scene examinations, medical provider fraud schemes and data mining. The Company also dedicates investigative resources to ensure that violations of law are reported to and prosecuted by law enforcement agencies.

Claims Services uses technology, management information and data analysis to assist the Company in reviewing its claim practices and results in order to evaluate and improve its claims management performance. The Company's claims management strategy is focused on segmentation of claims and appropriate technical specialization to drive effective claim resolution. The Company continually monitors its investment in claim resources to maintain an effective focus on claim outcomes and a disciplined approach to continual improvement. The Company operates a state-of-the-art claims training facility, offering hands-on experiential learning to help ensure that its claim professionals are properly trained. In recent years, the Company has invested significant additional resources in many of its claim handling operations and routinely monitors the effect of those investments to ensure a consistent optimization among outcomes, cost and service.

Table of Contents

In recent years, Claims Services refined its catastrophe response strategy to increase the Company's ability to respond to a significant catastrophic event using its own personnel, enabling it to minimize reliance on independent adjusters and appraisers. The Company has developed a large dedicated catastrophe response team and trained a large Enterprise Response Team of existing employees who can be deployed on short notice in the event of a catastrophe that generates claim volume exceeding the capacity of the dedicated catastrophe response team. In recent years, these internal resources were successfully deployed to respond to a record number of catastrophe claims, including those related to Storm Sandy in 2012.

**REINSURANCE**

The Company reinsures a portion of the risks it underwrites in order to control its exposure to losses. The Company cedes to reinsurers a portion of these risks and pays premiums based upon the risk and exposure of the policies subject to such reinsurance. Ceded reinsurance involves credit risk, except with regard to mandatory pools and associations, and is generally subject to aggregate loss limits. Although the reinsurer is liable to the Company to the extent of the reinsurance ceded, the Company remains liable as the direct insurer on all risks reinsured. Reinsurance recoverables are reported after reductions for known insolvencies and after allowances for uncollectible amounts. The Company also holds collateral, including trust agreements, escrow funds and letters of credit, under certain reinsurance agreements. The Company monitors the financial condition of reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically. Reinsurers are selected based on their financial condition, business practices, the price of their product offerings and the value of collateral provided. After reinsurance is purchased, the Company has limited ability to manage the credit risk to a reinsurer. In addition, in a number of jurisdictions, particularly the European Union and the United Kingdom, a reinsurer is permitted to transfer a reinsurance arrangement to another reinsurer, which may be less creditworthy, without a counterparty's consent, provided that the transfer has been approved by the applicable regulatory and/or court authority. For additional information concerning reinsurance, see note 5 of notes to the Company's consolidated financial statements and "Item 1A Risk Factors."

The Company utilizes a variety of reinsurance agreements to manage its exposure to large property and casualty losses, including:

facultative reinsurance, in which reinsurance is provided for all or a portion of the insurance provided by a single policy and each policy reinsured is separately negotiated;

quota share reinsurance, in which reinsurance is provided for an agreed-upon fixed percentage of liabilities, premiums and losses for each policy covered on a pro rata basis;

treaty reinsurance, in which reinsurance is provided for a specified type or category of risks; and

catastrophe reinsurance, in which the Company is indemnified for an amount of loss in excess of a specified retention with respect to losses resulting from a catastrophic event.

For a description of reinsurance-related litigation, see note 16 of notes to the Company's consolidated financial statements.

Included in reinsurance recoverables are amounts related to structured settlements, which comprise annuities purchased from various life insurance companies to settle certain personal physical injury claims, of which workers' compensation claims comprise a significant portion. In cases where the Company did not receive a release from the claimant, the amount due from the life insurance company related to the structured settlement is included in the Company's consolidated balance sheet as a liability and as a reinsurance recoverable, as the Company retains the contingent liability to the claimant. In the event that the life insurance company fails to make the required annuity payments, the

Table of Contents

Company would be required to make such payments, if and to the extent the purchased annuities are not covered by state guaranty associations.

**Catastrophe Reinsurance**

Catastrophes can be caused by a variety of events, including, among others, hurricanes, tornadoes and other windstorms, earthquakes, hail, wildfires, severe winter weather, floods, tsunamis and volcanic eruptions. Catastrophes can also result from a terrorist attack (including those involving nuclear, biological, chemical or radiological events), explosions, infrastructure failures or as a consequence of political instability. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes and earthquakes may produce significant damage in larger areas, especially those areas that are heavily populated. The Company generally seeks to manage its exposure to catastrophes through individual risk selection and the purchase of catastrophe reinsurance. The Company utilizes a general catastrophe reinsurance treaty with unaffiliated reinsurers to manage its exposure to losses resulting from catastrophes. In addition to the coverage provided under this treaty, the Company also utilizes a catastrophe bond program, as well as a Northeast catastrophe reinsurance treaty, to protect against certain losses resulting from catastrophes in the Northeastern United States. In addition, the Company also has a general catastrophe aggregate excess-of-loss reinsurance treaty, an earthquake excess-of-loss reinsurance treaty and several reinsurance treaties specific to its international operations.

*General Catastrophe Reinsurance Treaty.* The general catastrophe reinsurance treaty covers the accumulation of net property losses arising out of one occurrence. The treaty covers all of the Company's exposures in the United States and Canada and their possessions, and waters contiguous thereto, the Caribbean and Mexico. The treaty only provides coverage for terrorism events in limited circumstances and excludes entirely losses arising from nuclear, biological, chemical or radiological attacks.

The following table summarizes the Company's coverage under its General Catastrophe Reinsurance Treaty, effective for the period July 1, 2012 through June 30, 2013, as well as certain other catastrophe-related coverages:

| Layer of Loss                  | Reinsurance Coverage In-Force   |
|--------------------------------|---|
| \$0 - \$1.5 billion            | Loss 100% retained by the Company, except for certain losses covered by the Earthquake Excess-of-Loss Treaty as described below.  |
| \$1.5 billion - \$2.25 billion | 53.3% (\$400 million) of loss covered by treaty; 46.7% (\$350 million) of loss retained by the Company. Additionally, certain losses incurred in the Northeastern United States are covered by the Catastrophe Bond Program as described below. |
| Greater than \$2.25 billion    | 100% of loss retained by the Company, except for certain losses incurred in the Northeastern United States, which are covered by the Catastrophe Bond Program and Northeast Catastrophe Treaty as described below.                              |

In addition to the general catastrophe reinsurance treaty described above, the Company also maintains a General Catastrophe Aggregate Excess-of-Loss Treaty, the coverage terms of which are described below.

Table of Contents

*Catastrophe Bond Program.* On December 18, 2009, Longpoint Re II, Ltd. (Longpoint Re II), a newly formed independent Cayman Islands company licensed as a Class B insurer in the Cayman Islands, completed an offering to unrelated investors of \$500 million aggregate principal amount of catastrophe bonds. In connection with the offering, the Company and Longpoint Re II entered into two reinsurance agreements (covering a three-year and four-year period, respectively), each providing up to \$250 million of reinsurance on a proportional basis from certain losses resulting from certain hurricane events in the northeastern United States. The three-year term reinsurance agreement expired in December 2012, and the remaining reinsurance agreement expires in December 2013.

Under the terms of the remaining reinsurance agreement, the Company is obligated to pay annual reinsurance premiums to Longpoint Re II for the reinsurance coverage. The reinsurance agreement utilizes a dual trigger that is based upon the Company's covered losses incurred and an index that is created by applying predetermined percentages to insured industry losses in each state in the covered area as reported by a third-party service provider. The reinsurance agreement meets the requirements to be accounted for as reinsurance in accordance with the guidance for reinsurance contracts. Amounts payable to the Company under the reinsurance agreement with respect to any covered event will be determined by the index-based losses from such event (which are designed to approximate the Company's actual losses), but cannot exceed the Company's actual losses from such event. The Company's actual loss experience may differ from the index-based losses. The principal amount of the catastrophe bonds will be reduced by any amounts paid to the Company under the reinsurance agreement.

The attachment point for index-based losses and the maximum limit in the program's remaining reinsurance agreement are reset annually using a third-party proprietary computer model to estimate potential hurricane losses for the entire industry. The purpose of the annual reset is to maintain modeled probabilities of attachment and expected loss on the respective catastrophe bonds equal to their initial modeled probabilities. The attachment point for the indexed-based losses and maximum limit were increased significantly on May 1, 2012. Through April 30, 2013, the Company will be entitled to begin recovering amounts under the reinsurance agreement if the index-based losses in the covered area for a single occurrence reach an initial attachment amount of \$3.500 billion. The full \$250 million coverage amount of the reinsurance agreement is available on a proportional basis until index-based losses reach a maximum \$4.358 billion limit. In accordance with the Longpoint Re II program, the attachment point for the index-based losses and the maximum limit will be reset again for the period May 1, 2013 through December 18, 2013. Covered losses under the agreement are limited to the following geographic locations: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont.

As with any reinsurance agreement, there is credit risk associated with collecting amounts due from reinsurers. With regard to Longpoint Re II, the credit risk is mitigated by a reinsurance trust account that has been funded by Longpoint Re II with money market funds that invest solely in direct government obligations backed by the U.S. government with maturities of no more than 13 months. The money market funds must have a principal stability rating of at least AAAM by Standard & Poor's. Other permissible investments include repurchase and reverse repurchase agreements collateralized by direct government obligations backed by the U.S. government with terms of no more than 397 calendar days, and cash.

On June 6, 2012, Long Point Re III Ltd.(Long Point Re III), a newly formed independent Cayman Islands company licensed as a Class B insurer in the Cayman Islands, completed an offering to unrelated investors of \$250 million aggregate principal amount of catastrophe bonds. In connection with the offering, the Company and Long Point Re III entered into a three-year reinsurance agreement providing coverage to the Company for certain losses from a hurricane in the northeastern United States. Long Point Re III was structured similarly to Longpoint Re II but does not utilize a dual trigger reinsurance agreement that is based on index-based losses. The business covered by the reinsurance

Table of Contents

agreement comprises specified property and related coverages in the Company's Personal Insurance segment, and within the "Select Accounts" and the "Commercial Accounts" business groups within the Company's Business Insurance segment. Covered losses under the agreement are limited to the following geographic locations: Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Virginia and Vermont. Coverage under the agreement is subject to a \$2.0 billion retention, after which the Company is entitled to recover 50% of losses, up to a maximum recovery of \$250 million. The attachment point, maximum limit and insurance percentage are reset annually to maintain modeled probabilities of attachment and expected loss on the respective catastrophe bonds equal to the initial modeled probabilities of attachment and expected loss. Similar to Longpoint Re II, in Long Point Re III the proceeds of the offering were deposited in a reinsurance trust account. In addition, the permitted investments for such proceeds are of the same type as in Longpoint Re II in all material respects, except that in Long Point Re II the money market funds must always be rated at least AAAm by Standard & Poor's, and in Long Point Re III, the money market funds must have been rated AAAm by Standard & Poor's on the issuance date of the bonds and thereafter must be rated by Standard & Poor's. The reinsurance agreement meets the requirements to be accounted for as reinsurance in accordance with the guidance for reinsurance contracts.

At the time the agreements were entered into with Longpoint Re II and Long Point Re III, the Company evaluated the applicability of the accounting guidance that addresses variable interest entities or VIEs. Under this guidance, an entity that is formed for business purposes is considered a VIE if: (a) the equity investors lack the direct or indirect ability through voting rights or similar rights to make decisions about an entity's activities that have a significant effect on the entity's operations, or (b) the equity investors do not provide sufficient financial resources for the entity to support its activities. Additionally, a company that absorbs a majority of the expected losses from a VIE's activities or is entitled to receive a majority of the entity's expected residual returns, or both, is considered to be the primary beneficiary of the VIE and is required to consolidate the VIE in the company's financial statements.

As a result of the evaluation of the reinsurance agreements with Longpoint Re II and Long Point Re III, the Company concluded that they were VIEs because the conditions described in items (a) and (b) above were present. However, while Longpoint Re II and Long Point Re III were determined to be VIEs, the Company concluded that it did not have a variable interest in the entities, as the variability in their results, caused by the reinsurance agreements, is expected to be absorbed entirely by the investors in the catastrophe bonds issued by Longpoint Re II and Long Point Re III and residual amounts earned by them, if any, are expected to be absorbed by the equity investors (the Company has neither an equity nor a residual interest in Longpoint Re II or Long Point Re III).

Accordingly, the Company is not the primary beneficiary of Longpoint Re II or Long Point Re III and does not consolidate those entities in the Company's consolidated financial statements. Additionally, because the Company has no intention to pursue any transaction that would result in it acquiring interest in and becoming the primary beneficiary of Longpoint Re II or Long Point Re III, the consolidation of those entities in the Company's consolidated financial statements in future periods is unlikely.

The Company has not incurred any losses that have resulted or are expected to result in a recovery under the Longpoint Re II or Long Point Re III agreements since their inception.

*Northeast General Catastrophe Reinsurance Treaty.* In addition to its general catastrophe treaty and its multi-year catastrophe bond program, the Company also is party to a northeast general catastrophe reinsurance treaty which provides up to \$600 million of coverage, subject to a \$2.25 billion retention, for certain losses arising from hurricanes, tornados, hail storms, earthquakes and winter storm or freeze losses from Virginia to Maine for the period July 1, 2012 through June 30, 2013. Losses from a covered

Table of Contents

event (occurring over several days) anywhere in the United States, Canada, the Caribbean and Mexico and waters contiguous thereto may be used to satisfy the retention. Recoveries under the catastrophe bond programs (if any) would be first applied to reduce losses subject to this treaty.

*General Catastrophe Aggregate Excess-of-Loss Reinsurance Treaty.* For the period January 1, 2013 to December 31, 2013, the Company has entered into a reinsurance agreement that covers the accumulation of certain property losses arising from multiple occurrences. For each occurrence, qualifying losses are 90% of \$1.4 billion in excess of \$100 million. The treaty covers aggregate qualifying losses during 2013 for 40% of \$1.0 billion in excess of \$1.5 billion. The treaty covers all of the Company's exposures in the United States and Canada and their possessions, and waters contiguous thereto, the Caribbean and Mexico.

*Earthquake Excess-of-Loss Reinsurance Treaty.* For the period July 1, 2012 through June 30, 2013, the Company has entered into an earthquake excess-of-loss treaty that provides for up to \$142.5 million of coverage, subject to a \$125 million retention, for earthquake losses incurred under policies written by the National Property business unit in the Company's Business Insurance segment.

*International Reinsurance Treaties.* For business underwritten in Canada, the United Kingdom and Republic of Ireland and in the Company's operations at Lloyd's, separate reinsurance protections are purchased locally that have lower net retentions more commensurate with the size of the respective local balance sheet. The Company conducts an ongoing review of its risk and catastrophe coverages and makes changes as it deems appropriate.

*Terrorism Risk Insurance Program.* The Terrorism Risk Insurance Program (the Program) is a Federal program administered by the Department of the Treasury that provides 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 has been authorized through 2014. For a further description of the Program, including the Company's estimated deductible under the Program in 2012, see note 5 of notes to the Company's consolidated financial statements in this annual report and "Item 1A Risk Factors Catastrophe losses could materially and adversely affect our results of operations, our financial position and/or liquidity, and could adversely impact our ratings, our ability to raise capital and the availability and cost of reinsurance."

## **CLAIMS AND CLAIM ADJUSTMENT EXPENSE RESERVES**

Claims and claim adjustment expense reserves represent management's estimate of ultimate unpaid costs of losses and loss adjustment expenses for claims that have been reported and claims that have been incurred but not yet reported.

The Company continually refines its reserve estimates in a regular ongoing process that includes review of key assumptions, underlying variables and historical loss experience. The Company reflects adjustments to reserves in the results of operations in the periods in which the estimates are changed. In establishing reserves, the Company takes into account estimated recoveries for reinsurance, salvage and subrogation. The reserves are also reviewed regularly by qualified actuaries employed by the Company. For additional information on the process of estimating reserves and a discussion of underlying variables and risk factors, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates."

The process of estimating loss reserves involves a high degree of judgment and is subject to a number of variables. These variables (discussed by product line in the "Critical Accounting Estimates" section of "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations") are affected by both internal and external events, such as changes in claims handling procedures, inflation, judicial trends and legislative changes, among others. The impact of many of these items on ultimate costs for claims and claim adjustment expenses is difficult to estimate. Reserve

Table of Contents

estimation difficulties also differ significantly by product line due to differences in the underlying insurance contract (e.g., claims-made versus occurrence), claim complexity, the volume of claims, the potential severity of individual claims, the determination of the occurrence date for a claim, and reporting lags (the time between the occurrence of the insured event and when it is actually reported to the insurer). Informed judgment is applied throughout the process.

The Company derives estimates for unreported claims and development on reported claims principally from actuarial analyses of historical patterns of loss development by accident year for each type of exposure and business unit. Similarly, the Company derives estimates of unpaid loss adjustment expenses principally from actuarial analyses of historical development patterns of the relationship of loss adjustment expenses to losses for each line of business and type of exposure. For a description of the Company's reserving methods for asbestos and environmental claims, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Asbestos Claims and Litigation," and " Environmental Claims and Litigation."

**Discounting**

The claims and claim adjustment expense reserves for most long-term disability and annuity claim payments, primarily arising from workers' compensation insurance and workers' compensation excess insurance policies, were discounted to the present value of estimated future payments using a rate of 5% at both December 31, 2012 and 2011. These discounted reserves totaled \$2.01 billion and \$2.20 billion at December 31, 2012 and 2011, respectively.

**Claims and Claim Adjustment Expense Development Table**

The table that follows sets forth the year-end reserves from 2002 through 2012 and the subsequent changes in those reserves, presented on a historical basis. The original estimates, cumulative amounts paid and re-estimated reserves in the table for the years 2002 and 2003 have not been restated to reflect the acquisition by Travelers Property Casualty Corp. (TPC) of The St. Paul Companies, Inc. (SPC) in 2004 (referred to hereafter as the Merger). The table includes SPC reserves beginning at December 31, 2004.

The data in the table is presented in accordance with reporting requirements of the Securities and Exchange Commission (SEC). Care must be taken to avoid misinterpretation by those unfamiliar with this information or familiar with other data commonly reported by the insurance industry. The data in the table is not accident year data, but rather a display of 2002 to 2012 year-end reserves and the subsequent changes in those reserves.

For instance, the "cumulative deficiency (redundancy)" shown in the table for each year represents the aggregate amount by which original estimates of reserves as of that year-end have changed in subsequent years. Accordingly, the cumulative deficiency for a year relates only to reserves at that year-end and those amounts are not additive. Expressed another way, if the original reserves at the end of 2002 included \$4 million for a loss that is finally paid in 2007 for \$5 million, the \$1 million deficiency (the excess of the actual payment of \$5 million over the original estimate of \$4 million) would be included in the cumulative deficiencies in each of the years 2002 to 2006 shown in the accompanying table.

Various factors may distort the re-estimated reserves and cumulative deficiency or redundancy shown in the table. For example, a substantial portion of the cumulative deficiencies shown in the table arise from claims on policies written prior to the mid-1980s involving liability exposures such as asbestos and environmental claims. In the post-1984 period, the Company has developed more stringent underwriting standards and policy exclusions and has significantly contracted or terminated the writing of these risks. See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Asbestos Claims and Litigation," and " Environmental Claims and Litigation."

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### Table of Contents

General conditions and trends that have affected the development of these liabilities in the past will not necessarily recur in the future.

Other factors that affect the data in the table include the discounting of certain reserves (as discussed above) and the use of retrospectively rated insurance policies. For example, reserves for long-term disability and annuity claim payments (tabular reserves), primarily arising from workers' compensation insurance and workers' compensation excess insurance policies, are discounted to reflect the time value of money. Apparent deficiencies will continue to occur as the discount on these workers' compensation reserves is accreted at the appropriate interest rates. Also, a portion of National Accounts business is underwritten with retrospectively rated insurance policies in which the ultimate loss experience is primarily borne by the insured. For this business, increases in loss experience result in an increase in reserves and an offsetting increase in amounts recoverable from insureds. Likewise, decreases in loss experience result in a decrease in reserves and an offsetting decrease in amounts recoverable from these insureds. The amounts recoverable on these retrospectively rated policies mitigate the impact of the cumulative deficiencies or redundancies on the Company's earnings but are not reflected in the table.

Because of these and other factors, it is difficult to develop a meaningful extrapolation of estimated future redundancies or deficiencies in loss reserves from the data in the table.

| (at December 31, in millions)   | 2002      | 2003      | 2004      | 2005       | 2006       | 2007       | 2008       | 2009       | 2010       | 2011       | 2012      |
|---|-----------|-----------|-----------|------------|------------|------------|------------|------------|------------|------------|-----------|
| Reserves for claims and claim adjustment expense originally estimated | \$ 23,268 | \$ 24,055 | \$ 41,446 | \$ 42,895  | \$ 42,844  | \$ 43,098  | \$ 41,312  | \$ 40,941  | \$ 40,255  | \$ 40,919  | \$ 40,634 |
| Cumulative amounts paid as of   |           |           |           |            |            |            |            |            |            |            |           |
| One year later  | 5,170     | 4,651     | 8,871     | 8,632      | 7,417      | 8,146      | 7,519      | 7,748      | 7,653      | 8,326      |           |
| Two years later   | 8,319     | 8,686     | 14,666    | 13,837     | 13,181     | 12,798     | 12,454     | 12,374     | 12,567     |            |           |
| Three years later   | 11,312    | 11,541    | 18,733    | 18,466     | 16,545     | 16,264     | 15,668     | 15,708     |            |            |           |
| Four years later  | 13,548    | 13,708    | 22,514    | 21,025     | 19,113     | 18,524     | 18,053     |            |            |            |           |
| Five years later  | 15,229    | 15,574    | 24,572    | 22,992     | 20,820     | 20,244     |            |            |            |            |           |
| Six years later   | 16,836    | 16,624    | 26,189    | 24,423     | 22,205     |            |            |            |            |            |           |
| Seven years later   | 17,738    | 17,558    | 27,469    | 25,616     |            |            |            |            |            |            |           |
| Eight years later   | 18,563    | 18,320    | 28,557    |            |            |            |            |            |            |            |           |
| Nine years later  | 19,236    | 18,988    |           |            |            |            |            |            |            |            |           |
| Ten years later   | 19,854    |           |           |            |            |            |            |            |            |            |           |
| Reserves re-estimated as of   |           |           |           |            |            |            |            |            |            |            |           |
| One year later  | 23,658    | 24,222    | 41,706    | 42,466     | 42,172     | 41,373     | 39,863     | 39,524     | 39,413     | 39,845     |           |
| Two years later   | 24,592    | 25,272    | 42,565    | 42,311     | 40,837     | 39,925     | 38,640     | 38,421     | 38,393     |            |           |
| Three years later   | 25,553    | 26,042    | 42,940    | 41,692     | 39,739     | 38,842     | 37,613     | 37,539     |            |            |           |
| Four years later  | 26,288    | 26,501    | 43,148    | 40,855     | 38,734     | 38,223     | 36,892     |            |            |            |           |
| Five years later  | 26,731    | 26,803    | 42,655    | 40,026     | 38,409     | 37,716     |            |            |            |            |           |
| Six years later   | 27,055    | 26,619    | 42,068    | 39,849     | 38,134     |            |            |            |            |            |           |
| Seven years later   | 27,022    | 26,342    | 42,019    | 39,694     |            |            |            |            |            |            |           |
| Eight years later   | 26,815    | 26,382    | 41,987    |            |            |            |            |            |            |            |           |
| Nine years later  | 26,911    | 26,431    |           |            |            |            |            |            |            |            |           |
| Ten years later   | 27,002    |           |           |            |            |            |            |            |            |            |           |
| Cumulative deficiency (redundancy)                                    | 3,734     | 2,376     | 541       | (3,201)    | (4,710)    | (5,382)    | (4,420)    | (3,402)    | (1,862)    | (1,074)    |           |
| Gross liability end of year   | \$ 33,914 | \$ 34,760 | \$ 59,438 | \$ 61,461  | \$ 59,677  | \$ 58,094  | \$ 55,121  | \$ 53,529  | \$ 51,537  | \$ 51,353  | \$ 50,888 |
| Reinsurance recoverables  | 10,646    | 10,705    | 17,992    | 18,566     | 16,833     | 14,996     | 13,809     | 12,588     | 11,282     | 10,434     | 10,254    |
| Net liability end of year   | \$ 23,268 | \$ 24,055 | \$ 41,446 | \$ 42,895  | \$ 42,844  | \$ 43,098  | \$ 41,312  | \$ 40,941  | \$ 40,255  | \$ 40,919  | \$ 40,634 |
| Gross re-estimated liability latest                                   | \$ 39,064 | \$ 37,587 | \$ 59,849 | \$ 57,684  | \$ 53,689  | \$ 51,527  | \$ 49,345  | \$ 48,964  | \$ 48,996  | \$ 50,007  |           |
| Re-estimated reinsurance recoverables latest                          | 12,062    | 11,156    | 17,862    | 17,990     | 15,555     | 13,811     | 12,453     | 11,425     | 10,603     | 10,162     |           |
| Net re-estimated liability latest                                     | \$ 27,002 | \$ 26,431 | \$ 41,987 | \$ 39,694  | \$ 38,134  | \$ 37,716  | \$ 36,892  | \$ 37,539  | \$ 38,393  | \$ 39,845  |           |
| Gross cumulative deficiency (redundancy)                              | \$ 5,150  | \$ 2,827  | \$ 411    | \$ (3,777) | \$ (5,988) | \$ (6,567) | \$ (5,776) | \$ (4,565) | \$ (2,541) | \$ (1,346) |           |

Table of Contents

For years prior to 2004, the table excludes reserves of SPC, which were acquired in the Merger on April 1, 2004. Accordingly, the reserve development (net reserves for claims and claim adjustment expense re-estimated as of subsequent years less net reserves recorded at the end of the year, as originally estimated) for years prior to 2004 relates only to losses recorded by TPC and does not include reserve development recorded by SPC. For 2004 and subsequent years, the table includes SPC reserves acquired and subsequent development recorded on those reserves. At December 31, 2004, SPC gross reserves were \$23,274 million, and net reserves were \$15,959 million.

In December 2008, the Company completed the sale of Unionamerica Holdings Limited (Unionamerica), which comprised its United Kingdom (U.K.)-based runoff insurance and reinsurance businesses. (Unionamerica was acquired in 2004 as part of the Merger.) Immediately before the sale, the claims and claim adjustment expense reserves of Unionamerica totaled \$790 million. As a result of the sale, those obligations ceased being the responsibility of the Company and its affiliates. The sale is reflected in the table as a reduction in December 31, 2008 net reserves of \$790 million and as a \$790 million increase in paid losses for each of the years 2004 through 2007 to reflect the transfer (payment) of the reserves to the buyer, resulting in no impact to incurred losses.

The gross and net cumulative deficiency (redundancy) by calendar year as set forth in the table above includes the following impact of unfavorable prior year reserve development related to asbestos and environmental claims and claim adjustment expenses, in millions:

| <b>Asbestos</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> |
|-----------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Gross           | \$ 1,728    | \$ 1,703    | \$ 1,913    | \$ 1,079    | \$ 882      | \$ 883      | \$ 813      | \$ 628      | \$ 366      | \$ 171      |
| Net             | \$ 1,604    | \$ 1,580    | \$ 1,732    | \$ 901      | \$ 745      | \$ 745      | \$ 675      | \$ 490      | \$ 350      | \$ 175      |

  

| <b>Environmental</b> | <b>2002</b> | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Gross                | \$ 807      | \$ 748      | \$ 701      | \$ 684      | \$ 576      | \$ 394      | \$ 309      | \$ 224      | \$ 179      | \$ 99       |
| Net                  | \$ 760      | \$ 701      | \$ 691      | \$ 661      | \$ 541      | \$ 356      | \$ 271      | \$ 201      | \$ 166      | \$ 90       |

**Reserves on Statutory Accounting Basis**

At December 31, 2012, 2011 and 2010, claims and claim adjustment expense reserves (net of reinsurance) shown in the preceding table, which are prepared in accordance with U.S. generally accepted accounting principles (GAAP reserves), were \$22 million lower, \$20 million higher and \$20 million higher, respectively, than those reported in the Company's respective annual reports filed with insurance regulators, which are prepared in accordance with statutory accounting practices (statutory reserves).

The differences between GAAP and statutory reserves are primarily due to the differences in GAAP and statutory accounting for two items, (1) fees associated with billing of required reimbursements under large deductible business, and (2) the accounting for retroactive reinsurance. For large deductible business, the Company pays the deductible portion of a casualty insurance claim and then seeks reimbursement from the insured, plus a fee. This fee is reported as fee income for GAAP reporting, but as an offset to claim expenses paid for statutory reporting. Retroactive reinsurance balances result from reinsurance placed to cover losses on insured events occurring prior to the inception of a reinsurance contract. For GAAP reporting, retroactive reinsurance balances are included in reinsurance recoverables and result in lower net reserve amounts. Statutory accounting practices require retroactive reinsurance balances to be recorded in other liabilities as contra-liabilities rather than in loss reserves.

**Asbestos and Environmental Claims**

Asbestos and environmental claims are segregated from other claims and are handled separately by the Company's Special Liability Group, a separate unit staffed by dedicated legal, claim, finance and

Table of Contents

engineering professionals. For additional information on asbestos and environmental claims, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Asbestos Claims and Litigation" and " Environmental Claims and Litigation."

**INTERCOMPANY REINSURANCE POOLING ARRANGEMENTS**

Most of the Company's insurance subsidiaries are members of an intercompany property and casualty reinsurance pooling arrangement. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool's policyholders' surplus rather than just on its own policyholder surplus. Under such arrangements, the members share substantially all insurance business that is written and allocate the combined premiums, losses and expenses.

**RATINGS**

Ratings are an important factor in assessing the Company's competitive position in the insurance industry. The Company receives ratings from the following major rating agencies: A.M. Best Company (A.M. Best), Fitch Ratings (Fitch), Moody's Investors Service (Moody's) and Standard & Poor's Corp. (S&P). Rating agencies typically issue two types of ratings for insurance companies: claims-paying (or financial strength) ratings which reflect the rating agency's assessment of an insurer's ability to meet its financial obligations to policyholders and debt ratings which reflect the rating agency's assessment of a company's prospects for repaying its debts and are considered by lenders in connection with the setting of interest rates and terms for a company's short- and long-term borrowings. Agency ratings are not a recommendation to buy, sell or hold any security, and they may be revised or withdrawn at any time by the rating agency. Each agency's rating should be evaluated independently of any other agency's rating. The system and the number of rating categories can vary widely from rating agency to rating agency. Customers usually focus on claims-paying ratings, while creditors focus on debt ratings. Investors use both to evaluate a company's overall financial strength. The ratings issued on the Company or its subsidiaries by any of these agencies are announced publicly and are available on the Company's website and from the agencies.

A downgrade in one or more of the Company's claims-paying ratings could negatively impact the Company's business volumes and competitive position because demand for certain of its products may be reduced, particularly because some customers require that the Company maintain minimum ratings to enter into or renew business with it.

Additionally, a downgrade in one or more of the Company's debt ratings could adversely impact the Company's ability to access the capital markets and other sources of funds, including in the syndicated bank loan market, and/or result in higher financing costs. For example, downgrades in the Company's debt ratings could result in higher interest expense under the Company's revolving credit agreement (under which the cost of borrowing could range from LIBOR plus 100 basis points to LIBOR plus 175 basis points, depending on the Company's debt ratings), the Company's commercial paper program, or in the event that the Company were to access the capital markets by issuing debt or similar types of securities. See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a discussion of the Company's revolving credit agreement and commercial paper program. The Company considers the level of increased cash funding requirements in the event of a ratings downgrade as part of the evaluation of the Company's liquidity requirements. The Company currently believes that a one- to two-notch downgrade in its debt ratings would not result in a material increase in interest expense under its existing credit agreement and commercial paper programs. In addition, the Company considers the impact of a ratings downgrade as part of the evaluation of its common share repurchases.

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Table of Contents

**Claims Paying Ratings**

The following table summarizes the current claims-paying (or financial strength) ratings of the Travelers Reinsurance Pool, Travelers C&S Co. of America, Travelers Personal single state companies, Travelers C&S Co. of Europe, Ltd., Travelers Insurance Company of Canada and Travelers Insurance Company Limited as of February 19, 2013. The table presents the position of each rating in the applicable agency's rating scale.

|  | <b>A.M. Best</b>           | <b>Moody's</b>              | <b>S&amp;P</b>              | <b>Fitch</b>               |
|--|----------------------------|-----------------------------|-----------------------------|----------------------------|
| Travelers Reinsurance Pool(a)(b)               | A+ (2 <sup>nd</sup> of 16) | Aa2 (3 <sup>rd</sup> of 21) | AA (3 <sup>rd</sup> of 21)  | AA (3 <sup>rd</sup> of 21) |
| Travelers C&S Co. of America                   | A+ (2 <sup>nd</sup> of 16) | Aa2 (3 <sup>rd</sup> of 21) | AA (3 <sup>rd</sup> of 21)  | AA (3 <sup>rd</sup> of 21) |
| First Floridian Auto and Home Ins. Co.         | A- (4 <sup>th</sup> of 16) |                             |                             | AA (3 <sup>rd</sup> of 21) |
| First Trenton Indemnity Company                | A (3 <sup>rd</sup> of 16)  |                             |                             | AA (3 <sup>rd</sup> of 21) |
| The Premier Insurance Company of Massachusetts | A (3 <sup>rd</sup> of 16)  |                             |                             |                            |
| Travelers C&S Co. of Europe, Ltd.              | A+ (2 <sup>nd</sup> of 16) | Aa2 (3 <sup>rd</sup> of 21) | AA (3 <sup>rd</sup> of 21)  |                            |
| Travelers Insurance Company of Canada          | A+ (2 <sup>nd</sup> of 16) |                             | AA- (4 <sup>th</sup> of 21) |                            |
| Travelers Insurance Company Limited            | A (3 <sup>rd</sup> of 16)  |                             | AA (3 <sup>rd</sup> of 21)  |                            |

(a)

The Travelers Reinsurance Pool consists of: The Travelers Indemnity Company, The Charter Oak Fire Insurance Company, The Phoenix Insurance Company, The Travelers Indemnity Company of Connecticut, The Travelers Indemnity Company of America, Travelers Property Casualty Company of America, Travelers Commercial Casualty Company, TravCo Insurance Company, The Travelers Home and Marine Insurance Company, Travelers Casualty and Surety Company, Northland Insurance Company, Northfield Insurance Company, Northland Casualty Company, American Equity Specialty Insurance Company, The Standard Fire Insurance Company, The Automobile Insurance Company of Hartford, Connecticut, Travelers Casualty Insurance Company of America, Farmington Casualty Company, Travelers Commercial Insurance Company, Travelers Casualty Company of Connecticut, Travelers Property Casualty Insurance Company, Travelers Personal Security Insurance Company, Travelers Personal Insurance Company, Travelers Excess and Surplus Lines Company, St. Paul Fire and Marine Insurance Company, St. Paul Surplus Lines Insurance Company, The Travelers Casualty Company, St. Paul Protective Insurance Company, Travelers Constitution State Insurance Company, St. Paul Guardian Insurance Company, St. Paul Mercury Insurance Company, Fidelity and Guaranty Insurance Underwriters, Inc., Discover Property & Casualty Insurance Company, Discover Specialty Insurance Company and United States Fidelity and Guaranty Company.

(b)

The following affiliated companies are 100% reinsured by one of the pool participants noted in (a) above: Fidelity and Guaranty Insurance Company, Gulf Underwriters Insurance Company, American Equity Insurance Company, Select Insurance Company, St. Paul Fire and Casualty Insurance Company, The Travelers Lloyds Insurance Company and Travelers Lloyds of Texas Insurance Company.

**Debt Ratings**

The following table summarizes the current debt, trust preferred securities and commercial paper ratings of the Company and its subsidiaries as of February 19, 2013. The table also presents the position of each rating in the applicable agency's rating scale.

|                          | <b>A.M. Best</b>             | <b>Moody's</b>             | <b>S&amp;P</b>               | <b>Fitch</b>                 |
|--------------------------|------------------------------|----------------------------|------------------------------|------------------------------|
| Senior debt              | a (6 <sup>th</sup> of 22)    | A2 (6 <sup>th</sup> of 21) | A (6 <sup>th</sup> of 22)    | A (6 <sup>th</sup> of 22)    |
| Subordinated debt        | a- (7 <sup>th</sup> of 22)   | A3 (7 <sup>th</sup> of 21) | A- (7 <sup>th</sup> of 22)   | BBB+ (8 <sup>th</sup> of 22) |
| Junior subordinated debt | bbb+ (8 <sup>th</sup> of 22) | A3 (7 <sup>th</sup> of 21) | BBB+ (8 <sup>th</sup> of 22) | BBB+ (8 <sup>th</sup> of 22) |

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|                            |                              |                            |                              |                              |
|----------------------------|------------------------------|----------------------------|------------------------------|------------------------------|
| Trust preferred securities | a- (7 <sup>th</sup> of 22)   | A3 (7 <sup>th</sup> of 21) | BBB+ (8 <sup>th</sup> of 22) | BBB+ (8 <sup>th</sup> of 22) |
| Commercial paper           | AMB-1 (2 <sup>nd</sup> of 6) | P-1 (1 <sup>st</sup> of 4) | A-1 (2 <sup>nd</sup> of 10)  | F-1 (2 <sup>nd</sup> of 8)   |

Table of Contents

***Rating Agency Actions***

The following rating agency actions were taken with respect to the Company from February 16, 2012 (the date on which the Company filed its Form 10-K for the year ended December 31, 2011), through February 19, 2013:

On May 4, 2012, Moody's affirmed all ratings of the Company. The outlook for all ratings is stable.

On May 10, 2012, A.M. Best affirmed all ratings of the Company. The outlook for all ratings is stable.

On June 15, 2012, Fitch affirmed all ratings of the Company. The outlook for all ratings is stable.

On October 3, 2012, S&P affirmed its "3-" Lloyd's Syndicate assessment on Travelers Syndicate Management Syndicate 5000, and subsequently withdrew the assessment at the Company's request.

On November 21, 2012, A.M. Best affirmed the financial strength rating of Travelers Insurance Company Limited. The outlook is stable.

On December 19, 2012, Fitch affirmed all ratings of the Company. The outlook for all ratings is stable.

On January 24, 2013, S&P assigned its "AA-" financial strength rating to Travelers Insurance Company of Canada. The outlook is stable.

**INVESTMENT OPERATIONS**

The majority of funds available for investment are deployed in a widely diversified portfolio of high quality, liquid taxable U.S. government, tax-exempt U.S. municipal and taxable corporate and U.S. agency mortgage-backed bonds. The Company closely monitors the duration of its fixed maturity investments, and the Company's investment purchases and sales are executed with the objective of having adequate funds available to satisfy its insurance and debt obligations. Generally, the expected principal and interest payments produced by the Company's fixed maturity portfolio adequately fund the estimated runoff of the Company's insurance reserves. The Company's management of the duration of the fixed maturity investment portfolio, including its use of Treasury futures, has produced a duration that is less than the estimated duration of the Company's net insurance liabilities. In recent periods, the estimated average effective duration of the Company's portfolio of fixed maturity and short-term security investments has declined, primarily due to the impact of declining market yields and tightening investment spreads on existing holdings of mortgage-backed securities (both of which impact the assumptions related to optional pre-payments), an increase in pre-refunded municipal bonds and general portfolio management decisions. In 2013, subject to market conditions, the Company plans to increase its short position in U.S. Treasury futures, which it uses to manage the duration of its fixed maturity portfolio. The Company has also recently experienced an increase in the estimated average duration of its net insurance liabilities, primarily reflecting the impact of declining market interest rates and, to a lesser degree, an increase in the proportion of workers' compensation insurance reserves as a component of total insurance reserves. The substantial amount by which the fair value of the fixed maturity portfolio exceeds the value of the net insurance liabilities, as well as the positive cash flow from newly sold policies and the large amount of high quality liquid bonds, contributes to the Company's ability to fund claim payments without having to sell illiquid assets or access credit facilities.

The Company also invests much smaller amounts in equity securities, real estate, private equity limited partnerships, hedge funds, real estate partnerships, real estate and insurance joint ventures, mortgage loans, venture capital (through direct ownership and limited partnerships) and trading securities. These investment classes have the potential for higher returns but also involve varying degrees of risk, including less stable rates of return and less liquidity.

See note 3 of notes to the Company's consolidated financial statements for additional information regarding the Company's investment portfolio.



Table of Contents

**REGULATION**

**U.S. State and Federal Regulation**

TRV's insurance subsidiaries are subject to regulation in the various states and jurisdictions in which they transact business. The extent of regulation varies, but generally derives from statutes that delegate regulatory, supervisory and administrative authority to a department of insurance in each state. The regulation, supervision and administration relate, among other things, to standards of solvency that must be met and maintained, the licensing of insurers and their agents, the nature of and limitations on investments, premium rates, restrictions on the size of risks that may be insured under a single policy, reserves and provisions for unearned premiums, losses and other obligations, deposits of securities for the benefit of policyholders, approval of policy forms and the regulation of market conduct, including the use of credit information in underwriting as well as other underwriting and claims practices. In addition, many states have enacted variations of competitive ratemaking laws, which allow insurers to set certain premium rates for certain classes of insurance without having to obtain the prior approval of the state insurance department. State insurance departments also conduct periodic examinations of the financial condition and market conduct of insurance companies and require the filing of financial and other reports on a quarterly and annual basis. State insurance regulation continues to evolve in response to the changing economic and business environment as well as efforts by regulators internationally to develop a consistent approach to regulations. These changes are evidenced by the recent changes that the states have made to provide greater emphasis on understanding an insurer's corporate governance and control environment, including enterprise risk management (ERM), in conducting financial examinations. Additional requirements are also expected. For example, the National Association of Insurance Commissioners (NAIC) is considering an *Own Risk and Solvency Assessment* (ORSA) requirement, which if adopted by states would require insurers to perform an ORSA and, upon request, file an ORSA report that describes for the regulators the ERM process used by an insurer. See "Enterprise Risk Management" herein for further discussion of the Company's ERM. TRV's insurance subsidiaries are collectively licensed to transact insurance business in all U.S. states, the District of Columbia, Guam, Puerto Rico and the U.S. Virgin Islands.

Although the U.S. federal government historically has not regulated the insurance business, in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) established a Federal Insurance Office within the U.S. Department of the Treasury. The Federal Insurance Office has limited regulatory authority and is empowered to gather data and information regarding the insurance industry and insurers, including conducting a study for submission to the U.S. Congress on how to modernize and improve insurance regulation in the U.S. Further, the Dodd-Frank Act gives the Federal Reserve supervisory authority over a number of nonbank financial services holding companies, including insurance companies, if they are designated by a two-thirds vote by the newly created Financial Stability Oversight Council (the FSOC) as "systemically important financial institutions" (SIFI). The FSOC, chaired by the Secretary of the Treasury, is a group of federal and state financial regulators and includes an independent insurance expert. Based on rules and interpretive guidance adopted by the FSOC, the Company does not expect that it will be designated as a SIFI. Consistent with that expectation, the Company has not received a notice from the FSOC that it will be reviewed for systemic risk designation. Nonetheless, it is possible that the FSOC may change its rules or guidance in the future, or exercise the discretion granted to the Council by the Dodd-Frank Act, and conclude that the Company is a SIFI. If the Company were designated as a SIFI, the Federal Reserve's supervisory authority could include the ability to impose heightened financial regulation and could impact requirements regarding the Company's capital, liquidity and leverage as well as its business and investment conduct. As a result of the foregoing, the Dodd-Frank Act, or other additional state and federal regulation that may be adopted in the future, could impose significant burdens on the Company, including impacting the ways in which the Company conducts its business, increasing capital requirements or compliance costs and duplicating state regulation, and could result in a competitive

Table of Contents

disadvantage, particularly relative to other insurers that may not be subject to the same level of regulation.

*Insurance Regulation Concerning Dividends from Insurance Subsidiaries.* TRV's principal insurance subsidiaries are domiciled in the state of Connecticut. The Connecticut insurance holding company laws require notice to, and approval by, the state insurance commissioner for the declaration or payment of any dividend from an insurance subsidiary that, together with other distributions made within the preceding twelve months, exceeds the greater of 10% of the insurance subsidiary's policyholders' surplus as of the preceding December 31, or the insurance subsidiary's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices and by state regulation. This declaration or payment is further limited by adjusted unassigned surplus, as determined in accordance with statutory accounting practices.

The insurance holding company laws of other states in which TRV's insurance subsidiaries are domiciled generally contain similar, although in some instances somewhat more restrictive, limitations on the payment of dividends.

*Rate and Rule Approvals.* TRV's insurance subsidiaries are subject to each state's laws and regulations regarding rate and rule approvals. The applicable laws and regulations are used by states to establish standards to ensure that rates are not excessive, inadequate, unfairly discriminatory or used to engage in unfair price competition. An insurer's ability to increase rates and the relative timing of the process are dependent upon each respective state's requirements.

*Requirements for Exiting Geographic Markets and/or Canceling or Nonrenewing Policies.* Several states have laws and regulations which may impact the timing and/or the ability of an insurer to either discontinue or substantially reduce its writings in that state. These laws and regulations typically require prior notice, and in some instances insurance department approval, prior to discontinuing a line of business or withdrawing from that state, and they allow insurers to cancel or non-renew certain policies only for certain specified reasons.

*Assessments for Guaranty Funds and Second-Injury Funds and Other Mandatory Pooling and Reinsurance Arrangements.* Virtually all states require insurers licensed to do business in their state, including TRV's insurance subsidiaries, to bear a portion of the loss suffered by some claimants because of the insolvency of other insurers. Many states also have laws that establish second-injury funds to provide compensation to injured employees for aggravation of a prior condition or injury.

TRV's insurance subsidiaries are also required to participate in various involuntary assigned risk pools, principally involving workers' compensation, automobile insurance, property windpools in states prone to property damage from hurricanes, and FAIR plans, which provide various insurance coverages to individuals or other entities that otherwise are unable to purchase that coverage in the voluntary market.

Assessments may include any charge mandated by statute or regulatory authority that is related directly or indirectly to underwriting activities. Examples of such mechanisms include, but are not limited to, the Florida Hurricane Catastrophe Fund, Florida Citizens Property Insurance Corporation, National Workers' Compensation Reinsurance Pool, North Carolina Beach Plan, Louisiana Citizens Property Insurance Corporation, and the Texas Windstorm Insurance Association. Amounts payable or paid as a result of arrangements that are in substance reinsurance, including certain involuntary pools where insurers are required to assume premiums and losses from those pools, are accounted for as reinsurance (e.g., National Workers' Compensation Reinsurance Pool, North Carolina Beach Plan). Amounts related to assessments from arrangements that are not reinsurance are reported as a component of "General and Administrative Expenses." For additional information concerning assessments for guaranty funds and second-injury funds and other mandatory pooling and reinsurance agreements including state-funding mechanisms, see "Item 1A Risk Factors."

Table of Contents

*Insurance Regulatory Information System.* The NAIC developed the Insurance Regulatory Information System (IRIS) to help state regulators identify companies that may require special attention. Financial examiners review annual statements and key financial ratios based on year-end data. These ratios assist state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies. Each ratio has an established "usual range" of results. A ratio result falling outside the usual range of IRIS ratios, however, is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. Generally, an insurance company will become subject to regulatory scrutiny if it falls outside the usual ranges of four or more of the ratios.

Based on preliminary 2012 IRIS ratios calculated by the Company for its lead insurance subsidiaries, The Travelers Indemnity Company and St. Paul Fire and Marine Insurance Company had results outside the normal range for one IRIS ratio due to the size of their investments in certain non-fixed maturity securities.

In 2011, The Travelers Indemnity Company and St. Paul Fire and Marine Insurance Company had results outside the normal range for one IRIS ratio due to the size of their investments in certain non-fixed maturity securities. Travelers Casualty and Surety Company and The Standard Fire Insurance Company had results outside the normal range for two IRIS ratios due to the amount of dividends paid to their respective parent. Additionally, Travelers Casualty and Surety Company had results outside the normal range for one IRIS ratio due to the amount of dividends received from its subsidiaries.

Management does not anticipate regulatory action as a result of the 2012 IRIS ratio results for the lead insurance subsidiaries or their insurance subsidiaries. In all instances in prior years, regulators have been satisfied upon follow-up that no regulatory action was required.

*Risk-Based Capital (RBC) Requirements.* The NAIC has an RBC requirement for most property and casualty insurance companies. The RBC requirement determines minimum capital requirements and is intended to raise the level of protection for policyholder obligations. Under laws adopted by individual states, insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy.

The formulas have not been designed to differentiate among adequately capitalized companies that operate with levels of capital above the RBC requirement. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank these companies. At December 31, 2012, all of TRV's insurance subsidiaries had total adjusted capital in excess of the RBC requirement.

*Investment Regulation.* Insurance company investments must comply with applicable laws and regulations which prescribe the kind, quality and concentration of investments. In general, these laws and regulations permit investments in federal, state and municipal obligations, corporate bonds, preferred and common equity securities, mortgage loans, real estate and certain other investments, subject to specified limits and certain other qualifications. At December 31, 2012, the Company was in compliance with these laws and regulations.

## **International Regulation**

TRV's insurance underwriting subsidiaries based in the United Kingdom, Travelers Insurance Company Limited and Travelers Casualty and Surety Company of Europe Limited, are regulated by the Financial Services Authority (FSA). The FSA's principal objectives are to maintain market confidence, promote public understanding of the financial system, protect consumers, and fight financial crime. TRV's managing agency (Travelers Syndicate Management Ltd.) of its Lloyd's syndicate is also regulated by the FSA, which has delegated certain regulatory responsibilities to the Council of Lloyd's. During 2013, the role of the FSA as insurance regulator will be replaced by two successor bodies, The

Table of Contents

Prudential Regulation Authority ("PRA"), as prudential regulator, and The Financial Conduct Authority ("FCA"), as conduct regulator.

TRV's managing agency is licensed to write business in over 75 jurisdictions throughout the world by virtue of Lloyd's international licenses. In each such jurisdiction, TRV's managing agency, as part of Lloyd's, is subject to the laws and insurance regulation of that jurisdiction. In addition, TRV's managing agency has an underwriting agency in Singapore, the operations of which are regulated by the Monetary Authority of Singapore. A TRV subsidiary, Travelers Casualty and Surety Company, has a representative office in China. The representative office is regulated by the China Insurance Regulatory Commission. A TRV subsidiary, TCI Global Services, Inc., has a liaison office in India. Insurance business in India is regulated by the Insurance Regulatory and Development Authority.

TRV's insurance operations in the Republic of Ireland are conducted through an Irish branch of Travelers Insurance Company Limited which is regulated by the Insurance Supervision Departments of the Central Bank of Ireland (as to conduct) and also by the FSA. In Canada, the conduct of TRV's insurance business is regulated by the Office of the Superintendent of Financial Institutions under provisions of the Insurance Companies Act. TRV has an interest in JMalucelli, a joint venture holding company in Brazil. JMalucelli's subsidiaries operate in the insurance and reinsurance business in Brazil and are regulated by the Superintendencia de Seguros Privados.

Regulators require insurance companies to maintain certain levels of capital depending on the type and amount of insurance policies in force.

*Solvency II.* The European Union's executive body, the European Commission, is implementing new capital adequacy and risk management regulations called Solvency II that would apply to the Company's businesses across the European Union. Solvency II is currently required to be implemented on January 1, 2014; however, the effective implementation date may be delayed. Under Solvency II, it is possible that the U.S. parent of a European Union subsidiary could be subject to certain Solvency II requirements if the regulator determines that the subsidiary's capital position is dependent on the parent company and the U.S. company is not already subject to regulations deemed "equivalent" to Solvency II. In addition, regulators in countries where the Company has operations are working with the International Association of Insurance Supervisors (and with the NAIC in the U.S.) to consider changes to insurance company supervision, including group supervision. While it is not certain how or if these actions will impact the Company, it is currently not expected that the capital management strategies for the Company's U.S. or European Union operations will be materially impacted.

*International Association of Insurance Supervisors (IAIS) Guidance for Determining Global Systemically Important Insurers.* The IAIS is working with the Financial Stability Board (FSB) created by the G-20 and is developing a methodology for determining whether and which, if any, insurance companies pose a systemic risk to the global economy. Such insurers would be designated "global systemically important insurers" (G-SIIs) and would likely be subject to higher capital requirements, enhanced supervision or both. The IAIS has released for comment proposed methodology for identifying potential G-SIIs but has not yet decided upon the criteria for or the consequences of such designation. Upon finalizing the assessment methodology and determining the consequences of a G-SII designation, the FSB along with national authorities expect to publish the list of G-SIIs in April 2013. See "Part I Item 1A Risk Factors New regulations outside of the U.S., including in the European Union, could adversely impact our results of operations and limit our growth."

### **Insurance Holding Company Statutes**

As a holding company, TRV is not regulated as an insurance company. However, since TRV owns capital stock in insurance subsidiaries, it is subject to state insurance holding company statutes, as well as certain other laws, of each of its insurance subsidiaries' states of domicile. All holding company statutes, as well as other laws, require disclosure and, in some instances, prior approval of material

Table of Contents

transactions between an insurance company and an affiliate. The holding company statutes and other laws also require, among other things, prior approval of an acquisition of control of a domestic insurer, some transactions between affiliates and the payment of extraordinary dividends or distributions.

*Insurance Regulations Concerning Change of Control.* Many state insurance regulatory laws contain provisions that require advance approval by state agencies of any change in control of an insurance company that is domiciled, or, in some cases, having substantial business that it is deemed to be commercially domiciled, in that state.

The laws of many states also contain provisions requiring pre-notification to state agencies prior to any change in control of a non-domestic insurance company admitted to transact business in that state. While these pre-notification statutes do not authorize the state agency to disapprove the change of control, they do authorize issuance of cease and desist orders with respect to the non-domestic insurer if it is determined that some conditions, such as undue market concentration, would result from the acquisition.

Any transactions that would constitute a change in control of any of TRV's insurance subsidiaries would generally require prior approval by the insurance departments of the states in which the insurance subsidiaries are domiciled or commercially domiciled. They may also require pre-acquisition notification in those states that have adopted pre-acquisition notification provisions and in which such insurance subsidiaries are admitted to transact business.

Two of TRV's insurance subsidiaries and its operations at Lloyd's are domiciled in the United Kingdom. Insurers in the United Kingdom are subject to change of control restrictions in the Financial Services and Markets Act of 2000 including approval of the FSA, or the successor regulatory authority, the PRA (as described above). Some of TRV's other insurance subsidiaries are domiciled in, or authorized to conduct insurance business in, Canada. Authorized insurers in Canada are subject to change of control restrictions in Section 407 of the Insurance Companies Act, including approval of the Office of the Superintendent of Financial Institutions.

These requirements may deter, delay or prevent transactions affecting the control of or the ownership of common stock, including transactions that could be advantageous to TRV's shareholders.

## **ENTERPRISE RISK MANAGEMENT**

As a large property and casualty insurance enterprise, the Company is exposed to many risks. These risks are a function of the environments within which the Company operates. Since certain risks can be correlated with other risks, an event or a series of events can impact multiple areas of the Company simultaneously and have a material effect on the Company's results of operations, financial position and/or liquidity. These exposures require an entity-wide view of risk and an understanding of the potential impact on all aspects of the Company's operations. It also requires the Company to manage its risk-taking to be within its risk appetite in a prudent and balanced effort to create and preserve value for all of the Company's stakeholders. This approach to Company-wide risk evaluation and management is commonly called Enterprise Risk Management (ERM). ERM activities involve both the identification and assessment of a broad range of risks and the execution of synchronized strategies to effectively manage such risks. Effective ERM also includes the determination of the Company's risk capital needs, which takes into account regulatory requirements and credit rating considerations, in addition to economic and other factors.

ERM at the Company is an integral part of its business operations. All risk owners across all functions, all corporate leaders and the board of directors are engaged in ERM. ERM involves risk-based analytics, as well as reporting and feedback throughout the enterprise in support of the Company's long-term financial strategies and objectives.

Table of Contents

The Company uses various methods, including proprietary and third-party computer modeling processes, to continually monitor and analyze catastrophic events and the risks associated with them. These analyses and methods are used in making underwriting and reinsurance decisions as part of managing the Company's exposure to catastrophic events. In addition to catastrophe modeling and analysis, the Company also models and analyzes its exposure to other extreme events. The Company also utilizes proprietary and third-party computer modeling processes to evaluate capital adequacy. These analytical techniques are an integral component of the Company's ERM process and further support the Company's long-term financial strategies and objectives.

In addition to the day-to-day ERM activities within the Company's business units, other key internal risk management functions include the Management and Operating Committees (comprised of the Company's Chief Executive Officer and the other most senior members of management), the Enterprise and Underwriting Risk Committees of management, the Credit Committee, the Chief Compliance Officer, the Business Conduct Officer, the Corporate Actuarial group, the Corporate Audit group, the Accounting Policy group, the Enterprise Underwriting group and many others. A senior executive oversees the ERM process. The mission of this executive is to facilitate risk assessment and to collaborate in implementing effective risk management strategies throughout the Company. Another strategic ERM objective of this executive includes working across the Company to enhance effective and realistic risk modeling capabilities as part of the Company's overall effort to understand and manage its portfolio of risks to be within its risk appetite. Board oversight of ERM is provided by the Risk Committee of the board of directors, which reviews the strategies, processes and controls pertaining to the Company's insurance operations and oversees the implementation, execution and performance of the Company's ERM program.

The Company's ERM efforts build upon the foundation of an effective internal control environment. ERM expands the internal control objectives of effective and efficient operations, reliable financial reporting and compliance with applicable laws and regulations, to fostering, leading and supporting an integrated, risk-based culture within the Company that focuses on value creation and preservation. However, the Company can provide only reasonable, not absolute, assurance that these objectives will be met. Further, the design of any risk management or control system must reflect the fact that there are resource constraints, and the benefits must be considered relative to their costs. As a result, the possibility of material financial loss remains in spite of the Company's significant ERM efforts. An investor should carefully consider the risks and all of the other information set forth in this annual report, including the discussions included in "Item 1A Risk Factors," "Item 7A Quantitative and Qualitative Disclosures About Market Risk," and "Item 8 Financial Statements and Supplementary Data."

## **OTHER INFORMATION**

### **Customer Concentration**

In the opinion of the Company's management, no material part of the business of the Company and its subsidiaries is dependent upon a single customer or group of customers, the loss of any one of which would have a material adverse effect on the Company, and no one customer or group of affiliated customers accounts for 10% or more of the Company's consolidated revenues.

### **Employees**

At December 31, 2012, the Company had approximately 30,500 employees. The Company believes that its employee relations are satisfactory. None of the Company's employees are subject to collective bargaining agreements.

Table of Contents

**Sources of Liquidity**

For a discussion of the Company's sources of funds and maturities of the long-term debt of the Company, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources," and note 8 of notes to the Company's consolidated financial statements.

**Taxation**

For a discussion of tax matters affecting the Company and its operations, see note 12 of notes to the Company's consolidated financial statements.

**Financial Information about Reportable Business Segments**

For financial information regarding reportable business segments of the Company, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations," and note 2 of notes to the Company's consolidated financial statements.

**Recent Transactions**

For information regarding recent transactions of the Company, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Company Website and Availability of SEC Filings**

The Company's Internet website is *www.travelers.com*. Information on the Company's website is not incorporated by reference herein and is not a part of this Form 10-K. The Company makes available free of charge on its website or provides a link on its website to the Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after those reports are electronically filed with, or furnished to, the SEC. To access these filings, go to the Company's website, then click on "SEC Filings" under the "For Investors" heading.

From time to time, the Company may use its website as a channel of distribution of material company information. Financial and other material information regarding the Company is routinely posted on and accessible at *http://investor.travelers.com*. In addition, you may subscribe to receive e-mail alerts and other information about the Company by providing your e-mail address in the "E-mail Alert Service" section at *http://investor.travelers.com*.

**Glossary of Selected Insurance Terms**

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| Accident year               | The annual calendar accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid.   |
| Adjusted unassigned surplus | Unassigned surplus as of the most recent statutory annual report reduced by twenty-five percent of that year's unrealized appreciation in value or revaluation of assets or unrealized profits on investments, as defined in that report. |
| Admitted insurer            | A company licensed to transact insurance business within a state.   |

Table of Contents

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| Agent                       | A licensed individual who sells and services insurance policies, receiving a commission from the insurer for selling the business and a fee for servicing it. An independent agent represents multiple insurance companies and searches the market for the best product for its client.  |
| Annuity                     | A contract that pays a periodic benefit over the remaining life of a person (the annuitant), the lives of two or more persons or for a specified period of time.   |
| Assigned risk pools         | Reinsurance pools which cover risks for those unable to purchase insurance in the voluntary market. Possible reasons for this inability include the risk being too great or the profit being too small under the required insurance rate structure. The costs of the risks associated with these pools are charged back to insurance carriers in proportion to their direct writings.  |
| Assumed reinsurance         | Insurance risks acquired from a ceding company.  |
| Average value analysis      | <p>A conventional actuarial method used to estimate ultimate losses for a given cohort of claims such as an accident year/product line component. If the paid-to-date losses are then subtracted from the estimated ultimate losses, the result is an indication of the unpaid losses.</p> <p>The basic premise of the method is that average claim values are stable and predictable over time for a particular cohort of claims. The method is utilized most often where ultimate claim counts are known or reliably estimable fairly early after the start of an accident year and average values are expected to be fairly predictable from one year to the next.</p> <p>The method comes up with an estimate of ultimate claims counts by accident year cohort, and multiplies it by an estimate of average claim value by accident year cohort, with multiple methods used to estimate these average claim values.</p> |
| Book value per share        | Total common shareholders' equity divided by the number of common shares outstanding.  |
| Bornhuetter-Ferguson method | A conventional actuarial method to estimate ultimate losses for a given cohort of claims such as an accident year/product line component. If the paid-to-date losses are then subtracted from the estimated ultimate losses, the result is an indication of the outstanding losses.  |

Table of Contents

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| <p>Broker</p>                           | <p>The basic premise of the method is that the historical ratio of additional claim activity to earned premium for a given product line component/age-to-age period is stable and predictable. It implicitly assumes that the actual activity to date for past periods for that cohort is not a credible predictor of future activity for that cohort, or at least is not credible enough to override the "a priori" assumption as to future activity. It may be applied to either paid or case incurred claim data. It is used most often where the claim data is sparse and/or volatile and for relatively young cohorts with low volumes and/or data credibility. To illustrate, the method may assume that the ratio of additional paid losses from the 12 to 24 month period for an accident year is 10% of the original "a priori" expected losses for that accident year. The original "a priori" expected losses are typically based on the original loss ratio assumption for that accident year, with subsequent adjustment as facts develop. The ultimate losses equal actual activity to date plus the expected values for future periods.</p> |
| <p>Capacity</p>                         | <p>One who negotiates contracts of insurance or reinsurance on behalf of an insured party, receiving a commission from the insurer or reinsurer for placement and other services rendered.</p>   |
| <p>Captive</p>                          | <p>The percentage of surplus, or the dollar amount of exposure, that an insurer or reinsurer is willing or able to place at risk. Capacity may apply to a single risk, a program, a line of business or an entire book of business. Capacity may be constrained by legal restrictions, corporate restrictions or indirect restrictions.</p>  |
| <p>Case-incurred development method</p> | <p>A closely-held insurance company whose primary purpose is to provide insurance coverage to the company's owners or their affiliates.</p>  |
| <p>Case reserves</p>                    | <p>A conventional actuarial method to estimate ultimate losses for a given cohort of claims such as an accident year/product line component. If the paid-to-date losses are then subtracted from the estimated ultimate losses, the result is an indication of the unpaid losses. The approach is the same as that described in this glossary under the "paid loss development method," but based on the growth in cumulative case-incurred losses (i.e., the sum of claim-adjustor incurred estimates for claims in the cohort) rather than paid losses. The basic premise of the method is that cumulative case incurred losses for a given cohort of claims will grow in a stable, predictable pattern from year-to-year, based on the age of the cohort. Claim department estimates of anticipated future payments to be made on each specific individual reported claim.</p>  |

Table of Contents

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| Casualty insurance                           | Insurance which is primarily concerned with the losses caused by injuries to third persons, i.e., not the insured, and the legal liability imposed on the insured resulting therefrom. It includes, but is not limited to, employers' liability, workers' compensation, public liability, automobile liability, personal liability and aviation liability insurance. It excludes certain types of losses that by law or custom are considered as being exclusively within the scope of other types of insurance, such as fire or marine.   |
| Catastrophe                                  | A severe loss, resulting from a variety of events, including, among others, hurricanes, tornadoes and other windstorms, earthquakes, hail, wildfires, severe winter weather, floods, tsunamis and volcanic eruptions. Catastrophes can also result from a terrorist attack (including those involving nuclear, biological, chemical or radiological events), explosions, infrastructure failures or as a consequence of political instability. Each catastrophe has unique characteristics and catastrophes are not predictable as to timing or amount. Their effects are included in net and operating income and claims and claim adjustment expense reserves upon occurrence. A catastrophe may result in the payment of reinsurance reinstatement premiums and assessments from various pools. |
| Catastrophe loss                             | Loss and directly identified loss adjustment expenses from catastrophes, and related reinsurance reinstatement premiums.   |
| Catastrophe reinsurance                      | A form of excess-of-loss reinsurance which, subject to a specified limit, indemnifies the ceding company for the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event. The actual reinsurance document is called a "catastrophe cover." These reinsurance contracts are typically designed to cover property insurance losses but can be written to cover casualty insurance losses such as from workers' compensation policies.  |
| Cede; ceding company                         | When an insurer reinsures its liability with another insurer or a "cession," it "cedes" business and is referred to as the "ceding company."   |
| Ceded reinsurance                            | Insurance risks transferred to another company as reinsurance. See "Reinsurance."  |
| Claim  | Request by an insured for indemnification by an insurance company for loss incurred from an insured peril.   |
| Claim adjustment expenses                    | See "Loss adjustment expenses (LAE)."  |
| Claims and claim adjustment expenses         | See "Loss" and "Loss adjustment expenses (LAE)."   |
| Claims and claim adjustment expense reserves | See "Loss reserves."   |
| Cohort                                       | A group of items or individuals that share a particular statistical or demographic characteristic. For example, all claims for a given product in a given market for a given accident year would represent a cohort of claims.   |

Table of Contents

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| Commercial multi-peril policies   | Refers to policies which cover both property and third-party liability exposures.  |
| Commutation agreement   | An agreement between a reinsurer and a ceding company whereby the reinsurer pays an agreed-upon amount in exchange for a complete discharge of all obligations, including future obligations, between the parties for reinsurance losses incurred.   |
| Debt-to-total capital ratio   | The ratio of debt to total capitalization.   |
| Debt-to-total capital ratio excluding net unrealized gain (loss) on investments | The ratio of debt to total capitalization excluding the after-tax impact of net unrealized investment gains and losses.  |
| Deductible  | The amount of loss that an insured retains.  |
| Deferred acquisition costs  | Primarily commissions and premium-related taxes that vary with, and are primarily related to, the production of new contracts and are deferred and amortized to achieve a matching of revenues and expenses when reported in financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP).  |
| Deficiency  | With regard to reserves for a given liability, a deficiency exists when it is estimated or determined that the reserves are insufficient to pay the ultimate settlement value of the related liabilities. Where the deficiency is the result of an estimate, the estimated amount of deficiency (or even the finding of whether or not a deficiency exists) may change as new information becomes available. |
| Demand surge  | Significant short-term increases in building material and labor costs due to a sharp increase in demand for those materials and services, commonly as a result of a large catastrophe resulting in significant widespread property damage.   |
| Direct written premiums   | The amounts charged by an insurer to insureds in exchange for coverages provided in accordance with the terms of an insurance contract. The amounts exclude the impact of all reinsurance premiums, either assumed or ceded.   |
| Earned premiums or premiums earned  | That portion of property casualty premiums written that applies to the expired portion of the policy term. Earned premiums are recognized as revenues under both Statutory Accounting Practices (SAP) and GAAP.  |
| Excess liability  | Additional casualty coverage above a layer of insurance exposures.   |
| Excess-of-loss reinsurance  | Reinsurance that indemnifies the reinsured against all or a specified portion of losses over a specified dollar amount or "retention."   |
| Expense ratio   | See "Underwriting expense ratio."  |
| Exposure  | The measure of risk used in the pricing of an insurance product. The change in exposure is the amount of change in premium on policies that renew attributable to the change in portfolio risk.  |

Table of Contents

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| Facultative reinsurance  | The reinsurance of all or a portion of the insurance provided by a single policy. Each policy reinsured is separately negotiated.  |
| Fair Access to Insurance Requirements (FAIR) Plan  | A residual market mechanism which provides property insurance to those unable to obtain such insurance through the regular (voluntary) market. FAIR plans are set up on a state-by-state basis to cover only those risks in that state. For more information, see "residual market (involuntary business)."  |
| Fidelity and surety programs   | Fidelity insurance coverage protects an insured for loss due to embezzlement or misappropriation of funds by an employee. Surety is a three-party agreement in which the insurer agrees to pay a third party or make complete an obligation in response to the default, acts or omissions of an insured.   |
| GAAP combined ratio  | The sum of the loss and LAE ratio and the underwriting expense ratio. A combined ratio under 100% generally indicates an underwriting profit. A combined ratio over 100% generally indicates an underwriting loss.   |
| GAAP combined ratio excluding incremental impact of direct to consumer initiative Gross written premiums | The GAAP combined ratio adjusted to exclude the direct, variable impact of the Company's direct-to-consumer initiative in the Personal Insurance segment.<br>The direct and assumed contractually determined amounts charged to the policyholders for the effective period of the contract based on the terms and conditions of the insurance contract.  |
| Ground-up analysis   | A method to estimate ultimate claim costs for a given cohort of claims such as an accident year/product line component. It involves analyzing the exposure and claim activity at an individual insured level and then through the use of deterministic or stochastic scenarios and/or simulations, estimating the ultimate losses for those insureds. The total losses for the cohort are then the sum of the losses for each individual insured.<br>In practice, the method is sometimes simplified by performing the individual insured analysis only for the larger insureds, with the costs for the smaller insureds estimated via sampling approaches (extrapolated to the rest of the smaller insured population) or aggregate approaches (using assumptions consistent with the ground-up larger insured analysis). |
| Guaranteed cost products   | An insurance policy where the premiums charged will not be adjusted for actual loss experience during the covered period.  |
| Guaranty fund  | A state-regulated mechanism that is financed by assessing insurers doing business in those states. Should insolvencies occur, these funds are available to meet some or all of the insolvent insurer's obligations to policyholders.   |
| Holding company liquidity  | Total cash, short-term invested assets and other readily marketable securities held by the holding company.  |

Table of Contents

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| Incurring but not reported (IBNR) reserves | Reserves for estimated losses and LAE that have been incurred but not yet reported to the insurer. This includes amounts for unreported claims, development on known cases, and re-opened claims.  |
| Inland marine                              | A broad type of insurance generally covering articles that may be transported from one place to another, as well as bridges, tunnels and other instrumentalities of transportation. It includes goods in transit, generally other than transoceanic, and may include policies for movable objects such as personal effects, personal property, jewelry, furs, fine art and others.   |
| IRIS ratios                                | Financial ratios calculated by the NAIC to assist state insurance departments in monitoring the financial condition of insurance companies.  |
| Large deductible policy                    | An insurance policy where the customer assumes at least \$25,000 or more of each loss. Typically, the insurer is responsible for paying the entire loss under those policies and then seeks reimbursement from the insured for the deductible amount.  |
| Lloyd's                                    | An insurance marketplace based in London, England, where brokers, representing clients with insurable risks, deal with Lloyd's underwriters, who represent investors. The investors are grouped together into syndicates that provide capital to insure the risks.   |
| Loss                                       | An occurrence that is the basis for submission and/or payment of a claim. Losses may be covered, limited or excluded from coverage, depending on the terms of the policy.  |
| Loss adjustment expenses (LAE)             | The expenses of settling claims, including legal and other fees and the portion of general expenses allocated to claim settlement costs.   |
| Loss and LAE ratio                         | For SAP, it is the ratio of incurred losses and loss adjustment expenses to net earned premiums. For GAAP, it is the ratio of incurred losses and loss adjustment expenses reduced by an allocation of fee income to net earned premiums.  |
| Loss reserves                              | Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Reserves are established for losses and for LAE, and consist of case reserves and IBNR reserves. As the term is used in this document, "loss reserves" is meant to include reserves for both losses and LAE. |
| Loss reserve development                   | The increase or decrease in incurred claims and claim adjustment expenses as a result of the re-estimation of claims and claim adjustment expense reserves at successive valuation dates for a given group of claims. Loss reserve development may be related to prior year or current year development.   |

Table of Contents

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| Losses incurred  | The total losses sustained by an insurance company under a policy or policies, whether paid or unpaid. Incurred losses include a provision for IBNR.   |
| National Association of Insurance Commissioners (NAIC) | An organization of the insurance commissioners or directors of all 50 states, the District of Columbia and the five U.S. territories organized to promote consistency of regulatory practice and statutory accounting standards throughout the United States.  |
| Net written premiums                                   | Direct written premiums plus assumed reinsurance premiums less premiums ceded to reinsurers.   |
| New business volume                                    | The amount of written premium related to new policyholders and additional products sold to existing policyholders.   |
| Operating income (loss)                                | Net income (loss) excluding the after-tax impact of net realized investment gains (losses), discontinued operations and cumulative effect of changes in accounting principles when applicable.   |
| Operating income (loss) per share                      | Operating income (loss) on a per share basis.  |
| Operating return on equity                             | The ratio of operating income to average equity excluding net unrealized investment gains and losses and discontinued operations, net of tax.  |
| Paid development method                                | <p>A conventional actuarial method to estimate ultimate losses for a given cohort of claims such as an accident year/product line component. If the paid-to-date losses are then subtracted from the estimated ultimate losses, the result is an indication of the unpaid losses.</p> <p>The basic premise of the method is that cumulative paid losses for a given cohort of claims will grow in a stable, predictable pattern from year-to-year, based on the age of the cohort. These age-to-age growth factors are sometimes called "link ratios."</p> <p>For example, if cumulative paid losses for a product line XYZ for accident year 2004 were \$100 as of December 31, 2004 (12 months after the start of that accident year), then grew to \$120 as of December 31, 2005 (24 months after the start), the link ratio for that accident year from 12 to 24 months would be 1.20. If the link ratio for other recent accident years from 12 to 24 months for that product line were also at or around 1.20, then the method would assume a similar result for the most recent accident year, i.e., that it too would have its cumulative paid losses grow 20% from the 12 month to 24 month valuation.</p> <p>This is repeated for each age-to-age period into the future until the age-to-age link ratios for future periods are assumed to be 1.0 (i.e., the age at which cumulative losses are assumed to have stopped growing).</p> |

Table of Contents

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|                         | A given accident year's cumulative losses are then projected to ultimate by multiplying current cumulative losses by successive age-to-age link ratios up to that future age where growth is expected to end. For example, if growth is expected to end at 60 months, then the ultimate indication for an accident year with cumulative losses at 12 months equals those losses times a 12 to 24 month link ratio, times a 24 to 36 month link ratio, times a 36 to 48 month link ratio, times a 48 to 60 month link ratio.<br>Advanced applications of the method include adjustments for changing conditions during the historical period and anticipated changes in the future. |
| Policyholders' surplus  | As determined under SAP, the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. Admitted assets are assets of an insurer prescribed or permitted by a state to be recognized on the statutory balance sheet. Policyholders' surplus is also referred to as "surplus" or "statutory surplus" for statutory accounting purposes.  |
| Pool                    | An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses and expenses being shared in agreed-upon percentages.   |
| Premiums                | The amount charged during the year on policies and contracts issued, renewed or reinsured by an insurance company.   |
| Property insurance      | Insurance that provides coverage to a person or business with an insurable interest in tangible property for that person's or business's property loss, damage or loss of use.   |
| Quota share reinsurance | Reinsurance wherein the insurer cedes an agreed-upon fixed percentage of liabilities, premiums and losses for each policy covered on a pro rata basis.   |
| Rates                   | Amounts charged per unit of insurance.   |
| Redundancy              | With regard to reserves for a given liability, a redundancy exists when it is estimated or determined that the reserves are greater than what will be needed to pay the ultimate settlement value of the related liabilities. Where the redundancy is the result of an estimate, the estimated amount of redundancy (or even the finding of whether or not a redundancy exists) may change as new information becomes available.   |
| Reinstatement premiums  | Additional premiums payable to reinsurers to restore coverage limits that have been exhausted as a result of reinsured losses under certain excess-of-loss reinsurance treaties.   |
| Reinsurance             | The practice whereby one insurer, called the reinsurer, in consideration of a premium paid to that insurer, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more policies or contracts of insurance which it has issued.   |
| Reinsurance agreement   | A contract specifying the terms of a reinsurance transaction.  |

Table of Contents

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| Renewal premium change                 | The estimated change in average premium on policies that renew, including rate and exposure changes. Such statistics are subject to change based on a number of factors, including changes in actuarial estimates.  |
| Renewal rate change                    | The estimated change in average premium on policies that renew, excluding exposure changes. Such statistics are subject to change based on a number of factors, including changes in actuarial estimates.   |
| Reported claim development method      | <p>A conventional actuarial method to estimate ultimate claim counts for a given cohort of claims such as an accident year/product line component. If the reported-to-date counts are then subtracted from the estimated ultimate counts, the result is an indication of the IBNR counts.</p> <p>The approach is the same as that described in this glossary under the "paid loss development method", but based on the growth in cumulative claim counts rather than paid losses. The basic premise of the method is that cumulative claim counts for a given cohort of claims will grow in a stable, predictable pattern from year-to-year, based on the age of the cohort.</p>                         |
| Residual market (involuntary business) | Insurance market which provides coverage for risks for those unable to purchase insurance in the voluntary market. Possible reasons for this inability include the risks being too great or the profit potential too small under the required insurance rate structure. Residual markets are frequently created by state legislation either because of lack of available coverage such as: property coverage in a windstorm prone area or protection of the accident victim as in the case of workers' compensation. The costs of the residual market are usually charged back to the direct insurance carriers in proportion to the carriers' voluntary market shares for the type of coverage involved. |
| Retention                              | <p>The amount of exposure a policyholder company retains on any one risk or group of risks. The term may apply to an insurance policy, where the policyholder is an individual, family or business, or a reinsurance policy, where the policyholder is an insurance company.</p>  |
| Retention rate                         | The percentage of prior period premiums (excluding renewal premium changes), accounts or policies available for renewal in the current period that were renewed. Such statistics are subject to change based on a number of factors, including changes in actuarial estimates.  |
| Retrospective premiums                 | Premiums related to retrospectively rated policies.   |
| Retrospective rating                   | A plan or method which permits adjustment of the final premium or commission on the basis of actual loss experience, subject to certain minimum and maximum limits.   |

Table of Contents

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|--------------------------------------|--|
| Return on equity                     | The ratio of net income (loss) less preferred dividends to average shareholders' equity.   |
| Risk-based capital (RBC)             | A measure adopted by the NAIC and enacted by states for determining the minimum statutory policyholders' surplus requirements of insurers. Insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action depending on the level of capital inadequacy.   |
| Risk retention group                 | An alternative form of insurance in which members of a similar profession or business band together to self insure their risks.  |
| Runoff business                      | An operation which has been determined to be nonstrategic; includes non-renewals of in-force policies and a cessation of writing new business, where allowed by law.   |
| Salvage                              | The amount of money an insurer recovers through the sale of property transferred to the insurer as a result of a loss payment.   |
| S-curve method                       | A mathematical function which depicts an initial slow change, followed by a rapid change and then ending in a slow change again. This results in an "S" shaped line when depicted graphically. The actuarial application of these curves fit the reported data to date for a particular cohort of claims to an S-curve to project future activity for that cohort.   |
| Second-injury fund                   | The employer of an injured, impaired worker is responsible only for the workers' compensation benefit for the most recent injury; the second-injury fund would cover the cost of any additional benefits for aggravation of a prior condition. The cost is shared by the insurance industry and self-insureds, funded through assessments to insurance companies and self-insureds based on either premiums or losses. |
| Self-insured retentions              | That portion of the risk retained by a person for its own account.   |
| Servicing carrier                    | An insurance company that provides, for a fee, various services including policy issuance, claims adjusting and customer service for insureds in a reinsurance pool.   |
| Statutory accounting practices (SAP) | The practices and procedures prescribed or permitted by domiciliary state insurance regulatory authorities in the United States for recording transactions and preparing financial statements. Statutory accounting practices generally reflect a modified going concern basis of accounting.  |
| Statutory basis surplus              | The excess of an insurance company's assets over its liabilities in accordance with the statutory accounting practices required by state laws and regulations.   |
| Structured settlements               | Periodic payments to an injured person or survivor for a determined number of years or for life, typically in settlement of a claim under a liability policy, usually funded through the purchase of an annuity.   |

Table of Contents

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|---------------------------------------|--|
| Subrogation                           | A principle of law incorporated in insurance policies, which enables an insurance company, after paying a claim under a policy, to recover the amount of the loss from another person or entity who is legally liable for it.  |
| Third-party liability                 | A liability owed to a claimant (third party) who is not one of the two parties to the insurance contract. Insured liability claims are referred to as third-party claims.  |
| Total capitalization                  | The sum of total shareholders' equity and debt.  |
| Treaty reinsurance                    | The reinsurance of a specified type or category of risks defined in a reinsurance agreement (a "treaty") between a primary insurer or other reinsured and a reinsurer. Typically, in treaty reinsurance, the primary insurer or reinsured is obligated to offer and the reinsurer is obligated to accept a specified portion of all that type or category of risks originally written by the primary insurer or reinsured. |
| Umbrella coverage                     | A form of insurance protection against losses in excess of amounts covered by other liability insurance policies or amounts not covered by the usual liability policies.   |
| Unassigned surplus                    | The undistributed and unappropriated amount of policyholders' surplus.   |
| Underlying GAAP combined ratio        | The sum of the underlying loss and LAE ratio and the underlying underwriting expense ratio.  |
| Underlying loss and LAE ratio         | The ratio of incurred losses and loss adjustment expenses, reduced by an allocation of fee income, to net earned premiums, excluding the impact of catastrophe losses and prior year reserve development.  |
| Underlying underwriting expense ratio | The ratio of underwriting expenses incurred, reduced by an allocation of fee income and billing and policy fees, to net earned premiums, excluding the impact of catastrophe losses.   |
| Underlying underwriting margin        | Net earned premiums and fee income less claims and claim adjustment expenses (excluding catastrophe losses and prior year reserve development) and insurance-related expenses.   |
| Underwriter                           | An employee of an insurance company who examines, accepts or rejects risks and classifies accepted risks in order to charge an appropriate premium for each accepted risk. The underwriter is expected to select business that will produce an average risk of loss no greater than that anticipated for the class of business.  |
| Underwriting                          | The insurer's or reinsurer's process of reviewing applications for insurance coverage, and the decision as to whether to accept all or part of the coverage and determination of the applicable premiums; also refers to the acceptance of that coverage.  |

Table of Contents

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| Underwriting expense ratio | For SAP, it is the ratio of underwriting expenses incurred less other income to net written premiums. For GAAP, it is the ratio of underwriting expenses incurred reduced by an allocation of fee income and billing and policy fees to net earned premiums.  |
| Underwriting gain or loss  | Net earned premiums and fee income less claims and claim adjustment expenses and insurance-related expenses.  |
| Unearned premium           | The portion of premiums written that is allocable to the unexpired portion of the policy term.  |
| Voluntary market           | The market in which a person seeking insurance obtains coverage without the assistance of residual market mechanisms.   |
| Wholesale broker           | An independent or exclusive agent that represents both admitted and nonadmitted insurers in market areas, which include standard, non-standard, specialty and excess and surplus lines of insurance. The wholesaler does not deal directly with the insurance consumer. The wholesaler deals with the retail agent or broker. |
| Workers' compensation      | A system (established under state and federal laws) under which employers provide insurance for benefit payments to their employees for work-related injuries, deaths and diseases, regardless of fault.  |

Table of Contents

**PART IV**

**Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

Documents filed as part of this report:

| <b>Exhibit<br/>Number</b> | <b>Description of Exhibit</b>   |
|---------------------------|---|
| 31.1                      | Certification of Jay S. Fishman, Chairman and Chief Executive Officer of the Company, as required by Section 302 of the Sarbanes-Oxley Act of 2002, is filed herewith.    |
| 31.2                      | Certification of Jay S. Benet, Vice Chairman and Chief Financial Officer of the Company, as required by Section 302 of the Sarbanes-Oxley Act of 2002, is filed herewith. |

