

TRAVELERS COMPANIES, INC.  
Form 10-K  
February 19, 2013

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## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-K

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)

**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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**The Travelers Companies, Inc.**

**Annual Report on Form 10-K**

**For Fiscal Year Ended December 31, 2012**

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**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."



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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.



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*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 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
Total Business Insurance Core	11,873	11,330	10,844	100.0
Business Insurance Other	(1)	10	13	
<b>Total Business Insurance by market</b>	<b>\$ 11,872</b>	<b>\$ 11,340</b>	<b>\$ 10,857</b>	<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>	<b>\$ 11,340</b>	<b>\$ 10,857</b>	<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.

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**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.

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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,

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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.

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**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.

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**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



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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 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

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insurance policies it issues. This methodology enables Financial, Professional & International Insurance to facilitate its risk selection process and develop pricing parameters.

**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 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 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

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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

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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



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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.

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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

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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.

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*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

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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

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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

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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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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	19,744					
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)	



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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

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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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**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)

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***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.



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**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

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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."



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*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

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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

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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.

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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.

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**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**

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.

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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.

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	<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>
Broker	<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>
Capacity	<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>
Captive	<p>A closely-held insurance company whose primary purpose is to provide insurance coverage to the company's owners or their affiliates.</p>
Case-incurred 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. 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.</p>
Case reserves	<p>Claim department estimates of anticipated future payments to be made on each specific individual reported claim.</p>

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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.



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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.

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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. 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. 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.

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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.

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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>

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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. 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.

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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	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.  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.
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	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.
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.

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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.

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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.



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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.

**Item 1A. RISK FACTORS**

You should carefully consider the following risks and all of the other information set forth in this report, including our consolidated financial statements and the notes thereto.

**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.** Our property and casualty insurance operations expose us to claims arising out of catastrophes. Catastrophes can be caused by various natural events, including, among others, hurricanes, tornadoes and other windstorms, earthquakes, hail, wildfires, severe winter weather, floods, tsunamis and volcanic eruptions. Catastrophes can also be man-made, such as a terrorist attack (including those involving nuclear, biological, chemical or radiological events), explosions, infrastructure failures or a consequence of political instability. The geographic distribution of our business subjects us to catastrophe exposures in the United States, which include, but are not limited to: hurricanes from Maine through Texas; tornadoes throughout the Central, Mid-Atlantic and Southeastern regions of the United States; earthquakes in California, the New Madrid region and the Pacific Northwest region of North America; wildfires, particularly in the Southwest; and terrorism in major cities in the United States. In addition, our international operations subject us to catastrophe exposures in the United Kingdom, Canada and the Republic of Ireland, as well as to a variety of world-wide catastrophe exposures through our Lloyd's operations, and in Brazil through our joint venture investment.

The incidence and severity of catastrophes are inherently unpredictable, and it is possible that both the frequency and severity of natural and man-made catastrophic events could increase. Moreover, we could experience more than one highly severe catastrophic event in any given period.

Some scientists believe that in recent years changing climate conditions have added to the unpredictability and frequency of natural disasters and created additional uncertainty as to future trends and exposures. For example, in recent years hurricane activity has impacted areas further inland than previously experienced, thus expanding our overall hurricane exposure. Additionally, both the frequency and severity of tornadoes and hail storms have increased in recent years.

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All of the catastrophe modeling tools that we use, or that we rely on from outside parties, to help manage certain of our catastrophe exposures are based on assumptions and judgments that are subject to error and mis-estimation and may produce estimates that are materially different than actual results. In addition, compared to models for hurricanes, models for earthquakes are less reliable due to there being a more limited number of significant historical events to analyze, while models for tornadoes and hail storms are newer and may be even less reliable due to the highly random geographic nature and size of these events. As a result, models for earthquakes and especially for tornado and hail storms may have even greater difficulty predicting risks and estimating losses. Further, changes in climate conditions could cause our underlying modeling data to be less predictive, thus limiting our ability to effectively evaluate and manage catastrophe risk. See "We may be adversely affected if our pricing and capital models provide materially different indications than actual results" below as well as "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Catastrophe Modeling" and " Changing Climate Conditions."

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. Increases in the value and geographic concentration of insured property and the effects of inflation could increase the severity of claims from catastrophic events in the future. For example, the specific geographic location impacted by tornadoes is inherently random and unpredictable and the specific location impacted by a tornado may or may not be highly populated and may or may not have a high concentration of our insured exposures.

States have from time to time passed legislation, and regulators have taken action, that have the effect of limiting the ability of insurers to manage catastrophe risk, such as legislation prohibiting insurers from reducing exposures or withdrawing from catastrophe-prone areas or mandating that insurers participate in residual markets. Participation in residual market mechanisms has resulted in, and may continue to result in, significant losses or assessments to insurers, including us, and, in certain states, those losses or assessments may not be commensurate with our direct catastrophe exposure in those states. If our competitors leave those states having residual market mechanisms, remaining insurers, including us, may be subject to significant increases in losses or assessments following a catastrophe. In addition, following catastrophes, there are sometimes legislative and administrative initiatives and court decisions that seek to expand insurance coverage for catastrophe claims beyond the original intent of the policies or seek to prevent the application of deductibles. Also, our ability to adjust terms, including deductible levels, or to increase pricing to the extent necessary to offset rising costs of catastrophes, particularly in the Personal Insurance segment, requires approval of regulatory authorities of certain states. Our ability or our willingness to manage our catastrophe exposure by raising prices, modifying underwriting terms or reducing 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. We also may choose to write business in catastrophe-prone areas that we might not otherwise write for strategic purposes, such as improving our access to other underwriting activities.

There are also factors that impact the estimation of ultimate costs for catastrophes. For example, the estimation of claims and claim adjustment expense reserves related to hurricanes can be affected by the inability to access portions of the impacted areas, the complexity of factors contributing to the losses, the legal and regulatory uncertainties and the nature of the information available to establish the claims and claim adjustment expense reserves. Complex factors include, but are not limited to: determining whether damage was caused by flooding versus wind; evaluating general liability and pollution exposures; estimating additional living expenses; the impact of demand surge; infrastructure disruption; fraud; the effect of mold damage; business interruption costs; and reinsurance collectability. In recent years, increased late reporting of weather-related losses by claimants, particularly losses from hail damage, has led to higher costs than we previously expected. The timing of a catastrophe's occurrence, such as at or near the end of a reporting period, can also affect the information available to us in estimating claims and claim adjustment expense reserves for that reporting period. The

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estimates related to catastrophes are adjusted as actual claims emerge and additional information becomes available.

Exposure to catastrophe losses or actual losses resulting from a catastrophe could adversely affect our financial strength and claims-paying ratings and could impair our ability to raise capital on acceptable terms or at all. Also, as a result of our exposure to catastrophe losses or actual losses following a catastrophe, rating agencies may further increase capital requirements, which may require us to raise capital to maintain our ratings or adversely affect our ratings. A ratings downgrade could hurt our ability to compete effectively or attract new business. In addition, catastrophic events could cause us to exhaust our available reinsurance limits and could adversely impact the cost and availability of reinsurance. Such events can also impact the credit of our reinsurers. For a discussion of our catastrophe reinsurance coverage, see "Item 1 Business Reinsurance Catastrophe Reinsurance." Catastrophic events could also adversely impact the credit of the issuers of securities, such as states or municipalities, in whom we have invested.

In addition, coverage in our reinsurance program for terrorism is limited. Although the Terrorism Risk Insurance Program (the Program) provides benefits in the event of certain acts of terrorism, those benefits are subject to a deductible and other limitations. Under this Program, once our losses exceed 20% of our commercial property and casualty insurance premium for the preceding calendar year, the federal government will reimburse us for 85% of our losses attributable to certain acts of terrorism which exceed this deductible up to a total industry program cap of \$100 billion. Our estimated deductible under the program is \$2.26 billion for 2013. In addition, because the interpretation of this law is untested, there is substantial uncertainty as to how it will be applied to specific circumstances. It is also possible that future legislative action could change the Program. The Program is due to expire at the end of 2014, unless extended.

Because of the risks set forth above, catastrophes such as those caused by various natural events or man-made events such as a terrorist attack, including "unconventional" acts of terrorism involving nuclear, biological, chemical or radiological events, could materially and adversely affect our results of operations, financial position and/or liquidity. Further, while we seek to manage our exposure to man-made catastrophic events involving conventional means, there can be no assurance that we would have sufficient resources to respond to claims arising out of one or more man-made catastrophic events involving nuclear, biological, chemical or radiological means.

**During or following a period of financial market disruption or economic downturn, our business could be materially and adversely affected.** Over the past six years, worldwide financial markets have experienced significant disruptions and, during a portion of this period, the United States and many other economies experienced a prolonged economic downturn, resulting in heightened credit risk, reduced valuation of investments and decreased economic activity. While economic conditions have generally stabilized, there is continued uncertainty regarding the duration and strength of any economic recovery. Even if growth continues, it may be at a slow rate for an extended period of time, and other economic conditions, such as the residential and commercial real estate environment and employment rates, may continue to be weak.

In addition, while inflation has recently been limited and that trend may continue, it is possible that steps taken by the federal government to stabilize financial markets and improve economic conditions could lead to an inflationary environment. Furthermore, financial markets may again experience significant and prolonged disruption.

Economic uncertainty has been exacerbated in recent years by the increased potential for default by one or more European sovereign debt issuers, the potential partial or complete dissolution of the Eurozone and its common currency and the negative impact of such events on global financial institutions and capital markets generally. Actions or inactions of European governments may impact these actual or perceived risks. In the U.S. during 2011, one rating agency downgraded the U.S.'s

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long-term debt credit rating from AAA. Future actions or inactions of the United States government, including a failure to increase the government debt limit or a shutdown of the federal government, could increase the actual or perceived risk that the U.S. may not ultimately pay its obligations when due and may disrupt financial markets, including capital markets. Further, general uncertainty regarding the U.S. Federal budget and taxes has added to the uncertainty regarding economic conditions generally.

If economic conditions remain weak or deteriorate, or if financial markets experience significant disruption, it could materially adversely affect our results of operations, financial position and/or liquidity. Several of the risk factors discussed below identify risks that result from, or are exacerbated by, an economic slowdown or financial disruption. These include risks discussed below related to our investment portfolio, reinsurance arrangements, other credit exposures, our estimates of claims and claim adjustment expense reserves, emerging claim and coverage issues, the competitive environment, regulatory developments and the impact of rating agency actions. You should also refer to "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation", particularly the "Outlook" section.

Many of these risks could materialize, and our financial results could be negatively impacted, even after the end of an economic downturn or financial disruption. During or following an economic downturn, lower levels of economic activity could reduce (and historically have reduced) exposure changes at renewal. They also could adversely impact (and historically have adversely impacted) audit premium adjustments, policy endorsements and mid-term cancellations after policies are written, particularly in our business units within Business Insurance, which could adversely impact our written premiums. In addition, because earned premiums lag written premiums, our results can be adversely affected after general economic conditions have improved. An inflationary environment (which may follow government efforts to stabilize the economy) may also, as we discuss below, adversely impact our loss costs and could adversely impact the valuation of our investment portfolio. Finally, as a result of financial market disruption, we may, as discussed below, face increased regulation.

**If actual claims exceed our claims and claim adjustment expense reserves, or if changes in the estimated level of claims and claim adjustment expense reserves are necessary, our financial results could be materially and adversely affected.** Claims and claim adjustment expense reserves do not represent an exact calculation of liability, but instead represent management estimates of what the ultimate settlement and administration of claims will cost, generally utilizing actuarial expertise and projection techniques, at a given accounting date.

The process of estimating claims and claim adjustment expense reserves involves a high degree of judgment and is subject to a number of variables. These variables can be affected by both internal and external events, such as: changes in claims handling procedures; adverse changes in loss cost trends, including inflationary pressures on medical costs and auto and home repair costs; economic conditions including general inflation; legal trends and legislative changes; and varying judgments and viewpoints of the individuals involved in the estimation process, among others. The impact of many of these items on ultimate costs for claims and claim adjustment expenses is difficult to estimate. Claims and claim adjustment expense reserve estimation difficulties also differ significantly by product line due to differences in claim complexity, the volume of claims, the potential severity of individual claims, the determination of occurrence date for a claim and reporting lags (the time between the occurrence of the policyholder event and when it is actually reported to the insurer).

As discussed above, it is possible that steps taken by the federal government to stabilize the economy could lead to an inflationary environment, which could in turn lead to an increase in our loss costs. The impact of inflation on loss costs could be more pronounced for those lines of business that are considered "long tail", such as general liability, as they require a relatively long period of time to finalize and settle claims for a given accident year. In addition, inflationary pressures in medical costs

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may be increased by the healthcare reform legislation. The estimation of claims and claim adjustment expense reserves may also be more difficult during times of adverse or uncertain economic conditions due to unexpected changes in behavior of claimants and policyholders, including an increase in fraudulent reporting of exposures and/or losses, reduced maintenance of insured properties or increased frequency of small claims or delays in the reporting of claims.

We continually refine our claims and claim adjustment expense reserve estimates in a regular, ongoing process as historical loss experience develops, additional claims are reported and settled and the legal, regulatory and economic environment evolves. Business judgment is applied throughout the process, including the application of various individual experiences and expertise to multiple sets of data and analyses. Different experts may choose different assumptions when faced with material uncertainty, based on their individual backgrounds, professional experiences and areas of focus. Hence, such experts may at times produce estimates materially different from each other. This risk may be exacerbated in the context of an acquisition. Experts providing input to the various estimates and underlying assumptions include actuaries, underwriters, claim personnel and lawyers, as well as other members of management. Therefore, management may have to consider varying individual viewpoints as part of its estimation of claims and claim adjustment expense reserves.

We attempt to consider all significant facts and circumstances known at the time claims and claim adjustment expense reserves are established or reviewed. Due to the inherent uncertainty underlying claims and claim adjustment expense reserve estimates, the final resolution of the estimated liability for claims and claim adjustment expenses will likely be higher or lower than the related claims and claim adjustment expense reserves at the reporting date. Therefore, actual paid losses in the future may yield a materially different amount than is currently reserved.

Because of the uncertainties set forth above, additional liabilities resulting from one insured event, or an accumulation of insured events, may exceed the current related reserves. In addition, our estimate of claims and claim adjustment expenses may change. These additional liabilities or increases in estimates, or a range of either, cannot now be reasonably estimated and could materially and adversely affect our results of operations and/or our financial position.

For a discussion of claims and claim adjustment expense reserves by product line, including examples of common factors that can affect required reserves, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates Claims and Claim Adjustment Expense Reserves."

**Our investment portfolio may suffer reduced returns or material realized or unrealized losses.** Investment returns are an important part of our overall profitability. Fixed maturity and short-term investments comprised approximately 93% of the carrying value of our investment portfolio as of December 31, 2012. Changes in interest rates caused by inflation or other factors (inclusive of credit spreads) affect the carrying value of our fixed maturity investments and returns on our fixed maturity and short-term investments. A decline in interest rates reduces the returns available on short-term investments and new fixed maturity investments (including those purchased to re-invest maturities from the existing portfolio), thereby negatively impacting our net investment income, while rising interest rates reduce the market value of existing fixed maturity investments. Interest rates in recent periods have been at or near historically low levels, and it is possible that rates may remain at low levels for a prolonged period. The value of our fixed maturity and short-term investments is subject to the risk that certain investments may default or become impaired due to a deterioration in the financial condition of one or more issuers of the securities held in our portfolio, or due to a deterioration in the financial condition of an insurer that guarantees an issuer's payments of such investments. Such defaults and impairments could reduce our net investment income and result in realized investment losses. During an economic downturn, fixed maturity and short-term investments could be subject to a higher risk of default.

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Our fixed maturity investment portfolio is invested, in substantial part, in obligations of states, municipalities and political subdivisions (collectively referred to as the municipal bond portfolio). Notwithstanding the relatively low historical rates of default on many of these obligations and notwithstanding that we typically seek to invest in high-credit-quality securities (including those with structural protections such as being secured by dedicated or pledged sources of revenue), our municipal bond portfolio could be subject to default or impairment. In particular:

The prolonged economic downturn that began in 2008, and the limited economic recovery that has followed, has resulted in many states and local governments operating under deficits or projected deficits. The severity and duration of these deficits could have an adverse impact on the collectability and valuation of our municipal bond portfolio. These deficits may be exacerbated by the impact of unfunded pension plan obligations or by declining municipal tax bases and revenues in times of financial stress.

Some issuers may be unwilling to increase tax rates, or to reduce spending, to fund interest or principal payments on their municipal bonds, or may be unable to access the municipal bond market to fund such payments. The risk of widespread defaults may increase if some issuers voluntarily choose to default, instead of implementing difficult fiscal measures, and the actual or perceived consequences (such as reduced access to capital markets) are less severe than expected.

The risk of widespread defaults may also increase if there are changes in legislation that permit states, municipalities and political subdivisions to file for bankruptcy protection where they were not permitted before. In addition, the collectability and valuation of municipal bonds may be adversely affected if there are judicial interpretations in a bankruptcy or other proceeding that lessen the value of structural protections. For example, debtors may challenge the effectiveness of structural protections thought to be provided by municipal securities backed by a dedicated source of revenue. The collectability and valuation may also be adversely affected if there are judicial interpretations in a bankruptcy or other proceeding that question the payment priority of municipal bonds.

Our portfolio has also benefited from tax exemptions and certain other tax laws, including, but not limited to, those governing dividends-received deductions and tax credits (such as foreign tax credits). Changes in these laws could adversely impact the value of our investment portfolio. See "Changes in U.S. tax laws or in the tax laws of other jurisdictions in which we operate could adversely impact us" below.

Our investment portfolio includes: residential mortgage-backed securities; collateralized mortgage obligations; pass-through securities and asset-backed securities collateralized by sub-prime mortgages; commercial mortgage-backed securities; and wholly-owned real estate, real estate partnerships and mortgage loans, all of which could be adversely impacted by further declines in real estate valuations and/or financial market disruption. In addition, the potential for protracted disruption and/or suspension of foreclosure practices could also impact the returns on certain of these portfolios.

We also invest a portion of our assets in equity securities, private equity limited partnerships, hedge funds, and real estate partnerships. From time to time, we may also invest in other types of non-fixed maturity investments, including commodities. All of these asset classes are subject to greater volatility in their investment returns than fixed maturity investments. General economic conditions, changes in applicable tax laws and many other factors beyond our control can adversely affect the value of our non-fixed maturity investments and the realization of net investment income, and/or result in realized investment losses. As a result of these factors, we may realize reduced returns on these investments, incur losses on sales of these investments and be required to write down the value of these investments, which could reduce our net investment income and result in realized investment losses.

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Our investment portfolio is also subject to increased valuation uncertainties when investment markets are illiquid. The valuation of investments is more subjective when markets are illiquid, thereby increasing the risk that the estimated fair value (i.e., the carrying amount) of the portion of the investment portfolio that is carried at fair value as reflected in our financial statements is not reflective of prices at which actual transactions could occur.

Given that economic and market conditions are highly uncertain, we may, depending on circumstances in the future, make changes to the mix of investments in our investment portfolio. These changes may impact the duration, volatility and risk of our investment portfolio.

Because of the risks set forth above, the value of our investment portfolio could decrease, we could experience reduced net investment income and we could experience realized and/or unrealized investment losses, which could materially and adversely affect our results of operations, financial position and/or liquidity.

**Our business could be harmed because of our potential exposure to asbestos and environmental claims and related litigation.**

With regard to asbestos claims, we have received and continue to receive a significant number of asbestos claims from policyholders (including others seeking coverage under a policy). Factors underlying these claim filings include intensive advertising by lawyers seeking asbestos claimants and the continued focus by plaintiffs on previously peripheral defendants. The focus on these defendants is primarily the result of the number of traditional asbestos defendants who have sought bankruptcy protection in previous years. The bankruptcy of many traditional defendants has prompted plaintiffs to aggressively seek out potential new defendants and has caused increased settlement demands against those policyholders who are not in bankruptcy but who remain in the tort system. Currently, in many jurisdictions, those who allege very serious injury and who can present credible medical evidence of their injuries are receiving priority trial settings in the courts, while those who have not shown any credible disease manifestation are having their hearing dates delayed or placed on an inactive docket. This trend of prioritizing claims involving credible evidence of injuries, along with the focus on previously peripheral defendants, contributes to the claims and claim adjustment expense payments experienced by us.

We also continue to be involved in coverage litigation concerning a number of policyholders, some of whom have filed for bankruptcy, who in some instances have asserted that all or a portion of their asbestos-related claims are not subject to aggregate limits on coverage. In these instances, policyholders also may assert that each individual bodily injury claim should be treated as a separate occurrence under the policy. It is difficult to predict whether these policyholders will be successful on both issues. To the extent both issues are resolved in a policyholder's favor and our other defenses are not successful, our coverage obligations under the policies at issue would be materially increased and bounded only by the applicable per-occurrence limits and the number of asbestos bodily injury claims against the policyholders. Accordingly, although we have seen a moderation in the overall risk associated with these lawsuits, it remains difficult to predict the ultimate cost of these claims.

Further, in addition to asbestos claims against policyholders, proceedings have been launched directly against insurers, including us, by individuals challenging insurers' conduct with respect to the handling of past asbestos claims and by individuals seeking damages arising from alleged asbestos-related bodily injuries. It is possible that the filing of other direct actions against insurers, including us, could be made in the future. It is not possible to predict the outcome of these proceedings, including whether the plaintiffs will be able to sustain these actions against insurers based on novel legal theories of liability.

With regard to environmental claims, we have received and continue to receive claims from policyholders who allege that they are liable for injury or damage arising out of their alleged disposition of toxic substances. Mostly, these claims are due to various legislative as well as regulatory

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efforts aimed at environmental remediation. For instance, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), enacted in 1980 and later modified, enables private parties as well as federal and state governments to take action with respect to releases and threatened releases of hazardous substances. This federal statute permits the recovery of response costs from some liable parties and may require liable parties to undertake their own remedial action. Liability under CERCLA may be joint and several with other responsible parties.

The Company has been, and continues to be, involved in litigation involving insurance coverage issues pertaining to environmental claims. The Company believes that some court decisions have interpreted the insurance coverage to be broader than the original intent of the insurers and policyholders. These decisions continue to be inconsistent and vary from jurisdiction to jurisdiction.

Uncertainties surrounding the final resolution of these asbestos and environmental claims continue, and it is difficult to estimate our ultimate liability for such claims and related litigation. As a result, these reserves are subject to revision as new information becomes available and as claims develop. The continuing uncertainties include, without limitation:

the risks and lack of predictability inherent in complex litigation;

any impact from the bankruptcy protection sought by various asbestos producers and other asbestos defendants;

a further increase in the cost to resolve, and/or the number of, asbestos and environmental claims beyond that which is anticipated;

the role of any umbrella or excess policies we have issued;

the resolution or adjudication of disputes pertaining to the amount of available coverage for asbestos and environmental claims in a manner inconsistent with our previous assessment of these claims;

the number and outcome of direct actions against us;

future developments pertaining to our ability to recover reinsurance for asbestos and environmental claims;

the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or through the insolvency of other participating insurers; and

uncertainties arising from the insolvency or bankruptcy of policyholders and other defendants.

It is also not possible to predict changes in the legal, regulatory and legislative environment and their impact on the future development of asbestos and environmental claims. This environment could be affected by changes in applicable legislation and future court and regulatory decisions and interpretations, including the outcome of legal challenges to legislative and/or judicial reforms establishing medical criteria for the pursuit of asbestos claims. It is also difficult to predict the ultimate outcome of complex coverage disputes until settlement negotiations near completion and significant legal questions are resolved or, failing settlement, until the dispute is adjudicated. This is particularly the case with policyholders in bankruptcy where negotiations often involve a large number of claimants and other parties and require court approval to be effective.

While the ongoing evaluation of asbestos and environmental claims and associated liabilities considers the inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability and the risks inherent in complex litigation and other uncertainties, it is possible that the outcome of the continued uncertainties regarding these claims could result in liability in future periods that differs from current reserves by an amount that could materially and adversely affect our results of operations. See the "Asbestos Claims and Litigation" and "Environmental Claims and Litigation" sections of "Item 7 Management's Discussion and Analysis of Financial Condition and Results of



Operations." Also see "Item 3 Legal Proceedings."

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**We are exposed to, and may face adverse developments involving, mass tort claims such as those relating to exposure to potentially harmful products or substances.** In addition to asbestos and environmental claims, we face exposure to other types of mass tort claims, including claims related to exposure to potentially harmful products or substances, including lead paint, silica and welding rod fumes. Establishing claims and claim adjustment expense reserves for mass tort claims is subject to uncertainties because of many factors, including expanded theories of liability, disputes concerning medical causation with respect to certain diseases, geographical concentration of the lawsuits asserting the claims and the potential for a large rise in the total number of claims without underlying epidemiological developments suggesting an increase in disease rates. Moreover, evolving judicial interpretations regarding the application of various tort theories and defenses, including application of various theories of joint and several liabilities, as well as the application of insurance coverage to these claims, make it difficult to estimate our ultimate liability for such claims.

Because of the uncertainties set forth above, additional liabilities may arise for amounts in excess of the current related reserves. In addition, our estimate of claims and claim adjustment expenses may change, and such change could be material. These additional liabilities or increases in estimates, or a range of either, cannot now be reasonably estimated and could materially and adversely affect our results of operations.

**The effects of emerging claim and coverage issues on our business are uncertain.** As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claim and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. Examples of emerging claims and coverage issues include, but are not limited to:

judicial expansion of policy coverage and the impact of new theories of liability;

plaintiffs targeting property and casualty insurers, including us, in purported class action litigation relating to claims-handling and other practices;

claims relating to construction defects, which often present complex coverage and damage valuation questions;

claims under directors' & officers' insurance policies relating to losses from involvement in financial market activities, such as mortgage or financial product origination, distribution, structuring or servicing and foreclosure procedures; failed financial institutions; fraud, including those related to investment management businesses; possible accounting irregularities; and corporate governance issues;

the assertion of "public nuisance" or similar theories of liability, pursuant to which plaintiffs seek to recover monies spent to administer public health care programs, abate hazards to public health and safety and/or recover damages purportedly attributable to a "public nuisance";

claims relating to molestation by an employee of an insured;

medical developments that link health issues to particular causes (for example, cumulative trauma), resulting in liability or workers' compensation claims;

claims relating to unanticipated consequences of current or new technologies; and

claims relating to potentially changing climate conditions, including higher frequency and severity of weather-related events.

In some instances, these emerging issues may not become apparent for some time after we have issued the affected insurance policies. As a result, the full extent of liability under our insurance policies may not be known for many years after the policies are issued.



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In addition, the potential passage of new legislation designed to expand the right to sue, to remove limitations on recovery, to deem by statute the existence of a covered occurrence, to extend the statutes of limitations or otherwise to repeal or weaken tort reforms could have an adverse impact on our business.

The effects of these and other unforeseen emerging claim and coverage issues are extremely hard to predict and could harm our business and materially and adversely affect our results of operations.

**The intense competition that we face could harm our ability to maintain or increase our business volumes and our profitability.** The property and casualty insurance industry is highly competitive, and we believe that it will remain highly competitive for the foreseeable future. We compete with both domestic and foreign insurers which may offer products at prices and on terms that are not consistent with our economic standards in an effort to maintain or increase their business. The competitive environment in which we operate could also be impacted by current general economic conditions, which could reduce the volume of business available to us as well as to our competitors. In addition, the competitive environment could be impacted by changes in customer preferences, including customer demand for direct distribution channels. See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation Outlook."

In Personal Insurance, the use of comparative rating technologies has impacted, and may continue to impact, our business as well as the industry as a whole. A substantial amount of the Company's Personal Insurance new business is written after an agent compares quotes using comparative rating technologies, a cost-efficient means of obtaining quotes from multiple companies. Because the use of this technology, whether by agents or directly by customers, facilitates the process of generating multiple quotes, the technology has increased price comparison on new business and, increasingly, on renewal business. It also has resulted in an increase in the level of quote activity and a lower percentage of quotes that result in new business from customers, and these trends may continue or accelerate. If we are not able to operate with a competitive cost structure or accurately estimate and price for claims and claim adjustment expenses, our underwriting margins could be adversely affected over time. Additionally, there is potential for similar technology to be used to access comparative rates for small commercial business. Agents, brokers or other third parties may also create alternate distribution channels for personal or commercial business, such as insurance exchanges, that may adversely impact product differentiation and pricing.

Other technological changes may present competitive risks. For example, innovations, such as telematics and other usage-based methods of determining premiums, can impact product design and pricing and may become an increasingly important competitive factor. Other potential technological changes, such as driverless cars, could disrupt the demand for our products from current customers, and we may not be able to respond effectively. In addition, our competitive position could be impacted by our ability to deploy, in a cost effective manner, technology that collects and analyzes a wide variety of data points (so-called "big data" analysis) to make underwriting or other decisions. See also "Our business success and profitability depend, in part, on effective information technology systems and on continuing to develop and implement improvements in technology" below.

In recent years, we have undertaken various actions to improve our underwriting margins on many of our insurance products, and competitive dynamics may impact the success of these efforts. These efforts include seeking improved rates, as well as improved terms and conditions, and also include other initiatives, such as reducing operating expenses and acquisition costs. These efforts may not be successful and/or may result in lower retention and new business levels and therefore lower business volumes. In addition, if our underwriting is not effective, efforts to increase rates could also lead to "adverse selection", whereby accounts retained have higher losses, and are less profitable, than accounts lost. For more detail, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation Outlook."

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In particular, in our Agency Automobile line of business, we have undertaken various actions to improve our underwriting margins, which have been negatively impacted by various factors. These factors include (i) changes in customer preferences and demand for direct distribution channels, (ii) utilization of comparative rating technologies by agents, (iii) other technological changes, as described above, and (iv) loss cost increases that have exceeded earned rate increases. If our strategies to increase profitability through the actions described above are not effective, we may need to explore other actions or initiatives to improve our competitive position and profitability in this line of business.

Overall, our competitive position in our various businesses is based on many factors, including but not limited to our:

ability to profitably price our business, retain existing customers and obtain new business;

premiums charged, contract terms and conditions, products and services offered (including the ability to design customized programs);

agent, broker and client relationships;

ability to keep pace relative to our competitors with changes in technology and information systems;

speed of claims payment;

ability to provide our products and services in a cost effective manner;

perceived overall financial strength and corresponding ratings assigned by independent rating agencies;

reputation, experience and qualifications of employees;

geographic scope of business; and

local presence.

We may have difficulty in continuing to compete successfully on any of these bases in the future. If competition limits our ability to retain existing business or write new business at adequate rates, our results of operations could be materially and adversely affected. See "Competition" sections of the discussion on business segments in "Item 1 Business."

**We may not be able to collect all amounts due to us from reinsurers and reinsurance coverage may not be available to us in the future at commercially reasonable rates or at all.** Although the reinsurer is liable to us to the extent of the ceded reinsurance, we remain liable as the direct insurer on all risks reinsured. As a result, ceded reinsurance arrangements do not eliminate our obligation to pay claims. Accordingly, we are subject to credit risk with respect to our ability to recover amounts due from reinsurers.

In the past, certain reinsurers have ceased writing business and entered into runoff. Some of our reinsurance claims may be disputed by the reinsurers, and we may ultimately receive partial or no payment. This is a particular risk in the case of claims that relate to insurance policies written many years ago, including those relating to asbestos and environmental claims. 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.

Included in reinsurance recoverables are certain amounts related to structured settlements. Structured settlements comprise annuities purchased from various life insurance companies to settle certain personal physical injury claims, of which workers' compensation claims comprise a significant



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portion. In cases where we did not receive a release from the claimant, the structured settlement is included in reinsurance recoverables as we retain the contingent liability to the claimant. In the event that the life insurance company fails to make the required annuity payments, we would be required to make such payments if and to the extent not paid by state guaranty associations.

Many reinsurance companies and life insurance companies were negatively impacted by the financial markets disruption and the economic downturn over the past several years. A number of these companies, including certain of those with which we conduct business or to which we otherwise have credit exposure, were downgraded by various rating agencies during this time period. For a discussion of our top reinsurance groups by reinsurance recoverable and the top five groups by amount of structured settlements provided, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Reinsurance Recoverables."

The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity. The availability of reinsurance capacity can be impacted by general economic conditions and conditions in the reinsurance market, such as the occurrence of significant reinsured events. The availability and cost of reinsurance could affect our business volume and profitability.

Because of the risks set forth above, we may not be able to collect all amounts due to us from reinsurers, and reinsurance coverage may not be available to us in the future at commercially reasonable rates or at all, and/or life insurance companies may fail to make required annuity payments, and thus our results of operations could be materially and adversely affected.

**We are exposed to credit risk in certain of our business operations.** In addition to exposure to credit risk related to our investment portfolio and reinsurance recoverables (discussed above), we are exposed to credit risk in several other areas of our business operations, including credit risk relating to policyholders, independent agents and brokers.

We are exposed to credit risk in our surety insurance operations, where we guarantee to a third party that our customer will satisfy certain performance obligations (e.g., a construction contract) or certain financial obligations. If a customer of ours defaults, we may suffer losses and not be reimbursed by that customer. In addition, it is customary practice in the surety business for multiple insurers to participate as co-sureties on large surety bonds. Under these arrangements, the co-surety obligations are typically joint and several, in which case we are also exposed to credit risk with respect to our co-sureties.

In addition, a portion of our business is written with large deductible insurance policies. Under workers' compensation insurance contracts with deductible features, we are obligated to pay the claimant the full amount of the claim. We are subsequently reimbursed by the contractholder for the deductible amount, and, as a result, we are exposed to credit risk to the policyholder. Moreover, certain policyholders purchase retrospectively rated workers' compensation policies (i.e., policies in which premiums are adjusted after the policy period based on the actual loss experience of the policyholder during the policy period). Retrospectively rated policies expose us to additional credit risk to the extent that the adjusted premium is greater than the original premium.

Our efforts to mitigate the credit risk that we have to our insureds may not be successful. To reduce such credit risk, we require certain insureds to post collateral for some or all of these obligations, often in the form of pledged securities such as money market funds or letters of credit provided by banks. In cases where we receive pledged securities and the insureds are unable to honor their obligations, we may be exposed to credit risk on the securities pledged and/or the risk that our access to that collateral may be stayed during an insured's bankruptcy. In cases where we receive letters of credit from banks and the insureds are unable to honor their obligations, we are exposed to the credit risk of the banks that issued the letters of credit.

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In accordance with industry practice, when policyholders purchase insurance policies from us through independent agents and brokers, the premiums relating to those policies are often paid to the agents and brokers for payment to us. In most jurisdictions, the premiums will be deemed to have been paid to us whether or not they are actually received by us. Consequently, we assume a degree of credit risk associated with amounts due from independent agents and brokers.

To a large degree, the credit risk we face is a function of the economy; accordingly, we face a greater risk in an economic downturn. While we attempt to manage the risks discussed above through underwriting and investment guidelines, collateral requirements and other oversight mechanisms, our efforts may not be successful. For example, collateral obtained may subsequently have little or no value. As a result, our exposure to the above credit risks could materially and adversely affect our results of operations.

**Within the United States, our businesses are heavily regulated by the states in which we conduct business, including licensing and supervision, and changes in regulation may reduce our profitability and limit our growth.** These regulatory systems are generally designed to protect the interests of policyholders, and not necessarily the interests of insurers, their shareholders and other investors. For example, to protect policyholders whose insurance company becomes financially insolvent, guaranty funds have been established in all 50 states to pay the covered claims of policyholders in the event of an insolvency of an insurer, subject to applicable state limits. The funding of guaranty funds is provided through assessments levied against remaining insurers in the marketplace. As a result, the insolvency of one or more insurance companies could result in additional assessments levied against us.

These regulatory systems also address authorization for lines of business, policyholders' surplus requirements, limitations on the types and amounts of certain investments, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and non-financial components of an insurer's business.

In recent years, the state insurance regulatory framework has come under increased scrutiny, and some state legislatures have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. Further, the NAIC and state insurance regulators continually reexamine existing laws and regulations, specifically focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws and regulations. In a time of financial uncertainty or a prolonged economic downturn or otherwise, regulators may choose to adopt more restrictive insurance laws and regulations. For example, insurance regulators may choose to restrict the ability of insurance subsidiaries to make payments to their parent companies or reject rate increases due to the economic environment. The state insurance regulators may also increase the statutory capital requirements for our insurance subsidiaries.

In addition, state tax laws that specifically impact the insurance industry, such as premium taxes or other taxes, may be enacted or changed by states to raise revenues.

State laws or regulations that are adopted or amended may be more restrictive than current laws or regulations and may result in lower revenues and/or higher costs of compliance and thus could materially and adversely affect our results of operations and limit our growth.

**Changes in federal regulation could impose significant burdens on us and otherwise adversely impact our results.** While the U.S. federal government has not historically 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



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holding companies, including insurance companies, if they are designated by a two-thirds vote of a Financial Stability Oversight Council (the Council) as "systemically important financial institutions" (SIFI). Based on rules and interpretive guidance adopted by the Council, we do not expect that we will be designated as a SIFI. Nonetheless, it is possible that the Council may change its rules or interpretations in the future and conclude that we are a SIFI. If we were designated as "systemically important," the Federal Reserve's supervisory authority could include the ability to impose heightened financial regulation and could impact requirements regarding our capital, liquidity and leverage as well as our business and investment conduct. As a result of the foregoing, the Dodd-Frank Act, or other additional federal regulation that is adopted in the future, could impose significant burdens on us, including impacting the ways in which we conduct our business, increasing compliance costs and duplicating state regulation, and could result in a competitive disadvantage, particularly relative to other insurers that may not be subject to the same level of regulation.

Even if we are not subject to additional regulation by the federal government, significant financial sector regulatory reform, including the Dodd-Frank Act, could have a significant impact on us. For example, regulatory reform could have an unexpected impact on our rights as a creditor or on our competitive position. In particular, the Dodd-Frank Act authorizes assessments to pay for the resolution of systemically important financial institutions that have become insolvent. We (as a financial company with more than \$50 billion in assets) could be assessed, and, although any such assessment is required to be risk weighted (i.e., riskier firms pay more), such costs could be material to us and are not currently estimable.

Other potential changes in U.S. federal legislation, regulation and/or administrative policies, including the potential repeal of the McCarran-Ferguson Act (which exempts insurance from most federal regulation) and potential changes in federal taxation, could also significantly harm the insurance industry, including us.

**A downgrade in our claims-paying and financial strength ratings could adversely impact our business volumes, adversely impact our ability to access the capital markets and increase our borrowing costs.** Claims-paying and financial strength ratings are important to an insurer's competitive position. Rating agencies periodically review insurers' ratings and change their ratings criteria; therefore, our current ratings may not be maintained in the future. A downgrade in one or more of our ratings could negatively impact our business volumes because demand for certain of our products may be reduced, particularly because many customers may require that we maintain minimum ratings to enter into or renew business with us. Additionally, we may find it more difficult to access the capital markets and we may incur higher borrowing costs. If significant losses, including, but not limited to, those resulting from one or more major catastrophes, or significant reserve additions or significant investment losses were to cause our capital position to deteriorate significantly, or if one or more rating agencies substantially increase their capital requirements, we may need to raise equity capital in the future (which we may not be able to do at a reasonable cost or at all, especially at a time of financial market disruption) in order to maintain our ratings or limit the extent of a downgrade. A continued trend of more frequent and severe weather-related catastrophes or a prolonged financial market disruption or economic downturn may lead rating agencies to substantially increase their capital requirements. See also "During or following a period of financial market disruption or economic downturn, our business could be materially and adversely affected." For further discussion about our ratings, see, "Item 1 Business Ratings."

**The inability of our insurance subsidiaries to pay dividends to our holding company in sufficient amounts would harm our ability to meet our obligations, pay future shareholder dividends or make future share repurchases.** Our holding company relies on dividends from our insurance subsidiaries to meet our obligations for payment of interest and principal on outstanding debt, to pay dividends to shareholders, to make contributions to our qualified domestic pension plan, to pay other corporate expenses and to make share repurchases. The ability of our insurance subsidiaries to pay dividends to

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our holding company in the future will depend on their statutory surplus, earnings and regulatory restrictions.

We are subject to regulation by some states as an insurance holding company system. Our insurance subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of insurance regulatory authorities. In a time of prolonged economic downturn or otherwise, regulators may choose to further restrict the ability of insurance subsidiaries to make payments to their parent companies. The ability of our insurance subsidiaries to pay dividends to our holding company is also restricted by regulations that set standards of solvency that must be met and maintained.

The inability of our insurance subsidiaries to pay dividends to our holding company in an amount sufficient to meet our debt service obligations and other cash requirements could harm our ability to meet our obligations, to pay future shareholder dividends and to make share repurchases.

**Disruptions to our relationships with our independent agents and brokers could adversely affect us.** We market our insurance products primarily through independent agents and brokers. An important part of our business is written through less than a dozen such intermediaries. Further, there has been a trend of increased consolidation by agents and brokers, which could impact our relationships with and fees paid to some agents and brokers. Loss of all or a substantial portion of the business provided through such agents and brokers could materially and adversely affect our future business volume and results of operations.

We may also seek to develop new product distribution channels, including our current efforts to establish a direct-to-consumer platform in the Personal Insurance segment. In addition, agents and brokers may create alternate distribution channels for commercial business, such as insurance exchanges, that may adversely impact product differentiation and pricing. Our efforts or their efforts with respect to alternate distribution channels could adversely impact our business relationship with independent agents and brokers who currently market our products, resulting in a lower volume of business generated from these sources.

We rely on internet applications for the marketing and sale of certain of our products, and we may increasingly rely on internet applications and toll-free numbers for distribution. In some instances, our agents and brokers are required to access separate business platforms to execute the sale of our personal insurance or commercial insurance products. Should internet disruptions occur, or frustration with our business platforms or distribution initiatives develop among our independent agents and brokers, any resulting loss of business could materially and adversely affect our future business volume and results of operations. See "If we experience difficulties with technology, data security and/or outsourcing relationships, our ability to conduct our business could be negatively impacted" below.

**Our efforts to develop new products or expand in targeted markets may not be successful and may create enhanced risks.** A number of our recent and planned business initiatives involve developing new products or expanding existing products in targeted markets. This includes the following efforts, from time to time, to protect or grow market share:

We may develop products that insure risks we have not previously insured or contain new coverage or coverage terms.

We may refine our underwriting processes. For example, in certain of our businesses in recent years, we have substantially increased the volume of business that flows through our automated underwriting and pricing systems.

We may seek to expand distribution channels, such as our efforts to develop a direct-to-consumer platform in Personal Insurance.

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We may focus on geographic markets within or outside of the United States where we have had relatively little or no market share.

We may not be successful in introducing new products or expanding in targeted markets and, even if we are successful, these efforts may create enhanced risks. Among other risks:

Demand for new products or in new markets may not meet our expectations.

To the extent we are able to market new products or expand in new markets, our risk exposures may change, and the data and models we use to manage such exposures may not be as sophisticated as those we use in existing markets or with existing products. This, in turn, could lead to losses in excess of our expectations.

Models underlying automated underwriting and pricing decisions may not be effective.

Efforts to develop new products or markets have the potential to create or increase distribution channel conflict, such as described above under " Disruptions to our relationships with our independent agents and brokers could adversely affect us."

In connection with the conversion of existing policyholders to a new product, some policyholders' pricing may increase, while the pricing for other policyholders may decrease, the net impact of which could negatively impact retention and margins.

To develop new products or markets, we may need to make substantial capital and operating expenditures, which may also negatively impact results in the near term.

If our efforts to develop new products or expand in targeted markets are not successful, our results of operations could be materially and adversely affected.

**Changes in U.S. tax laws or in the tax laws of other jurisdictions in which we operate could adversely impact us.** Tax laws may change in ways that adversely impact us. For example, federal tax legislation could be enacted to reduce the existing statutory U.S. federal corporate income tax rate from 35%, which would, accordingly, reduce any U.S. deferred tax asset. The amount of any net deferred tax asset is volatile and significantly impacted by changes in unrealized investment gains and losses. The effect of a reduction in a tax rate on net deferred tax assets is required to be recognized, in full, as a reduction of income from continuing operations in the period when enacted and, along with other changes in the tax rules that may increase the Company's actual tax expense, could materially and adversely affect our results of operations.

Our investment portfolio has benefited from tax exemptions and certain other tax laws, including, but not limited to, those governing dividends-received deductions and tax credits (such as foreign tax credits). Federal and/or state tax legislation could be enacted in connection with deficit reduction or various types of fundamental tax reform that would lessen or eliminate some or all of the tax advantages currently benefiting us and therefore could materially and adversely impact our results of operations. In addition, such legislation could adversely affect the value of our investment portfolio, particularly changes to the taxation of interest from municipally bonds (which comprise 52% of our investment portfolio as of December 31, 2012) could materially and adversely impact the value of those bonds.

Other tax law changes could adversely impact us. The size of the federal deficit, as well as the budget constraints faced by many states and localities, increases the likelihood that Congress and state and local governments will raise revenue by enacting legislation increasing the taxes paid by individuals and corporations.

**We may be adversely affected if our pricing and capital models provide materially different indications than actual results.** The profitability of our property and casualty business substantially depends on the extent to which our actual claims experience is consistent with the assumptions we use



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in pricing our policies. We utilize third-party and proprietary models to help us price business in a manner that is intended to be consistent, over time, with actual results and return objectives. We incorporate the Company's historical loss experience, external industry data and economic indices into our modeling processes, and we use various methods, including predictive modeling, forecasting and sophisticated simulation modeling techniques, to analyze loss trends and the risks associated with our assets and liabilities. We also use these modeling processes, analyses and methods in making underwriting, pricing and reinsurance decisions as part of managing our exposure to catastrophes and other extreme adverse events. These modeling processes incorporate numerous assumptions and forecasts about the future level and variability of: interest rates, inflation, capital requirements, and frequency and severity of losses, among others, that are difficult to make and may differ materially from actual results.

Whether we use a proprietary or third-party model, future experience may be materially different from past and current experience incorporated in a model's forecasts or simulations. This includes the likelihood of events occurring or continuing or the correlation among events. Third party models may provide substantially different indications than what our proprietary modeling processes provide. As a result, third-party model estimates of losses can be, and often have been, materially different for similar events in comparison to our proprietary estimates. The differences between third-party model estimates and our proprietary estimates are driven by the use of different data sets as well as different assumptions and forecasts regarding the frequency and severity of events and claims arising from the events.

If we fail to appropriately price the risks we insure, or fail to change our pricing model to appropriately reflect our current experience, or if our claims experience is more frequent or severe than our underlying risk assumptions, our profit margins may be negatively affected. If we underestimate the frequency and/or severity of extreme adverse events occurring, our financial condition may be adversely affected. If we overestimate the risks we are exposed to, we may overprice our products, and new business growth and retention of our existing business may be adversely affected. As we expand into different markets and geographies, we will write more policies in markets and geographical areas where we have less data specific to these new markets and geographies, and, accordingly, we may be more susceptible to error in our models and strategy. See "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Catastrophe Modeling."

**Our business success and profitability depend, in part, on effective information technology systems and on continuing to develop and implement improvements in technology.** We depend in large part on our technology systems for conducting business and processing claims, as well as for providing the data and analytics we utilize to manage our business, and thus our business success is dependent on maintaining the effectiveness of existing technology systems and on continuing to develop and enhance technology systems that support our business processes and strategic initiatives in a cost and resource efficient manner. Some system development projects are long-term in nature, may negatively impact our expense ratios as we invest in the projects and may cost more than we expect to complete. In addition, system development projects may not deliver the benefits we expect once they are complete, or may be replaced or become obsolete more quickly than expected, which could result in accelerated recognition of expenses. If we do not effectively and efficiently manage and upgrade our technology portfolio, or if the costs of doing so are higher than we expect, our ability to provide competitive services to new and existing customers in a cost effective manner and our ability to implement our strategic initiatives could be adversely impacted.

**If we experience difficulties with technology, data security and/or outsourcing relationships, our ability to conduct our business could be negatively impacted.** While technology can streamline many business processes and ultimately reduce the cost of operations, technology initiatives present significant risks. Our business is highly dependent upon our employees' ability to perform, in an efficient and uninterrupted fashion, necessary business functions. A shut-down of, or inability to access, one or more

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of our facilities (including our primary data processing facility); a power outage; or a failure of one or more of our information technology, telecommunications or other systems could significantly impair our ability to perform such functions on a timely basis, particularly if such an interruption lasts for an extended period of time. In the event of a disaster such as a natural catastrophe, terrorist attack or industrial accident, or due to a computer virus, our systems could be inaccessible for an extended period of time. In addition, because our information technology and telecommunications systems increasingly interface with and depend on third-party systems, we could experience service denials or failures of controls if demand for our service exceeds capacity or a third-party system fails or experiences an interruption. If our business continuity plans did not sufficiently address such a business interruption, system failure or service denial, this could result in a deterioration of our ability to write and process new and renewal business, provide customer service, pay claims in a timely manner or perform other necessary business functions.

Our operations rely on the reliable and secure processing, storage and transmission of confidential and other information in our computer systems and networks. Computer viruses, hackers, employee misconduct and other external hazards could expose our data systems to security breaches, cyber-attacks or other disruptions. In addition, we routinely transmit and receive personal, confidential and proprietary information by e-mail and other electronic means. While we attempt to develop secure transmission capabilities with third-party vendors and others with whom we do business, we may be unable to put in place secure capabilities with all of such vendors and third parties and, in addition, these third parties may not have appropriate controls in place to protect the confidentiality of the information.

Our computer systems have been and will likely continue to be, subject to computer viruses or other malicious codes, unauthorized access, cyber-attacks or other computer-related penetrations. While, to date, we are not aware that we have experienced a material breach of cyber security, administrative and technical controls as well as other preventative actions we take to reduce the risk of cyber incidents and protect our information may be insufficient to prevent physical and electronic break-ins, cyber-attacks or other security breaches to our computer systems or those of third parties with whom we do business. In addition, new technology that could result in greater operational efficiency may further expose our computer systems to the risks of cyber-attacks. We may forego the implementation of such new technology to limit this additional risk.

These increased risks, and expanding regulatory requirements regarding data security, could expose us to data loss, disruption of service, monetary and reputational damages and significant increases in compliance costs and costs to improve the security and resiliency of our computer systems. As a result, our ability to conduct our business might be adversely affected.

We have increasingly outsourced certain technology and business process functions to third parties and may continue to do so in the future. If we do not effectively develop, implement and monitor our outsourcing relationships, third party providers do not perform as anticipated or we experience technological or other problems with a transition, we may not realize expected productivity improvements or cost efficiencies and may experience operational difficulties, increased costs and a loss of business. Our outsourcing of certain technology and business process functions to third parties may expose us to increased risk related to data security or service disruptions, which could result in monetary and reputational damages. In addition, our ability to receive services from third party providers outside of the United States might be impacted by cultural differences, political instability, unanticipated regulatory requirements or policies inside or outside of the United States. As a result, our ability to conduct our business might be adversely affected.

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**We are subject to a number of risks associated with our business outside the United States.** We conduct business outside the United States primarily in the United Kingdom, Canada and the Republic of Ireland. In addition, we have a joint venture in Brazil and may also explore opportunities in other countries, including Latin American countries and other emerging markets such as India and China.

While our business outside of the United States currently constitutes a relatively small portion of our revenues, in conducting such business we are subject to a number of significant risks, particularly in emerging economies. These risks include restrictions such as price controls, capital controls, currency exchange limits, ownership limits and other restrictive or anti-competitive governmental actions, which could have an adverse effect on our business and our reputation. Our investments outside the United States may also subject us to currency risk and, in some markets, it may be difficult to effectively hedge that risk. In addition, in some markets, we may invest as part of a joint venture with a local counterparty. Because our governance rights may be limited, we may not have control over the ability of the joint venture to make certain decisions and/or mitigate risks it faces, and significant disagreements with a joint venture counterparty may adversely impact our investment. Investments outside the United States also subject us to additional domestic and foreign laws and regulations, including the Foreign Corrupt Practices Act and similar laws in other countries that prohibit the making of improper payments to foreign officials. Although we have policies and controls in place that are designed to ensure compliance with these laws, if those controls are ineffective and an employee or intermediary fails to comply with applicable laws and regulations, we could suffer civil and criminal penalties and our business and our reputation could be adversely affected. Some countries, particularly emerging economies, have laws and regulations that lack clarity and, even with local expertise and effective controls, it can be difficult to determine the exact requirements of, and potential liability under, the local laws. For example, in some jurisdictions, including Brazil, parties to a joint venture may, in some circumstances, have liability for some obligations of the venture and that liability may extend beyond the capital invested. Failure to comply with local laws in a particular market may result in substantial liability and could have a significant and negative effect not only on our business in that market but also on our reputation generally.

**New regulations outside of the U.S., including in the European Union, could adversely impact our results of operations and limit our growth.** Insurance laws or regulations that are adopted or amended in jurisdictions outside the U.S. may be more restrictive than current laws or regulations and may result in lower revenues and/or higher costs of compliance and thus could materially and adversely affect our results of operations and limit our growth.

In particular, 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 our businesses in the European Union beginning as soon as January 1, 2014; however, the effective implementation date may be delayed. Under Solvency II, it is possible that the direct or indirect parent of a European Union subsidiary (including a U.S. parent company) could be subject to certain Solvency II requirements if the regulator determines that the subsidiary's capital position is dependent on an affiliated or parent company and the affiliated or parent company is not already subject to regulations deemed "equivalent" to Solvency II. In addition, regulators in countries where we have operations are working with the International Association of Insurance Supervisors (IAIS) (and in the U.S., with the NAIC) to consider changes to insurance company supervision, including group supervision.

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

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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.

While it is not yet known how these actions will impact us, such regulation could result in increased costs of compliance, increased disclosure and less flexibility in our capital management.

**Acquisitions and integration of acquired businesses may result in operating difficulties and other unintended consequences.** From time to time we may investigate and pursue acquisition opportunities if we believe that such opportunities are consistent with our long-term objectives and that the potential rewards of an acquisition justify the risks. The process of integrating an acquired company or business can be complex and costly, however, and may create unforeseen operating difficulties and expenditures. For example, acquisitions may present significant risks, including:

the potential disruption of our ongoing business;

the ineffective integration of underwriting, claims handling and actuarial practices;

the uncertainty of an acquiree's reserve estimates;

the diversion of management time and resources to acquisition integration challenges;

the loss of key employees;

the cultural challenges associated with integrating employees; and

the impact of an acquisition on our financial position and/or credit ratings.

The acquired business may not perform as projected, and any cost savings and other synergies anticipated from the acquisition may not materialize. There is no guarantee that any businesses acquired in the future will be successfully integrated, and the ineffective integration of our businesses and processes may result in substantial costs or delays and adversely affect our ability to compete.

**Changes to existing accounting standards may adversely impact our reported results.** As a U.S.-based SEC reporting company, we are currently required to prepare our financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP), as promulgated by the Financial Accounting Standards Board (FASB). During the last several years, the Securities and Exchange Commission (SEC) has been evaluating whether, when and how International Financial Reporting Standards (IFRS) should be incorporated into the U.S. financial reporting system, including for companies such as us. The FASB and the International Accounting Standards Board (IASB) have also embarked on a long-term project to converge GAAP and IFRS. Additionally, the IASB and the FASB are in the process of developing a global insurance standard that may involve methodologies for valuing insurance contract liabilities that may be significantly different from the methodologies required by current GAAP. In June 2012, the FASB issued a statement that indicated that based on the nature and totality of differences between the FASB's and IASB's views, it is not likely that the two boards will achieve convergence on this project. The FASB further noted that the FASB and IASB have very different perspectives on the project, given that the U.S. has existing guidance on insurance contracts whereas there is currently no comprehensive IFRS insurance standard for insurance contracts. As a result of this, it is currently unclear what changes, if any, may be made to the accounting for insurance contracts under GAAP as a result of this project, and we are not able to predict whether we will choose to, or be required to, adopt IFRS or how the adoption of IFRS (or the convergence of GAAP and IFRS, including the project for valuing insurance contract liabilities) may impact our financial statements in the future. Changes in accounting standards, particularly those that specifically apply to insurance company operations, may impact the content and presentation of our reported financial results and could have adverse consequences to our reported financial results, including lower reported results of operations and shareholders' equity and increased volatility and decreased comparability of our reported results with other insurers.



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**We could be adversely affected if our controls designed to ensure compliance with guidelines, policies and legal and regulatory standards are not effective.** Our business is highly dependent on our ability to engage on a daily basis in a large number of insurance underwriting, claim processing and investment activities, many of which are highly complex. These activities often are subject to internal guidelines and policies, as well as legal and regulatory standards. A control system, no matter how well designed and operated, can provide only reasonable assurance that the control system's objectives will be met. If our controls are not effective, it could lead to financial loss, unanticipated risk exposure (including underwriting, credit and investment risk) or damage to our reputation.

In addition, ineffective controls could lead to litigation or regulatory action. The volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against various types of financial institutions have increased in recent years following the recent economic downturn and market disruption. Substantial legal liability or significant regulatory action against us could have a material adverse financial impact. See note 16 of notes to our consolidated financial statements for a discussion of certain legal proceedings in which we are involved.

**Our businesses may be adversely affected if we are unable to hire and retain qualified employees.** There is significant competition from within the property and casualty insurance industry and from businesses outside the industry for qualified employees, especially those in key positions and those possessing highly specialized underwriting knowledge. Our performance is largely dependent on the talents, efforts and proper conduct of highly-skilled individuals, including our senior executives, many of whom have decades of experience in the insurance industry. See "Item 10 Directors, Executive Officers and Corporate Governance" for more information relating to our executive officers. Our continued ability to compete effectively in our businesses and to expand into new business areas depends on our ability to attract new employees and to retain and motivate our existing employees. If we are not able to successfully attract, retain and motivate our employees, our business, financial results and reputation could be materially and adversely affected.

**Loss of or significant restriction on the use of credit scoring in the pricing and underwriting of Personal Insurance products could reduce our future profitability.** In Personal Insurance, we use credit scoring as a factor in pricing decisions where allowed by state law. Some consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against people with low incomes, minority groups and the elderly and are calling for the prohibition or restriction on the use of credit scoring in underwriting and pricing. Laws or regulations that significantly curtail the use of credit scoring, if enacted in a large number of states, could adversely affect our future profitability.

**Item 1B. UNRESOLVED STAFF COMMENTS**

NONE.

**Item 2. PROPERTIES**

The Company leases its principal executive offices in New York, New York, as well as 200 field and claim offices totaling approximately 4.8 million square feet throughout the United States under leases or subleases with third parties. The Company also leases offices in the United Kingdom, Canada, India, China, Singapore and the Republic of Ireland that house operations (primarily for the Financial, Professional & International Insurance segment) in those locations. The Company owns six buildings in Hartford, Connecticut, consisting of approximately 1.8 million square feet of office space. The Company also owns office buildings located at 385 Washington Street and 130 West Sixth Street in St. Paul, Minnesota. These buildings are adjacent to one another and consist of approximately 1.1 million square feet of gross floor space. The Company also owns other real property, including an office building in Fall River, Massachusetts, and a data center located in Norcross, Georgia.

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The Company owns a building in London, England, which houses a portion of its Financial, Professional & International Insurance segment's operations in the United Kingdom.

The Company, through its subsidiaries, owns an investment portfolio of income-producing properties and real estate funds. Included in this portfolio are four office buildings in which the Company holds a 50% ownership interest located in New York, New York, which collectively accounted for approximately 12% of the carrying value of the property portfolio at December 31, 2012.

In the opinion of the Company's management, the Company's properties are adequate and suitable for its business as presently conducted and are adequately maintained.

**Item 3. LEGAL PROCEEDINGS**

The information required with respect to this item can be found under "Contingencies" in note 16 of notes to the Company's consolidated financial statements in this annual report and is incorporated by reference into this Item 3.

**Item 4. MINE SAFETY DISCLOSURES**

NONE.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

Information about the Company's executive officers is incorporated by reference from Part III, Item 10 of this annual report.

Table of Contents**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Company's common stock is traded on the New York Stock Exchange under the symbol "TRV." The number of holders of record, including individual owners, of the Company's common stock was 65,297 as of February 11, 2013. This is not the actual number of beneficial owners of the Company's common stock, as shares are held in "street name" by brokers and others on behalf of individual owners. The following table sets forth the high and low closing sales prices of the Company's common stock for each quarter during the last two fiscal years and the amount of cash dividends declared per share.

	High	Low	Cash Dividend Declared
<b>2012</b>			
First Quarter	\$ 61.59	\$ 56.87	\$ 0.41
Second Quarter	64.77	57.75	0.46
Third Quarter	68.61	60.89	0.46
Fourth Quarter	74.33	68.07	0.46
<b>2011</b>			
First Quarter	\$ 60.92	\$ 53.33	\$ 0.36
Second Quarter	64.05	56.68	0.41
Third Quarter	59.11	47.12	0.41
Fourth Quarter	59.68	46.80	0.41

The Company paid cash dividends per share of \$1.79 in 2012 and \$1.59 in 2011. Future dividend decisions will be based on, and affected by, a number of factors, including the operating results and financial requirements of the Company and the impact of dividend restrictions. For information on dividends, as well as restrictions on the ability of certain of the Company's subsidiaries to transfer funds to the Company in the form of cash dividends or otherwise, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources." Dividends will be paid by the Company only if declared by its board of directors out of funds legally available, and subject to any other restrictions that may be applicable to the Company.

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**SHAREHOLDER RETURN PERFORMANCE GRAPH**

The following graph shows a five-year comparison of the cumulative total return to shareholders for the Company's common stock and the common stock of companies included in the S&P 500 Index and the S&P Property & Casualty Insurance Index, which the Company believes is the most appropriate comparative index.

**COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN TO SHAREHOLDERS(1)**

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- (1) The cumulative return to shareholders is a concept used to compare the performance of a company's stock over time and is the ratio of the net stock price change plus the cumulative amount of dividends over the specified time period (assuming dividend reinvestment), to the stock price at the beginning of the time period.
- (2) Assumes \$100 invested in common shares of The Travelers Companies, Inc. on December 31, 2007.
- (3) Companies in the S&P Property-Casualty Index as of December 31, 2012 were the following: The Travelers Companies, Inc., The Chubb Corporation, Cincinnati Financial Corporation, Progressive Corporation, Allstate Corporation, XL Group, plc., ACE Ltd. and Berkshire Hathaway, Inc.

Returns of each of the companies included in this index have been weighted according to their respective market capitalizations.



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The table below sets forth information regarding repurchases by the Company of its common stock during the periods indicated.

<b>Period Beginning</b>	<b>Period Ending</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced plans or programs</b>	<b>Approximate dollar value of shares that may yet be purchased under the plans or programs</b>
Oct. 1, 2012	Oct. 31, 2012	1,552,888	\$ 71.30	1,547,146	\$ 2,448,899,277
Nov. 1, 2012	Nov. 30, 2012	15,152	\$ 70.93		\$ 2,448,899,277
Dec. 1, 2012	Dec. 31, 2012	3,937,605	\$ 73.66	3,932,635	\$ 2,159,219,303
<b>Total</b>		5,505,645	\$ 72.99	5,479,781	\$ 2,159,219,303

The Company's board of directors has approved common share repurchase authorizations under which repurchases may be made from time to time in the open market, pursuant to pre-set trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934, in private transactions or otherwise. The authorizations do not have a stated expiration date. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including the Company's financial position, earnings, common share price, catastrophe losses, funding of the Company's qualified pension plan, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, other investment opportunities (including mergers and acquisitions), market conditions and other factors.

The Company acquired 25,864 shares during the three months ended December 31, 2012 that were not part of the publicly announced share repurchase authorization. These shares consisted of shares retained to cover payroll withholding taxes in connection with the vesting of restricted stock awards and shares used by employees to cover the exercise price of certain stock options that were exercised.

Information relating to compensation plans under which the Company's equity securities are authorized for issuance is set forth in Part III Item 12 of this Report.

Table of Contents**Item 6. SELECTED FINANCIAL DATA**

	At and for the year ended December 31,				
	2012	2011	2010	2009	2008
	(in millions, except per share amounts)				
Total revenues	\$ 25,740	\$ 25,446	\$ 25,112	\$ 24,680	\$ 24,477
Net income	\$ 2,473	\$ 1,426	\$ 3,216	\$ 3,622	\$ 2,924
Total investments	\$ 73,838	\$ 72,701	\$ 72,722	\$ 74,965	\$ 70,738
Total assets	104,938	104,575	105,631	110,013	110,088
Claims and claim adjustment expense reserves	50,922	51,392	51,581	53,580	55,179
Total long-term debt	5,750	6,255	6,502	6,154	5,939
Total liabilities	79,533	80,098	80,156	82,598	84,769
Total shareholders' equity	25,405	24,477	25,475	27,415	25,319
<b>Net income per share(1):</b>					
Basic	\$ 6.35	\$ 3.40	\$ 6.69	\$ 6.38	\$ 4.87
Diluted	\$ 6.30	\$ 3.36	\$ 6.62	\$ 6.33	\$ 4.81
Year-end common shares outstanding	377.4	392.8	434.6	520.3	585.1
Per common share amounts:					
Cash dividends	\$ 1.79	\$ 1.59	\$ 1.41	\$ 1.23	\$ 1.19
Book value	\$ 67.31	\$ 62.32	\$ 58.47	\$ 52.54	\$ 43.12

(1)

On January 1, 2009, the Company adopted the FASB's updated accounting guidance related to earnings per share. The impact of the adoption of this guidance was a reduction of previously reported basic and diluted earnings per share for the year ended December 31, 2008 by \$0.03 per share and \$0.01 per share, respectively.

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**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion and analysis of the Company's financial condition and results of operations.

**FINANCIAL HIGHLIGHTS**

**2012 Consolidated Results of Operations**

Net income of \$2.47 billion, or \$6.35 per share basic and \$6.30 diluted

Net earned premiums of \$22.36 billion

Catastrophe losses of \$1.86 billion (\$1.21 billion after-tax)

Net favorable prior year reserve development of \$940 million (\$622 million after-tax)

GAAP combined ratio of 97.1%

Net investment income of \$2.89 billion (\$2.32 billion after-tax)

Operating cash flows of \$3.23 billion

**2012 Consolidated Financial Condition**

Total investments of \$73.84 billion; fixed maturities and short-term securities comprise 93% of total investments

Total assets of \$104.94 billion

Total debt of \$6.35 billion, resulting in a debt-to-total capital ratio of 20.0% (22.2% excluding net unrealized investment gains, net of tax)

Repurchased 22.4 million common shares for total cost of \$1.45 billion under share repurchase authorization

Shareholders' equity of \$25.41 billion

Book value per common share of \$67.31

Holding company liquidity of \$2.03 billion





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(for the year ended December 31, in millions except per share amounts)	2012	2011	2010
<b>Revenues</b>			
Premiums	\$ 22,357	\$ 22,090	\$ 21,432
Net investment income	2,889	2,879	3,059
Fee income	323	296	287
Net realized investment gains	51	55	264
Other revenues	120	126	70
<b>Total revenues</b>	<b>25,740</b>	<b>25,446</b>	<b>25,112</b>
<b>Claims and expenses</b>			
Claims and claim adjustment expenses	14,676	16,276	13,210
Amortization of deferred acquisition costs	3,910	3,876	3,802
General and administrative expenses	3,610	3,556	3,406
Interest expense	378	386	388
<b>Total claims and expenses</b>	<b>22,574</b>	<b>24,094</b>	<b>20,806</b>
<b>Income before income taxes</b>	<b>3,166</b>	<b>1,352</b>	<b>4,306</b>
Income tax expense (benefit)	693	(74)	1,090
<b>Net income</b>	<b>\$ 2,473</b>	<b>\$ 1,426</b>	<b>\$ 3,216</b>
<b>Net income per share</b>			
Basic	\$ 6.35	\$ 3.40	\$ 6.69
Diluted	\$ 6.30	\$ 3.36	\$ 6.62
<b>GAAP combined ratio</b>			
Loss and loss adjustment expense ratio	64.9%	72.9%	61.0%
Underwriting expense ratio	32.2	32.2	32.2
<b>GAAP combined ratio</b>	<b>97.1%</b>	<b>105.1%</b>	<b>93.2%</b>
<b>Incremental impact of direct to consumer initiative on GAAP combined ratio</b>	<b>0.8%</b>	<b>0.9%</b>	<b>0.8%</b>

The following discussions of the Company's net income and segment operating income (loss) are presented on an after-tax basis. Discussions of the components of net income and segment operating income are presented on a pretax basis, unless otherwise noted. Discussions of earnings per common share are presented on a diluted basis.

*Overview*

Diluted net income per share in 2012 was \$6.30, an increase of 88% over diluted net income per share of \$3.36 in 2011. Net income in 2012 was \$2.47 billion, an increase of 73% over net income of \$1.43 billion in 2011. The higher rate of increase in diluted net income per share reflected the impact of common share repurchases. The improvement in net income in 2012 compared with 2011 primarily reflected the pretax impact of (i) higher underwriting margins excluding catastrophe losses and prior year reserve development ("underlying underwriting margins") primarily resulting from lower non-catastrophe weather-related losses in the Business Insurance and Personal Insurance segments and the impact of earned pricing that exceeded loss cost trends in the Business Insurance and Financial, Professional & International Insurance segments, (ii) a decline in catastrophe losses and (iii) higher net favorable prior year reserve development. Partially offsetting these pretax improvements were their



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related tax expense. The effective tax rate in 2012 increased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a lower percentage of pretax income. Net income in 2011 benefited from a reduction in income tax expense of \$104 million resulting from the favorable resolution of various prior year tax matters. Catastrophe losses in 2012 were \$1.86 billion, compared with \$2.56 billion in 2011. Net favorable prior year reserve development in 2012 was \$940 million, compared with \$715 million in 2011.

Diluted net income per share in 2011 was \$3.36, a decrease of 49% from diluted net income per share of \$6.62 in 2010. Net income in 2011 was \$1.43 billion, a decrease of 56% from net income of \$3.22 billion in 2010. The lower rate of decline in diluted net income per share reflected the impact of common share repurchases. The decline in net income in 2011 compared with 2010 primarily reflected the pretax impact of (i) a significant increase in catastrophe losses, (ii) lower net favorable prior year reserve development, (iii) lower underlying underwriting margins related to earned pricing and loss cost trends and higher non-catastrophe weather-related losses, (iv) lower net investment income and (v) lower net realized investment gains. Partially offsetting these pretax declines were their related tax benefit. The effective tax rate in 2011 decreased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a higher percentage of pretax income. These factors were partially offset by a \$104 million benefit resulting from the favorable resolution of various prior year tax matters. Catastrophe losses in 2011 and 2010 were \$2.56 billion and \$1.11 billion, respectively. Net favorable prior year reserve development in 2011 and 2010 was \$715 million and \$1.25 billion, respectively.

**Revenues***Earned Premiums*

Earned premiums in 2012 were \$22.36 billion, \$267 million or 1% higher than in 2011. In the Business Insurance segment, earned premiums in 2012 increased by 3% over 2011. In the Financial, Professional & International Insurance segment, earned premiums in 2012 decreased by 4% from 2011. In the Personal Insurance segment, earned premiums in 2012 increased by less than 1% over 2011.

Earned premiums in 2011 were \$22.09 billion, \$658 million or 3% higher than in 2010. In the Business Insurance segment, earned premiums in 2011 increased by 5% over 2010. In the Financial, Professional & International Insurance segment, earned premiums in 2011 decreased by 4% from 2010. In the Personal Insurance segment, earned premiums in 2011 increased by 3% over 2010.

Factors contributing to the changes in earned premiums in each segment in 2012 and 2011 compared with the respective prior year are discussed in more detail in the segment discussions that follow.

*Net Investment Income*

The following table sets forth information regarding the Company's investments.

<b>(for the year ended December 31, in millions)</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Average investments(1)	\$ 69,863	\$ 70,471	\$ 71,637
Pretax net investment income	2,889	2,879	3,059
After-tax net investment income	2,316	2,330	2,468
Average pretax yield(2)	4.1%	4.1%	4.3%
Average after-tax yield(2)	3.3%	3.3%	3.4%

- (1) Excludes net unrealized investment gains and losses, net of tax, and reflects cash, receivables for investment sales, payables on investment purchases and accrued investment income.

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- (2) Excludes net realized investment gains and losses and net unrealized investment gains and losses.

Net investment income in 2012 was \$2.89 billion, \$10 million or less than 1% higher than in 2011. Net investment income from fixed maturity investments was \$2.44 billion in 2012, a decrease of \$104 million from 2011, primarily resulting from lower long-term reinvestment yields available in the market. Net investment income generated by non-fixed maturity investments was \$476 million in 2012, an increase of \$121 million over 2011, primarily driven by improved results from the Company's real estate partnerships and hedge fund investments. On an after-tax basis, net investment income in 2012 was \$14 million or less than 1% lower than in 2011, reflecting a higher proportion of taxable net investment income in 2012 compared with 2011.

Net investment income in 2011 was \$2.88 billion, \$180 million or 6% lower than in 2010. Net investment income from fixed maturity investments was \$2.54 billion in 2011, a decrease of \$167 million from 2010, primarily resulting from lower long-term reinvestment yields available in the market, as well as lower average levels of fixed maturity invested assets due to the Company's common share repurchases. Net investment income generated by non-fixed maturity investments was \$355 million in 2011, a decrease of \$15 million from 2010.

*Fee Income*

The National Accounts market in the Business Insurance segment is the primary source of the Company's fee-based business. The \$27 million and \$9 million increases in fee income in 2012 and 2011, respectively, compared with the respective prior years are described in the Business Insurance segment discussion that follows.

*Net Realized Investment Gains*

The following table sets forth information regarding the Company's net pretax realized investment gains.

(for the year ended December 31, in millions)	2012	2011	2010
<b>Net Realized Investment Gains</b>			
Other-than-temporary impairment losses	(15)	(25)	(26)
Other net realized investment gains	66	80	290
<b>Net realized investment gains</b>	<b>\$ 51</b>	<b>\$ 55</b>	<b>\$ 264</b>

*Other Net Realized Investment Gains* Other net realized investment gains in 2012 of \$66 million were primarily driven by \$61 million of net realized investment gains related to fixed maturity investments, \$19 million of net realized investment gains related to real estate and \$8 million of net realized investment gains related to equity securities. These net realized investment gains were partially offset by \$14 million of net realized investment losses associated with U.S. Treasury futures contracts (which require daily mark-to-market settlement and are used to shorten the duration of the Company's fixed maturity portfolio) and \$8 million of net realized investment losses related to other investments.

Other net realized investment gains in 2011 of \$80 million were primarily driven by \$52 million of net realized investment gains related to fixed maturity investments, \$46 million of net realized investment gains related to equity securities and \$41 million of net realized investment gains related to other investments, partially offset by net realized investment losses of \$62 million associated with U.S. Treasury futures contracts.

Other net realized investment gains in 2010 of \$290 million were primarily driven by a \$205 million gain resulting from the Company's sale of substantially all of its remaining common stock holdings in Verisk Analytics, Inc. (Verisk) for total proceeds of approximately \$230 million as part of a secondary public offering of Verisk. The 2010 total also included \$96 million of net realized investment gains

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related to fixed maturity investments and \$25 million of net realized investment gains related to equity securities. These gains were partially offset by \$30 million of net realized investment losses related to U.S. Treasury futures contracts.

*Other Revenues*

Other revenues primarily consist of premium installment charges. In 2010, this category also included \$60 million of expenses related to the Company's purchase and retirement of \$885 million of its \$1.0 billion 6.25% fixed-to-floating rate junior subordinated debentures.

**Claims and Expenses**

*Claims and Claim Adjustment Expenses*

Claims and claim adjustment expenses in 2012 were \$14.68 billion, \$1.60 billion or 10% lower than in 2011. The decrease primarily reflected (i) a decline in catastrophe losses and, to a lesser extent, (ii) lower levels of non-catastrophe weather-related losses and (iii) higher net favorable prior year reserve development, partially offset by (iv) the impact of loss cost trends. Catastrophe losses in 2012 and 2011 were \$1.86 billion and \$2.56 billion, respectively. Catastrophe losses in 2012 primarily resulted from Storm Sandy, as well as multiple tornado, wind and hail storms in several regions of the United States. Catastrophe losses in 2011 primarily resulted from Hurricane Irene and Tropical Storm Lee, multiple tornadoes and hail storms in the Midwest and Southeast regions of the United States and severe winter storms throughout the United States. Catastrophe losses in 2011 also included losses from floods in Thailand and an earthquake in Japan that impacted the Financial, Professional & International Insurance segment. Net favorable prior year reserve development in 2012 and 2011 was \$940 million and \$715 million, respectively. Factors contributing to net favorable prior year reserve development in each segment during these periods are discussed in more detail in note 7 of notes to the Company's consolidated financial statements.

Claims and claim adjustment expenses in 2011 were \$16.28 billion, \$3.07 billion or 23% higher than in 2010. The increase primarily reflected (i) the significant increase in catastrophe losses, (ii) the decrease in net favorable prior year reserve development, (iii) the impact of loss cost trends and (iv) higher non-catastrophe weather-related losses. Catastrophe losses in 2011 and 2010 were \$2.56 billion and \$1.11 billion, respectively. Catastrophe losses in 2010 primarily resulted from several severe wind and hail storms, as well as severe winter storms. In addition, catastrophe losses in 2010 included losses from an earthquake in Chile that impacted the Financial, Professional & International Insurance segment. Net favorable prior year reserve development in 2011 and 2010 was \$715 million and \$1.25 billion, respectively. Factors contributing to net favorable prior year reserve development in each segment are discussed in note 7 of notes to the Company's consolidated financial statements.

*Amortization of Deferred Acquisition Costs*

The amortization of deferred acquisition costs in 2012 was \$3.91 billion, \$34 million or 1% higher than in 2011. The amortization of deferred acquisition costs in 2011 was \$3.88 billion, \$74 million or 2% higher than in 2010. Changes in the amortization of deferred acquisition costs in both 2012 and 2011 were generally consistent with the increase in earned premiums compared with the respective prior year.

*General and Administrative Expenses*

General and administrative expenses in 2012 were \$3.61 billion, \$54 million or 2% higher than in 2011. General and administrative expenses in 2011 were \$3.56 billion, \$150 million or 4% higher than in 2010. General and administrative expenses are discussed in more detail in the segment discussions that follow.

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*Interest Expense*

Interest expense in 2012, 2011 and 2010 was \$378 million, \$386 million and \$388 million, respectively. The decline in 2012 compared with 2011 reflected the repayment of \$258 million of debt in the second quarter of 2012.

*Income Tax Expense (Benefit)*

The Company's consolidated income tax expense in 2012 was \$693 million, compared to an income tax benefit of \$74 million in 2011. The increase in income tax expense of \$767 million in 2012 from 2011 primarily reflected the \$1.77 billion improvement in underwriting margins in 2012 (including the favorable impacts of a decrease in catastrophe losses and an increase in net favorable prior year reserve development) over 2011 and, to a lesser extent, the \$121 million increase in net investment income from non-fixed maturity investments over 2011. The change in income tax expense (benefit) in 2012 from 2011 was also impacted by the \$104 million benefit recorded in 2011 resulting from the favorable resolution of various prior year tax matters.

The Company's consolidated income tax benefit in 2011 was \$74 million, compared to an income tax expense of \$1.09 billion in 2010. The decrease in income tax expense of \$1.16 billion in 2011 from 2010 primarily reflected the \$2.59 billion decrease in underwriting margins in 2011 (including the unfavorable impacts of an increase in catastrophe losses and a decrease in net favorable prior year reserve development) from 2010 and, to a lesser extent, the decrease in net realized investment gains of \$209 million from 2010. The change in income tax expense (benefit) in 2011 from 2010 was also impacted by the \$104 million benefit recorded in 2011 resulting from the favorable resolution of various prior year tax matters.

The Company's effective tax rate was 22%, (5%) and 25% in 2012, 2011 and 2010, respectively. The Company's effective tax rates in 2012 and 2010 were lower than the statutory rate of 35% primarily due to the impact of tax-exempt investment income on the calculation of the Company's income tax provision. In addition to the impact of tax-exempt income, the Company's effective tax rate of (5%) in 2011 also reflected the impact of the Company's significant underwriting loss that primarily resulted from catastrophe losses and the \$104 million benefit resulting from the favorable resolution of various prior year tax matters recorded in the first quarter of 2011.

**GAAP Combined Ratios**

The consolidated GAAP combined ratio of 97.1% in 2012 was 8.0 points lower than the consolidated GAAP combined ratio of 105.1% in 2011.

The consolidated loss and loss adjustment expense ratio of 64.9% in 2012 was 8.0 points lower than the consolidated loss and loss adjustment expense ratio of 72.9% in 2011. Catastrophe losses accounted for 8.3 points and 11.6 points of the 2012 and 2011 loss and loss adjustment expense ratios, respectively. The 2012 and 2011 loss and loss adjustment expense ratios included 4.2 points and 3.2 points of benefit from net favorable prior year reserve development, respectively. The consolidated 2012 loss and loss adjustment expense ratio excluding catastrophe losses and prior year reserve development ("underlying loss and loss adjustment expense ratio") was 3.7 points lower than the 2011 ratio on the same basis, primarily reflecting the factors discussed above.

The consolidated underwriting expense ratio of 32.2% in 2012 was level with the consolidated underwriting expense ratio of 32.2% in 2011.

The consolidated GAAP combined ratio of 105.1% in 2011 was 11.9 points higher than the consolidated GAAP combined ratio of 93.2% in 2010.

The consolidated loss and loss adjustment expense ratio of 72.9% in 2011 was 11.9 points higher than the loss and loss adjustment expense ratio of 61.0% in 2010. Catastrophe losses accounted for 11.6

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points and 5.2 points of the 2011 and 2010 loss and loss adjustment expense ratios, respectively. The 2011 and 2010 loss and loss adjustment expense ratios included 3.2 points and 5.8 points of benefit from net favorable prior year reserve development, respectively. The consolidated 2011 underlying loss and loss adjustment expense ratio was 2.9 points higher than the 2010 ratio on the same basis, reflecting the factors discussed above.

The consolidated underwriting expense ratio of 32.2% in 2011 was level with the underwriting expense ratio in 2010.

**Written Premiums**

Consolidated gross and net written premiums were as follows:

(for the year ended December 31, in millions)	Gross Written Premiums		
	2012	2011	2010
Business Insurance	\$ 13,111	\$ 12,418	\$ 11,891
Financial, Professional & International Insurance	3,275	3,408	3,534
Personal Insurance	7,923	8,061	7,877
<b>Total</b>	<b>\$ 24,309</b>	<b>\$ 23,887</b>	<b>\$ 23,302</b>

(for the year ended December 31, in millions)	Net Written Premiums		
	2012	2011	2010
Business Insurance	\$ 11,872	\$ 11,340	\$ 10,857
Financial, Professional & International Insurance	2,981	3,102	3,211
Personal Insurance	7,594	7,745	7,567
<b>Total</b>	<b>\$ 22,447</b>	<b>\$ 22,187</b>	<b>\$ 21,635</b>

Gross and net written premiums in 2012 increased by 2% and 1%, respectively, over 2011. Gross and net written premiums in 2011 both increased by 3% over 2010. Factors contributing to the changes in gross and net written premiums in each segment in 2012 and 2011 as compared with the respective prior year are discussed in more detail in the segment discussions that follow.

**RESULTS OF OPERATIONS BY SEGMENT**

**Business Insurance**

Results of the Company's Business Insurance segment were as follows:

(for the year ended December 31, in millions)	2012	2011	2010
<b>Revenues:</b>			
Earned premiums	\$ 11,691	\$ 11,327	\$ 10,766
Net investment income	2,090	2,041	2,156
Fee income	322	295	285
Other revenues	40	31	28
<b>Total revenues</b>	<b>\$ 14,143</b>	<b>\$ 13,694</b>	<b>\$ 13,235</b>
<b>Total claims and expenses</b>	<b>\$ 11,761</b>	<b>\$ 12,206</b>	<b>\$ 10,157</b>
<b>Operating income</b>	<b>\$ 1,843</b>	<b>\$ 1,354</b>	<b>\$ 2,301</b>
Loss and loss adjustment expense ratio	65.9%	73.1%	59.1%



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Underwriting expense ratio	31.5	31.6	32.2
<b>GAAP combined ratio</b>	<b>97.4%</b>	104.7%	91.3%

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*Overview*

Operating income in 2012 was \$1.84 billion, \$489 million or 36% higher than operating income of \$1.35 billion in 2011. The improvement in operating income in 2012 compared with 2011 primarily reflected the pretax impact of (i) higher underlying underwriting margins primarily resulting from earned pricing that exceeded loss cost trends, lower non-catastrophe weather-related losses and higher business volume, (ii) a decline in catastrophe losses, (iii) an increase in net favorable prior year reserve development and (iv) an increase in net investment income. Partially offsetting these pretax improvements were their related tax expense. The effective tax rate in 2012 increased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a lower percentage of pretax income. Operating income in 2011 included a \$76 million benefit resulting from the favorable resolution of various prior year tax matters. Catastrophe losses in 2012 were \$794 million, compared with \$1.02 billion in 2011. Net favorable prior year reserve development in 2012 was \$467 million, compared with \$245 million in 2011.

Operating income in 2011 was \$1.35 billion, \$947 million or 41% lower than in 2010. The decline in operating income in 2011 compared with 2010 primarily reflected the pretax impact of (i) lower net favorable prior year reserve development, (ii) a significant increase in catastrophe losses, (iii) lower underlying underwriting margins related to earned pricing and loss cost trends, partially offset by higher business volume, and (iv) lower net investment income. Partially offsetting these net pretax declines were their related net tax benefit. The effective tax rate in 2011 decreased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a higher percentage of pretax income. These factors were partially offset by the \$76 million benefit resulting from the favorable resolution of various prior year tax matters. Net favorable prior year reserve development was \$245 million in 2011, compared with \$901 million in 2010. Catastrophe losses in 2011 were \$1.02 billion, compared with \$437 million in 2010.

**Revenues**

*Earned Premiums*

Earned premiums in 2012 were \$11.69 billion, \$364 million or 3% higher than in 2011. Earned premiums in 2011 were \$11.33 billion, \$561 million or 5% higher than in 2010. The increases in both years primarily reflected the impact of increases in net written premiums over the preceding twelve months. Earned premiums in 2012 and 2011 also benefited from positive audit premium adjustments related to increased insured exposures for existing policyholders, compared with negative audit premium adjustments in 2010 related to decreased insured exposures for existing policyholders.

*Net Investment Income*

Net investment income in 2012 was \$2.09 billion, \$49 million or 2% higher than in 2011, primarily due to higher net investment income generated by non-fixed maturity investments, partially offset by lower net investment income from fixed maturity investments. Net investment income in 2011 was \$2.04 billion, \$115 million or 5% lower than in 2010, primarily due to lower net investment income generated by fixed maturity investments. Refer to the "Net Investment Income" section of the "Consolidated Results of Operations" discussion herein for a description of the factors contributing to the changes in the Company's consolidated net investment income in 2012 and 2011 compared with the respective prior years. In addition, refer to note 2 of notes to the Company's consolidated financial statements herein for a discussion of the Company's net investment income allocation methodology.

*Fee Income*

National Accounts is the primary source of fee income due to its service businesses, which include claim and loss prevention services to large companies that choose to self-insure a portion of their insurance risks, as well as claims and policy management services to workers' compensation residual

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market pools. Fee income in 2012 increased by \$27 million or 9% over 2011. Fee income in 2011 increased by \$10 million or 4% over 2010. The increases in both years primarily reflected higher serviced premium volume in workers' compensation residual market pools.

**Claims and Expenses**

*Claims and Claim Adjustment Expenses*

Claims and claim adjustment expenses in 2012 were \$7.86 billion, \$590 million or 7% lower than in 2011, primarily reflecting (i) a decline in catastrophe losses, (ii) lower non-catastrophe weather-related losses and (iii) an increase in net favorable prior year reserve development, partially offset by (iv) the impact of loss cost trends. Catastrophe losses in 2012 were \$794 million, compared with \$1.02 billion in 2011. Net favorable prior year reserve development in 2012 was \$467 million, compared with \$245 million in 2011. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements.

Claims and claim adjustment expenses in 2011 were \$8.45 billion, \$1.94 billion or 30% higher than in 2010. The increase in 2011 primarily reflected (i) a significant decline in net favorable prior year reserve development, (ii) a significant increase in catastrophe losses and (iii) the impact of loss cost trends that included slightly higher than expected loss costs in the workers' compensation and commercial auto product lines. Net favorable prior year reserve development in 2011 was \$245 million, compared with \$901 million in 2010. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements. Catastrophe losses in 2011 were \$1.02 billion, compared with \$437 million in 2010.

*Amortization of Deferred Acquisition Expenses*

The amortization of deferred acquisition costs in 2012 was \$1.88 billion, \$69 million or 4% higher than in 2011. The amortization of deferred acquisition costs in 2011 was \$1.82 billion, \$66 million or 4% higher than in 2010. The increases in both 2012 and 2011 were generally consistent with the increases in earned premiums compared to the respective prior year.

*General and Administrative Expenses*

General and administrative expenses in 2012 were \$2.02 billion, \$76 million or 4% higher than in 2011. The increase in 2012 included the impact of higher employee-related costs. General and administrative expenses in 2011 were \$1.94 billion, \$40 million or 2% higher than in 2010, primarily driven by a higher level of state assessment expenses related to workers' compensation business in New York, which more than offset an overall reduction in operating expenses that was driven by lower employee-related costs.

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*Income Tax Expense*

Income tax expense in 2012 was \$539 million, compared to \$134 million in 2011. The increase in income tax expense of \$405 million in 2012 from 2011 primarily reflected the \$836 million improvement in underwriting margins (including the favorable impacts of a decrease in catastrophes and an increase in net favorable prior year reserve development) over 2011 and, to a lesser degree, an increase in net investment income from non-fixed maturity investments over 2011. The change in income tax expense in 2012 from 2011 was also impacted by the \$76 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters.

Income tax expense in 2011 was \$134 million, compared to \$777 million in 2010. The decrease in income tax expense of \$643 million in 2011 from 2010 primarily reflected the \$1.48 billion decrease in underwriting margins (including the unfavorable impacts of an increase in catastrophes and a decrease in net favorable prior year reserve development) from 2010. The change in income tax expense in 2011 from 2010 was also impacted by the \$76 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters.

**GAAP Combined Ratios**

The GAAP combined ratio of 97.4% in 2012 was 7.3 points lower than the GAAP combined ratio of 104.7% in 2011.

The loss and loss adjustment expense ratio of 65.9% in 2012 was 7.2 points lower than the loss and loss adjustment expense ratio of 73.1% in 2011. Catastrophe losses in 2012 and 2011 accounted for 6.8 points and 9.0 points, respectively, of the loss and loss adjustment expense ratio. Net favorable prior year reserve development in 2012 and 2011 provided 4.0 points and 2.2 points of benefit, respectively, to the loss and loss adjustment expense ratio. The 2012 underlying loss and loss adjustment expense ratio was 3.2 points lower than the 2011 ratio on the same basis, reflecting the factors discussed above.

The underwriting expense ratio of 31.5% in 2012 was 0.1 points lower than the 2011 underwriting expense ratio of 31.6%.

The GAAP combined ratio of 104.7% in 2011 was 13.4 points higher than the GAAP combined ratio of 91.3% in 2010.

The loss and loss adjustment expense ratio of 73.1% in 2011 was 14.0 points higher than the loss and loss adjustment expense ratio of 59.1% in 2010. Catastrophe losses in 2011 and 2010 accounted for 9.0 points and 4.1 points, respectively, of the loss and loss adjustment expense ratio. Net favorable prior year reserve development in 2011 and 2010 provided 2.2 points and 8.4 points of benefit, respectively, to the loss and loss adjustment expense ratio. The 2011 underlying loss and loss adjustment expense ratio was 2.9 points higher than the 2010 ratio on the same basis, reflecting the factors discussed above.

The underwriting expense ratio of 31.6% in 2011 was 0.6 points lower than the 2010 underwriting expense ratio, primarily reflecting the impact of higher earned premiums.

Table of Contents**Written Premiums**

The Business Insurance segment's gross and net written premiums by market were as follows:

(for the year ended December 31, in millions)	Gross Written Premiums		
	2012	2011	2010
Select Accounts	\$ 2,827	\$ 2,830	\$ 2,758
Commercial Accounts	3,280	3,076	2,753
National Accounts	1,387	1,112	1,111
Industry-Focused Underwriting	2,627	2,473	2,368
Target Risk Underwriting	2,116	2,035	2,008
Specialized Distribution	876	886	883
<b>Total Business Insurance Core</b>	<b>13,113</b>	<b>12,412</b>	<b>11,881</b>
Business Insurance Other	(2)	6	10
<b>Total Business Insurance</b>	<b>\$ 13,111</b>	<b>\$ 12,418</b>	<b>\$ 11,891</b>

(for the year ended December 31, in millions)	Net Written Premiums		
	2012	2011	2010
Select Accounts	\$ 2,775	\$ 2,784	\$ 2,718
Commercial Accounts	3,101	2,890	2,576
National Accounts	907	782	806
Industry-Focused Underwriting	2,554	2,407	2,299
Target Risk Underwriting	1,666	1,587	1,573
Specialized Distribution	870	880	872
<b>Total Business Insurance Core</b>	<b>11,873</b>	<b>11,330</b>	<b>10,844</b>
Business Insurance Other	(1)	10	13
<b>Total Business Insurance</b>	<b>\$ 11,872</b>	<b>\$ 11,340</b>	<b>\$ 10,857</b>

In 2012, gross and net written premiums increased by 6% and 5%, respectively, over 2011. The increases in gross and net written premiums were concentrated in Commercial Accounts, Industry-Focused Underwriting, National Accounts and Target Risk Underwriting, and were largely driven by rate increases and positive audit premium adjustments (which were higher than in 2011). Overall business retention rates remained strong in 2012 but were lower than in 2011. Both components of renewal premium changes – renewal rate changes and insured exposure growth – remained positive in 2012, and renewal premium changes increased over 2011. New business levels in 2012 declined from 2011.

In 2011, gross and net written premiums both increased by 4% over 2010. The increase in gross and net written premiums in 2011 was concentrated in Commercial Accounts and Industry-Focused Underwriting and, to a lesser extent, in Select Accounts. Gross and net written premiums were favorably impacted by positive audit premium adjustments in 2011, as compared with negative adjustments in 2010. Overall business retention rates remained strong in 2011 and were consistent with 2010. Both components of renewal premium changes – renewal rate changes and insured exposure growth – were positive in 2011 and increased over 2010. New business levels in 2011 declined modestly from 2010.

*Select Accounts.* Net written premiums of \$2.78 billion in 2012 were virtually level with 2011. Business retention rates in 2012 remained strong but were lower than in 2011. Renewal premium changes remained positive in 2012 and increased over 2011, primarily due to renewal rate increases. New business volume in 2012 declined from 2011. Net written premiums in 2012 were favorably impacted by positive audit premium adjustments. Net written premiums of \$2.78 billion in 2011 increased by 2% over 2010. Business retention rates remained strong and were consistent with 2010. Renewal premium changes in 2011 improved over 2010 due to growth in both renewal rate changes and insured exposures. New business volume in 2011 declined from 2010.

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*Commercial Accounts.* Net written premiums of \$3.10 billion in 2012 increased by 7% over 2011. Business retention rates remained strong but were lower than in 2011. Renewal premium changes remained positive in 2012 and increased over 2011, primarily due to renewal rate increases. New business volumes in 2012 declined compared with 2011. Net written premiums in 2012 were favorably impacted by positive audit premium adjustments (which were higher than in 2011). Net written premiums of \$2.89 billion in 2011 increased by 12% over 2010. The increase was partially due to the benefit of positive audit premium adjustments, compared with negative adjustments in 2010. Business retention rates remained strong, decreasing slightly in 2011 compared with 2010. Renewal premium changes were positive in 2011 and increased over 2010, primarily driven by positive renewal rate changes. New business volume in 2011 declined slightly from 2010.

*National Accounts.* Net written premiums of \$907 million in 2012 increased by 16% over 2011. Business retention rates remained high in 2012 and were level with 2011. Renewal premium changes were positive and increased over 2011, driven by payroll exposure growth. New business volumes in 2012 also increased over 2011. In addition, growth in workers' compensation residual market pools contributed to premium growth in 2012. Net written premiums of \$782 million in 2011 decreased by 3% from 2010, primarily reflecting negative retrospective premium adjustments related to prior year policies. Business retention rates remained high in 2011 and increased slightly over 2010, while renewal premium changes in 2011 also increased over 2010. New business volume in 2011 declined slightly from 2010.

*Industry-Focused Underwriting.* Net written premiums of \$2.55 billion in 2012 increased by 6% over 2011. Premium increases in 2012 were driven by growth in the Construction, Oil & Gas and Technology business units. Business retention rates in 2012 remained strong and were virtually level with 2011. Renewal premium changes remained positive in 2012 and increased over 2011, primarily due to renewal rate increases. New business volume in 2012 declined from 2011. Net written premiums of \$2.41 billion in 2011 increased by 5% over 2010, primarily driven by growth in Construction, Oil & Gas and Technology.

*Target Risk Underwriting.* Net written premiums of \$1.67 billion in 2012 increased by 5% over 2011. Premium increases in 2012 were concentrated in the National Property and Inland Marine business units. Business retention rates in 2012 remained strong but declined from 2011. Renewal premium changes remained positive in 2012 and increased over 2011, primarily due to renewal rate increases. New business volume in 2012 declined from 2011. Net written premiums of \$1.59 billion in 2011 increased slightly over 2010, as premium growth in Inland Marine and Excess Casualty was largely offset by a decline in National Property.

*Specialized Distribution.* Net written premiums of \$870 million in 2012 decreased by 1% from 2011. Premium decreases in the Northland business unit were largely offset by premium growth in the National Programs business unit. Business retention rates in 2012 remained strong but declined from 2011. Renewal premium changes remained positive in 2012 and increased over 2011, primarily due to renewal rate increases. New business volume in 2012 declined from 2011. Net written premiums of \$880 million in 2011 increased slightly over 2010, driven by growth in the National Programs business unit.

Table of Contents**Financial, Professional & International Insurance**

Results of the Company's Financial, Professional & International Insurance segment were as follows:

(for the year ended December 31, in millions)	2012	2011	2010
<b>Revenues:</b>			
Earned premiums	\$ 3,045	\$ 3,174	\$ 3,317
Net investment income	395	414	439
Fee income	1	1	2
Other revenues	26	26	27
<b>Total revenues</b>	<b>\$ 3,467</b>	<b>\$ 3,615</b>	<b>\$ 3,785</b>
<b>Total claims and expenses</b>	<b>\$ 2,570</b>	<b>\$ 2,738</b>	<b>\$ 2,920</b>
<b>Operating income</b>	<b>\$ 642</b>	<b>\$ 647</b>	<b>\$ 620</b>
Loss and loss adjustment expense ratio	42.8%	46.4%	50.9%
Underwriting expense ratio	41.3	39.4	36.8
<b>GAAP combined ratio</b>	<b>84.1%</b>	<b>85.8%</b>	<b>87.7%</b>

*Overview*

Operating income in 2012 was \$642 million, \$5 million or 1% lower than operating income in 2011. The decline in operating income in 2012 compared with 2011 primarily reflected the pretax declines in net favorable prior year reserve development and net investment income, largely offset by higher underlying underwriting margins resulting from the pretax impact of (i) lower levels of what the Company defines as large losses and (ii) earned pricing that exceeded loss cost trends, partially offset by (iii) the impact of lower business volumes. The effective tax rate in 2012 increased slightly from the prior year, reflecting the impact of a \$14 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters. Net favorable prior year reserve development in 2012 was \$298 million, compared with \$360 million in 2011. Catastrophe losses in 2012 were \$50 million, compared with \$55 million in 2011.

Operating income in 2011 was \$647 million, \$27 million or 4% higher than operating income in 2010. The improvement in operating income in 2011 compared with 2010 primarily reflected a pretax increase in underwriting margins, partially offset by a pretax decline in net investment income. The increase in underwriting margins was driven by the pretax impact of (i) higher net favorable prior year reserve development and (ii) declines in catastrophe and non-catastrophe weather-related losses, partially offset by the impact of (i) lower business volume, (ii) higher general and administrative expenses and (iii) a higher level of large losses. The effective tax rate in 2011 decreased slightly from the prior year, reflecting the impact of a \$14 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters. Net favorable prior year reserve development in 2011 was \$360 million, compared with \$259 million in 2010. Catastrophe losses in 2011 were \$55 million, compared with \$82 million in 2010.

**Revenues***Earned Premiums*

Earned premiums in 2012 were \$3.05 billion, \$129 million or 4% lower than in 2011, primarily reflecting the impact of lower construction surety premium volumes over the preceding twelve months, intentional underwriting actions undertaken in the Company's operations at Lloyd's intended to improve risk and reward (particularly in the catastrophe-exposed lines of business), the impact of the termination of an exclusive broker relationship in the Republic of Ireland, the Company's withdrawal from personal insurance business in the Republic of Ireland, competitive market conditions and, to a lesser extent, foreign currency rates of exchange.

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Earned premiums in 2011 were \$3.17 billion, \$143 million or 4% lower than in 2010. The decline primarily reflected the impact of the termination of an exclusive broker relationship in the Republic of Ireland, lower construction surety premium volumes over the preceding twelve months, intentional underwriting actions undertaken in the Company's operations at Lloyd's intended to improve risk and reward (particularly in the catastrophe-exposed lines of business) and competitive market conditions. Earned premiums in 2011 benefited slightly from the favorable impact of foreign currency exchange rates. In addition, earned premiums in 2010 benefited from the impact of a reduction in surety reinsurance costs associated with prior year reinsurance treaties.

*Net Investment Income*

Net investment income in 2012 was \$395 million, \$19 million or 5% lower than in 2011, primarily due to lower net investment income from fixed maturity investments, partially offset by higher net investment income generated by non-fixed maturity investments. Net investment income in 2011 was \$414 million, \$25 million or 6% lower than in 2010. Included in the Financial, Professional & International Insurance segment are certain legal entities whose invested assets and related net investment income are reported exclusively in this segment and not allocated among all business segments. As a result, reported net investment income in the Financial, Professional & International Insurance segment reflects a significantly smaller proportion of allocated net investment income, including that from the Company's non-fixed maturity investments that experienced an increase in investment income in 2012 and 2011. Refer to the "Net Investment Income" section of the "Consolidated Results of Operations" discussion herein for a description of the factors contributing to the changes in the Company's consolidated net investment income in 2012 and 2011 compared with the respective prior years. In addition, refer to note 2 of notes to the Company's consolidated financial statements herein for a discussion of the Company's net investment income allocation methodology.

**Claims and Expenses**

*Claims and Claim Adjustment Expenses*

Claims and claim adjustment expenses in 2012 were \$1.31 billion, \$173 million or 12% lower than in 2011, primarily reflecting (i) lower levels of large losses and (ii) the impact of lower construction surety premium volumes and intentional underwriting actions as discussed above, partially offset by (iii) a decline in net favorable prior year reserve development. Net favorable prior year reserve development in 2012 was \$298 million, compared with \$360 million in 2011. Both Bond & Financial Products and International contributed to net favorable prior year reserve development in 2012. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements. Catastrophe losses in 2012 were \$50 million, compared with \$55 million in 2011.

Claims and claim adjustment expenses in 2011 were \$1.49 billion, \$213 million or 13% lower than in 2010, primarily reflecting (i) an increase in net favorable prior year reserve development, (ii) a decline in catastrophe losses, (iii) lower non-catastrophe weather-related losses and (iv) lower business volume, partially offset by a higher level of large losses. Net favorable prior year reserve development was \$360 million and \$259 million in 2011 and 2010, respectively. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements. Catastrophe losses in 2011 were \$55 million, compared with \$82 million in 2010.

*Amortization of Deferred Acquisition Costs*

The amortization of deferred acquisition costs in 2012 was \$589 million, \$14 million or 2% lower than in 2011. The amortization of deferred acquisition costs was \$603 million in 2011, \$9 million or 1%



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lower than in 2010. The decrease in 2012 was generally consistent with the decrease in earned premiums, whereas the decrease in 2011 was less than the decrease in earned premiums, primarily due to the increase to earned premiums in 2010 as a result of a reduction in surety reinsurance costs associated with prior year reinsurance treaties.

*General and Administrative Expenses*

General and administrative expenses in 2012 were \$667 million, \$19 million or 3% higher than in 2011. General and administrative expenses were \$648 million in 2011, \$40 million or 7% higher than in 2010. The increases in both 2012 and 2011 primarily reflected increases in employee- and technology-related costs to enhance operations and support future business growth.

*Income Tax Expense*

Income tax expense in 2012 was \$255 million, compared to \$230 million in 2011. The increase in income tax expense of \$25 million in 2012 from 2011 primarily reflected the impact of a \$14 million benefit in 2011 from the favorable resolution of various prior year tax matters and, to a lesser extent, an increase in underwriting margins in 2012 from 2011.

Income tax expense in 2011 was \$230 million, compared with \$245 million in 2010. The decrease in income tax of \$15 million in 2011 from 2010 primarily reflected the impact of a \$14 million benefit in 2011 from the favorable resolution of various prior year tax matters.

**GAAP Combined Ratios**

The GAAP combined ratio of 84.1% in 2012 was 1.7 points lower than the GAAP combined ratio of 85.8% in 2011.

The loss and loss adjustment expense ratio of 42.8% in 2012 was 3.6 points lower than the loss and loss adjustment expense ratio of 46.4% in 2011. The 2012 and 2011 ratios included 9.8 points and 11.3 points of benefit, respectively, from net favorable prior year reserve development. Catastrophe losses in 2012 and 2011 accounted for 1.7 points of the loss and loss adjustment expense ratio in each year. The 2012 underlying loss and loss adjustment expense ratio was 5.1 points lower than the 2011 ratio on the same basis, reflecting the factors discussed above.

The underwriting expense ratio of 41.3% in 2012 was 1.9 points higher than the underwriting expense ratio of 39.4% in 2011, primarily reflecting the impact of a decline in earned premiums and, to a lesser extent, the impact of an increase in general and administrative expenses.

The GAAP combined ratio of 85.8% in 2011 was 1.9 points lower than the GAAP combined ratio of 87.7% in 2010.

The loss and loss adjustment expense ratio of 46.4% in 2011 was 4.5 points lower than the 2010 ratio of 50.9%. Catastrophe losses in 2011 and 2010 accounted for 1.7 and 2.4 points of the loss and loss adjustment expense ratio, respectively. Net favorable prior year reserve development provided 11.3 points and 7.8 points of benefit to the loss and loss adjustment expense ratio in 2011 and 2010, respectively. The 2011 underlying loss and loss adjustment expense ratio was 0.3 points lower than the 2010 ratio on the same basis, reflecting the factors discussed above.

The underwriting expense ratio of 39.4% in 2011 was 2.6 points higher than the underwriting expense ratio of 36.8% in 2010. The increase in 2011 primarily reflected lower earned premium volumes in International and construction surety and the increase in general and administrative expenses discussed above.

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Financial, Professional & International Insurance gross and net written premiums by market were as follows:

(for the year ended December 31, in millions)	Gross Written Premiums		
	2012	2011	2010
Bond & Financial Products	\$ 2,059	\$ 2,092	\$ 2,133
International	1,216	1,316	1,401
<b>Total Financial, Professional &amp; International Insurance</b>	<b>\$ 3,275</b>	<b>\$ 3,408</b>	<b>\$ 3,534</b>

(for the year ended December 31, in millions)	Net Written Premiums		
	2012	2011	2010
Bond & Financial Products	\$ 1,924	\$ 1,953	\$ 1,981
International	1,057	1,149	1,230
<b>Total Financial, Professional &amp; International Insurance</b>	<b>\$ 2,981</b>	<b>\$ 3,102</b>	<b>\$ 3,211</b>

Gross and net written premiums in 2012 both decreased by 4% from 2011. Gross and net written premiums in 2011 decreased by 4% and 3%, respectively, compared with 2010.

Net written premiums in Bond & Financial Products in 2012 were \$1.92 billion, \$29 million or 1% lower than in 2011. The decrease was primarily driven by lower business volume in construction surety due to the continued low levels of government construction spending, which was largely offset by growth in management liability business volume. Excluding the surety line of business, for which the following are not relevant measures, business retention rates in 2012 remained strong and were slightly higher than in 2011. Renewal premium changes in 2012 were positive and significantly higher than in 2011, primarily driven by positive renewal rate changes. New business volume in 2012 was slightly lower than in 2011.

Net written premiums in Bond & Financial Products in 2011 were \$1.95 billion, \$28 million or 1% lower than in 2010, reflecting lower construction surety premium volume due to the continued slowdown in construction spending, and disciplined underwriting. The decrease also reflected the impact of reductions in surety reinsurance costs in 2010 associated with prior year reinsurance treaties. Excluding the surety line of business, for which the following are not relevant measures, business retention rates in 2011 remained strong and were higher than in 2010. Renewal premium changes in 2011 were slightly positive (compared with slightly negative in 2010), as the modest growth in insured exposures exceeded negative renewal rate changes. New business volume in 2011 increased considerably over 2010.

Net written premiums in International in 2012 were \$1.06 billion, \$92 million or 8% lower than in 2011. The decrease in 2012 primarily reflected lower business volume in the Company's operations at Lloyd's, lower surety volumes in Canada, the impact of the Company's withdrawal from personal insurance business in the Republic of Ireland and, to a lesser extent, the impact of foreign currency rates of exchange. Excluding the surety line of business, for which the following are not relevant measures, business retention rates in 2012 were strong and higher than in 2011. Renewal premium changes in 2012 were negative and slightly lower than in 2011, as positive renewal rate changes were more than offset by a decline in insured exposures. New business volumes in 2012 were slightly lower than in 2011.

Net written premiums in International in 2011 were \$1.15 billion, \$81 million or 7% lower than in 2010, primarily reflecting the impact of the Company's termination of an exclusive broker relationship in the Republic of Ireland. Excluding the surety line of business, business retention rates in 2011

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declined from 2010, primarily as a result of the Company's withdrawal from personal insurance business in the Republic of Ireland. New business volume in International in 2011 decreased from 2010, primarily reflecting the Company's withdrawal from personal insurance business in the Republic of Ireland and intentional underwriting actions in the Company's operations at Lloyd's. Renewal premium changes were flat in 2011 (compared with slightly positive in 2010), as positive renewal rate changes were offset by a decline in insured exposures.

**Personal Insurance**

Results of the Company's Personal Insurance segment were as follows:

(for the year ended December 31, in millions)	2012	2011	2010
<b>Revenues:</b>			
Earned premiums	\$ 7,621	\$ 7,589	\$ 7,349
Net investment income	404	424	464
Other revenues	66	70	75
<b>Total revenues</b>	<b>\$ 8,091</b>	<b>\$ 8,083</b>	<b>\$ 7,888</b>
<b>Total claims and expenses</b>	<b>\$ 7,842</b>	<b>\$ 8,708</b>	<b>\$ 7,314</b>
<b>Operating income (loss)</b>	<b>\$ 217</b>	<b>\$ (332)</b>	<b>\$ 440</b>
Loss and loss adjustment expense ratio	72.3%	83.5%	68.1%
Underwriting expense ratio	29.6	30.1	30.2
<b>GAAP combined ratio</b>	<b>101.9%</b>	<b>113.6%</b>	<b>98.3%</b>
<b>Incremental impact of direct to consumer initiative on GAAP combined ratio</b>	<b>2.3%</b>	<b>2.5%</b>	<b>2.2%</b>

*Overview*

Operating income in 2012 was \$217 million, \$549 million higher than the operating loss of (\$332) million in 2011. The improvement in operating income in 2012 compared with 2011 primarily reflected the pretax impact of (i) a decline in catastrophe losses, (ii) higher underlying underwriting margins resulting from lower non-catastrophe weather-related losses and lower fire-related losses and (iii) an increase in net favorable prior year reserve development. Partially offsetting these pretax improvements were their related tax expense. The effective tax rate in 2012 increased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a lower percentage of pretax income. The operating loss in 2011 included the impact of a \$10 million benefit resulting from the favorable resolution of various prior year tax matters. Catastrophe losses in 2012 were \$1.02 billion, compared with \$1.49 billion in 2011. Net favorable prior year reserve development in 2012 was \$175 million, compared with \$110 million in 2011.

An operating loss of (\$332) million in 2011 compared with operating income of \$440 million in 2010. The decline in operating income in 2011 compared with 2010 primarily reflected the pretax impact of (i) a significant increase in catastrophe losses, (ii) lower underlying underwriting margins related to earned pricing and loss cost trends, higher non-catastrophe weather-related losses and an increase in expenses related to the Company's direct to consumer initiative, partially offset by higher business volumes, and (iii) lower net investment income. Partially offsetting these net pretax declines were their related net tax benefit. The effective tax rate in 2011 decreased from the prior year due to interest on municipal bonds, which is effectively taxed at a rate that is lower than the corporate tax rate of 35%, comprising a higher percentage of pretax income. These factors were partially offset by an increase in net favorable prior year reserve development and a \$10 million benefit resulting from the

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favorable resolution of various prior year tax matters. Catastrophe losses in 2011 were \$1.49 billion, compared with \$594 million in 2010. Net favorable prior year reserve development in 2011 was \$110 million, compared with \$87 million in 2010.

**Revenues**

*Earned Premiums*

Earned premiums in 2012 were \$7.62 billion, \$32 million or less than 1% higher than in 2011. Earned premiums of \$7.59 billion in 2011 were \$240 million or 3% higher than in 2010.

*Net Investment Income*

Net investment income in 2012 was \$404 million, \$20 million or 5% lower than in 2011, primarily due to lower net investment income from fixed maturity investments, partially offset by higher net investment income generated by non-fixed maturity investments. Net investment income in 2011 was \$424 million, \$40 million or 9% lower than in 2010, primarily due to lower net investment income from fixed maturity investments. Refer to the "Net Investment Income" section of "Consolidated Results of Operations" herein for a discussion of the change in the Company's net investment income in 2012 and 2011 as compared with the respective prior year. In addition, refer to note 2 of notes to the Company's consolidated financial statements herein for a discussion of the Company's net investment income allocation methodology.

**Claims and Expenses**

*Claims and Claim Adjustment Expenses*

Claims and claim adjustment expenses in 2012 were \$5.50 billion, \$837 million or 13% lower than in 2011. The decrease primarily reflected (i) a decline in catastrophe losses and, to a lesser extent, (ii) lower non-catastrophe weather-related losses, (iii) lower fire-related losses and (iv) higher net favorable prior year reserve development, partially offset by (v) the impact of loss cost trends, including a higher number of severe bodily injury claims in the automobile line of business. Catastrophe losses in 2012 were \$1.02 billion, compared with \$1.49 billion in 2011. Net favorable prior year reserve development in 2012 was \$175 million, compared with \$110 million in 2011. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements.

Claims and claim adjustment expenses in 2011 were \$6.34 billion, \$1.34 billion or 27% higher than in 2010. The increase primarily reflected (i) the significant increase in catastrophe losses, (ii) the impact of loss cost trends, (iii) higher non-catastrophe weather-related losses and (iv) higher business volumes. These factors were partially offset by an increase in net favorable prior year reserve development. Catastrophe losses in 2011 and 2010 were \$1.49 billion and \$594 million, respectively. Net favorable prior year reserve development in 2011 and 2010 was \$110 million and \$87 million, respectively. Factors contributing to net favorable prior year reserve development are discussed in more detail in note 7 of notes to the Company's consolidated financial statements.

*Amortization of Deferred Acquisition Costs*

The amortization of deferred acquisition costs in 2012 was \$1.44 billion, \$21 million or 1% lower than in 2011. The amortization of deferred acquisition costs in 2011 was \$1.46 billion, \$17 million or 1% higher than in 2010. The changes in deferred acquisition costs in both 2012 and 2011 differed from the change in earned premiums, primarily reflecting an increase in the number of agents reverting to a contingent commission compensation program (the costs of which are classified in "general and administrative expenses") from a fixed-value compensation program (the costs of which are classified in

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"amortization of deferred acquisition costs"), and growth in the Company's direct to consumer business (for which no commission expense is incurred).

*General and Administrative Expenses*

General and administrative expenses in 2012 were \$900 million, \$8 million or 1% lower than in 2011. General and administrative expenses in 2011 were \$908 million, \$41 million or 5% higher than in 2010. The increase in 2011 was primarily driven by costs associated with the Company's direct to consumer initiative, as well as the increase in contingent commission expense due to the increase in the number of agents reverting to a contingent commission compensation program. The cost of the contingent commission program is not subject to deferred acquisition cost accounting treatment and, therefore, is expensed as incurred.

*Income Tax Expense*

Income tax expense in 2012 was \$32 million, compared to an income tax benefit of \$293 million in 2011. The change in income tax expense of \$325 million in 2012 from 2011 primarily reflected the \$898 million decrease in underwriting loss (including the favorable impacts of a decrease in catastrophes and an increase in net favorable prior year reserve development) from 2011. The change in income tax expense in 2012 from 2011 was also impacted by the \$10 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters.

The income tax benefit in 2011 was \$293 million, compared to income tax expense of \$134 million in 2010. The change in income tax expense (benefit) of (\$427) million in 2011 from 2010 primarily reflected the \$1.15 billion decrease in underwriting margins (including the unfavorable impacts of an increase in catastrophes and a decline in net favorable prior year reserve development) from 2011. The change in income tax expense (benefit) was also impacted by the \$10 million benefit in 2011 resulting from the favorable resolution of various prior year tax matters.

**GAAP Combined Ratio**

The GAAP combined ratio of 101.9% in 2012 was 11.7 points lower than the GAAP combined ratio of 113.6% in 2011.

The loss and loss adjustment expense ratio of 72.3% in 2012 was 11.2 points lower than the loss and loss adjustment expense ratio of 83.5% in 2011. Catastrophe losses accounted for 13.4 points and 19.6 points of the loss and loss adjustment expense ratios in 2012 and 2011, respectively. The loss and loss adjustment expense ratio for 2012 and 2011 included 2.3 points and 1.5 points of benefit, respectively, from net favorable prior year reserve development. The 2012 underlying loss and loss adjustment expense ratio was 4.2 points lower than the 2011 ratio on the same basis, reflecting the factors discussed above.

The underwriting expense ratio of 29.6% in 2012 was 0.5 points lower than the underwriting expense ratio of 30.1% in 2011.

The GAAP combined ratio of 113.6% in 2011 was 15.3 points higher than the GAAP combined ratio of 98.3% in 2010.

The loss and loss adjustment expense ratio of 83.5% in 2011 was 15.4 points higher than the 2010 ratio of 68.1%. Catastrophe losses accounted for 19.6 and 8.1 points of the loss and loss adjustment expense ratio in 2011 and 2010, respectively. Net favorable prior year reserve development provided 1.5 points and 1.2 points of benefit to the loss and loss adjustment expense ratio in 2011 and 2010, respectively. The 2011 underlying loss and loss adjustment expense ratio was 4.2 points higher than the 2010 ratio on the same basis, reflecting the factors discussed above.

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The underwriting expense ratio of 30.1% in 2011 was 0.1 points lower than the underwriting expense ratio of 30.2% in 2010.

**Agency Written Premiums**

Gross and net written premiums by product line were as follows for the Personal Insurance segment's Agency business, which comprises business written through agents, brokers and other intermediaries and represents almost all of the segment's gross and net written premiums:

(for the year ended December 31, in millions)	Gross Written Premiums		
	2012	2011	2010
Agency Automobile	\$ 3,544	\$ 3,706	\$ 3,720
Agency Homeowners and Other	4,220	4,221	4,060
<b>Total Agency Personal Insurance</b>	<b>\$ 7,764</b>	<b>\$ 7,927</b>	<b>\$ 7,780</b>

(for the year ended December 31, in millions)	Net Written Premiums		
	2012	2011	2010
Agency Automobile	\$ 3,527	\$ 3,688	\$ 3,698
Agency Homeowners and Other	3,909	3,923	3,772
<b>Total Agency Personal Insurance</b>	<b>\$ 7,436</b>	<b>\$ 7,611</b>	<b>\$ 7,470</b>

In 2012, gross and net written Agency written premiums both decreased 2% from the respective totals in 2011. In 2011, gross and net Agency written premiums both increased 2% over the respective totals in 2010.

In the Agency Automobile line of business, net written premiums in 2012 were 4% lower than in 2011. Business retention rates remained strong but were lower than in 2011, while new business levels in 2012 declined from 2011, largely as a result of the Company's pricing strategy and other profitability improvement initiatives. Renewal premium changes remained positive in 2012 and increased over 2011. Net written premiums in 2011 were slightly lower than in 2010. Business retention rates in 2011 remained strong, while new business levels declined from 2010. Renewal premium changes remained positive in 2011 and increased over 2010.

In the Agency Homeowners and Other line of business, net written premiums in 2012 were slightly lower than in 2011. Business retention rates remained strong but were lower than in 2011, while new business levels in 2012 declined from 2011, largely as a result of the Company's pricing strategy, higher deductibles and other profitability improvement initiatives. Renewal premium changes remained positive in 2012 and increased over 2011. Net written premiums in 2011 were 4% higher than in 2010. Business retention rates in 2011 remained strong, while new business levels were lower than in 2010. Renewal premium changes in 2011 remained positive and increased slightly over 2010.

For its Agency business, the Personal Insurance segment had approximately 7.1 million and 7.7 million active policies at December 31, 2012 and 2011, respectively.

**Direct to Consumer Written Premiums**

In its direct to consumer business, net written premiums in 2012 were \$158 million, \$24 million or 18% higher than in 2011. The increase in net written premiums in 2012 resulted from a \$15 million or 15% increase in automobile net written premiums and a \$9 million or 26% increase in homeowners and other net written premiums compared to 2011. Net written premiums in 2011 were \$134 million, \$37 million or 38% higher than in 2010. The increase in net written premiums in 2011 resulted from a \$26 million or 35% increase in automobile net written premiums and an \$11 million or 48% increase in

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homeowners and other net written premiums compared to 2010. The direct to consumer business had 160,000 and 140,000 active policies at December 31, 2012 and 2011, respectively.

**Interest Expense and Other**

(for the year ended December 31, in millions)	2012	2011	2010
Operating loss	\$ (261)	\$ (279)	\$ (318)

The operating loss for Interest Expense and Other in 2012 was \$18 million lower than in 2011. The operating loss in 2011 was \$39 million lower than in 2010, primarily reflecting \$39 million of after-tax expenses related to the Company's purchase and retirement of a significant portion of its 6.25% fixed-to-floating rate junior subordinated debentures in 2010. The operating loss in 2010 also included a \$12 million increase in tax expense associated with recent federal health care legislation and an increase in interest expense. After-tax interest expense in 2012, 2011 and 2010 was \$246 million, \$251 million and \$252 million, respectively.

**ASBESTOS CLAIMS AND LITIGATION**

The Company believes that the property and casualty insurance industry has suffered from court decisions and other trends that have expanded insurance coverage for asbestos claims far beyond the original intent of insurers and policyholders. The Company has received and continues to receive a significant number of asbestos claims from the Company's policyholders (which includes others seeking coverage under a policy). Factors underlying these claim filings include intensive advertising by lawyers seeking asbestos claimants and the continued focus by plaintiffs on previously peripheral defendants. The focus on these defendants is primarily the result of the number of traditional asbestos defendants who have sought bankruptcy protection in previous years. In addition to contributing to the overall number of claims, bankruptcy proceedings may increase the volatility of asbestos-related losses by initially delaying the reporting of claims and later by significantly accelerating and increasing loss payments by insurers, including the Company. The bankruptcy of many traditional defendants has also caused increased settlement demands against those policyholders who are not in bankruptcy but that remain in the tort system. Currently, in many jurisdictions, those who allege very serious injury and who can present credible medical evidence of their injuries are receiving priority trial settings in the courts, while those who have not shown any credible disease manifestation are having their hearing dates delayed or placed on an inactive docket. This trend of prioritizing claims involving credible evidence of injuries, along with the focus on previously peripheral defendants, contributes to the claims and claim adjustment expense payments experienced by the Company. The Company's asbestos-related claims and claim adjustment expense experience also has been impacted by the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or through the insolvency of other participating insurers.

The Company continues to be involved in coverage litigation concerning a number of policyholders, some of whom have filed for bankruptcy, who in some instances have asserted that all or a portion of their asbestos-related claims are not subject to aggregate limits on coverage. In these instances, policyholders also may assert that each individual bodily injury claim should be treated as a separate occurrence under the policy. It is difficult to predict whether these policyholders will be successful on both issues. To the extent both issues are resolved in a policyholder's favor and other Company defenses are not successful, the Company's coverage obligations under the policies at issue would be materially increased and bounded only by the applicable per-occurrence limits and the number of asbestos bodily injury claims against the policyholders. Accordingly, although the Company has seen a moderation in the overall risk associated with these lawsuits, it remains difficult to predict the ultimate cost of these claims.

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Many coverage disputes with policyholders are only resolved through settlement agreements. Because many policyholders make exaggerated demands, it is difficult to predict the outcome of settlement negotiations. Settlements involving bankrupt policyholders may include extensive releases which are favorable to the Company but which could result in settlements for larger amounts than originally anticipated. There also may be instances where a court may not approve a proposed settlement, which may result in additional litigation and potentially less beneficial outcomes for the Company. As in the past, the Company will continue to pursue settlement opportunities.

In addition to claims against policyholders, proceedings have been launched directly against insurers, including the Company, by individuals challenging insurers' conduct with respect to the handling of past asbestos claims and by individuals seeking damages arising from alleged asbestos-related bodily injuries. It is possible that the filing of other direct actions against insurers, including the Company, could be made in the future. It is difficult to predict the outcome of these proceedings, including whether the plaintiffs will be able to sustain these actions against insurers based on novel legal theories of liability. The Company believes it has meritorious defenses to these claims and has received favorable rulings in certain jurisdictions.

Travelers Property Casualty Corp. (TPC), a wholly-owned subsidiary of the Company, had entered into settlement agreements which are subject to a number of contingencies, in connection with a number of these direct action claims (Direct Action Settlements). For a full discussion of these settlement agreements, see the "Asbestos Direct Action Litigation" section of note 16 of notes to the consolidated financial statements.

Because each policyholder presents different liability and coverage issues, the Company generally reviews the exposure presented by each policyholder at least annually. Among the factors which the Company may consider in the course of this review are: available insurance coverage, including the role of any umbrella or excess insurance the Company has issued to the policyholder; limits and deductibles; an analysis of the policyholder's potential liability; the jurisdictions involved; past and anticipated future claim activity and loss development on pending claims; past settlement values of similar claims; allocated claim adjustment expense; potential role of other insurance; the role, if any, of non-asbestos claims or potential non-asbestos claims in any resolution process; and applicable coverage defenses or determinations, if any, including the determination as to whether or not an asbestos claim is a products/completed operation claim subject to an aggregate limit and the available coverage, if any, for that claim.

In the third quarter of 2012, the Company completed its annual in-depth asbestos claim review. As in prior years, the annual claim review considered active policyholders and litigation cases for potential product and "non-product" liability. The Company noted the following trends:

continued high level of litigation activity in certain jurisdictions involving individuals alleging serious asbestos-related illness;

while overall payment patterns have been generally stable, there has been an increase in severity for certain policyholders due to the continued high level of litigation activity;

continued moderate level of asbestos-related bankruptcy activity; and

the absence of new theories of liability or new classes of defendants.

While the Company believes that over the past several years there has been a reduction in the volatility associated with the Company's overall asbestos exposure, there nonetheless remains a high degree of uncertainty with respect to future exposure from asbestos claims.

During 2012, total gross and net asbestos-related payments decreased when compared with 2011, primarily resulting from a decline in both gross and net payments to policyholders with whom the Company has entered into settlement agreements. The Home Office and Field Office categories, which



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account for the vast majority of policyholders with active asbestos-related claims, experienced a modest reduction in gross asbestos-related payments during 2012 when compared with 2011, while net asbestos payments were flat. Payments on behalf of policyholders in these categories continue to be influenced by the high level of litigation activity in a limited number of jurisdictions where individuals alleging serious asbestos-related injury continue to target previously peripheral defendants. The number of policyholders tendering asbestos claims for the first time in 2012 and the number of policyholders with open asbestos claims both increased slightly when compared with 2011.

The Company's quarterly asbestos reserve reviews include an analysis of exposure and claim payment patterns by policyholder category, as well as recent settlements, policyholder bankruptcies, judicial rulings and legislative actions. The Company also analyzes developing payment patterns among policyholders in the Home Office, Field Office and Assumed Reinsurance and Other categories as well as projected reinsurance billings and recoveries. In addition, the Company reviews its historical gross and net loss and expense paid experience, year-by-year, to assess any emerging trends, fluctuations, or characteristics suggested by the aggregate paid activity. Conventional actuarial methods are not utilized to establish asbestos reserves nor have the Company's evaluations resulted in any way of determining a meaningful average asbestos defense or indemnity payment.

The completion of these reviews and analyses in 2012, 2011 and 2010 resulted in \$175 million, \$175 million and \$140 million increases, respectively, in the Company's net asbestos reserves in each period. In each year, the reserve increases were primarily driven by increases in the Company's estimate of projected settlement and defense costs related to a broad number of policyholders in the Home Office category and by higher projected payments on assumed reinsurance accounts. The increase in the estimate of projected settlement and defense costs resulted from payment trends that continue to be moderately higher than previously anticipated due to the impact of the current litigation environment discussed above. The increase in 2010 also reflected increases in costs of litigating asbestos-related coverage matters and was partially offset by a \$70 million benefit from the reduction in the allowance for uncollectible reinsurance resulting from a favorable ruling related to a reinsurance dispute. Notwithstanding these trends, the Company's overall view of the underlying asbestos environment is essentially unchanged from recent periods, and there remains a high degree of uncertainty with respect to future exposure to asbestos claims.

Net asbestos losses paid in 2012, 2011 and 2010 were \$236 million, \$284 million and \$350 million, respectively. Approximately 6%, 19% and 32% of total net paid losses in 2012, 2011 and 2010, respectively, related to policyholders with whom the Company had entered into settlement agreements limiting the Company's liability.

The Company categorizes its asbestos reserves as follows:

(at and for the year ended December 31, \$ in millions)	Number of Policyholders		Total Net Paid		Net Asbestos Reserves	
	2012	2011	2012	2011	2012	2011
Policyholders with settlement agreements	15	15	\$ 13	\$ 54	\$ 91	\$ 588
Home office and field office	1,678	1,616	199	199	2,089	1,660
Assumed reinsurance and other			24	31	198	191
<b>Total</b>	<b>1,693</b>	<b>1,631</b>	<b>\$ 236</b>	<b>\$ 284</b>	<b>\$ 2,378</b>	<b>\$ 2,439</b>

The "policyholders with settlement agreements" category includes structured settlements, coverage in place arrangements and, with respect to TPC, Wellington accounts. Reserves are based on the expected payout for each policyholder under the applicable agreement. Structured settlements are arrangements under which policyholders and/or plaintiffs agree to fixed financial amounts to be paid at scheduled times. Coverage in place arrangements represent agreements with policyholders on specified amounts of coverage to be provided. Payment obligations may be subject to annual maximums and are

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only made when valid claims are presented. Wellington accounts refer to the 35 defendants that are parties to a 1985 agreement settling certain disputes concerning insurance coverage for their asbestos claims. Many of the aspects of the Wellington agreement are similar to those of coverage in place arrangements in which the parties have agreed on specific amounts of coverage and the terms under which the coverage can be accessed.

The "home office and field office" category relates to all other policyholders and also includes unallocated IBNR reserves and reserves for the costs of defending asbestos-related coverage litigation. Policyholders are identified for the annual home office review based upon, among other factors: a combination of past payments and current case reserves in excess of a specified threshold (currently \$100,000), perceived level of exposure, number of reported claims, products/completed operations and potential "non-product" exposures, size of policyholder and geographic distribution of products or services sold by the policyholder. In addition to IBNR amounts contained in the reserves for "home office and field office" policyholders and the costs of litigating asbestos coverage matters, the Company has established a reserve for further adverse development related to existing policyholders, new claims from policyholders reporting claims for the first time and policyholders for which there is, or may be, litigation and direct actions against the Company. During 2012, \$502 million of reserves included in "Policyholders with settlement agreements" were reclassified to the unallocated IBNR component in the "home office and field office" category as a result of the U.S. District Court ruling on March 1, 2012 that the conditions of the Direct Action Settlements had not been satisfied. For a full discussion of these settlement agreements see the "Asbestos Direct Action Litigation" section of note 16 of notes to the consolidated financial statements. The "assumed reinsurance and other" category primarily consists of reinsurance of excess coverage, including various pool participations.

On January 29, 2009, the Company and PPG Industries, Inc ("PPG"), along with approximately 30 other insurers of PPG, agreed in principle to an agreement to settle asbestos-related coverage litigation under insurance policies issued to PPG. The tentative settlement agreement has been incorporated into the Modified Third Amended Plan of Reorganization ("Amended Plan") proposed as part of the Pittsburgh Corning Corp. ("PCC", which is 50% owned by PPG) bankruptcy proceeding. Pursuant to the proposed Amended Plan, which was filed on January 30, 2009, PCC, along with enumerated other companies (including PPG as well as the Company as a participating insurer), are to receive protections afforded by Section 524(g) of the Bankruptcy Code from certain asbestos-related bodily injury claims. Under the agreement in principle, the Company has the option to make a series of payments over the next 20 years totaling approximately \$620 million to the Trust to be created under the Amended Plan, or it may elect to make a one-time discounted payment, which, as of March 31, 2013, would total approximately \$481 million (approximately \$452 million after reinsurance). The agreement in principle with PPG is subject to numerous contingencies, including final court approval of the Amended Plan, and the Company has no obligation to make the settlement payment until all contingencies are satisfied. The Company's obligations under this agreement in principle are included in the "home office and field office" category in the preceding table.

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The following table displays activity for asbestos losses and loss expenses and reserves:

(at and for the year ended December 31, in millions)	2012	2011	2010
<b>Beginning reserves:</b>			
Gross	\$ 2,780	\$ 2,941	\$ 3,097
Ceded	(341)	(393)	(339)
Net	2,439	2,548	2,758
<b>Incurred losses and loss expenses:</b>			
Gross	171	195	262
Ceded	4	(20)	(122)
Net	175	175	140
<b>Losses paid:</b>			
Gross	262	356	418
Ceded	(26)	(72)	(68)
Net	236	284	350
<b>Ending reserves:</b>			
Gross	2,689	2,780	2,941
Ceded	(311)	(341)	(393)
Net	\$ 2,378	\$ 2,439	\$ 2,548

See " Uncertainty Regarding Adequacy of Asbestos and Environmental Reserves."

**ENVIRONMENTAL CLAIMS AND LITIGATION**

The Company has received and continues to receive claims from policyholders who allege that they are liable for injury or damage arising out of their alleged disposition of toxic substances. Mostly, these claims are due to various legislative as well as regulatory efforts aimed at environmental remediation. For instance, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), enacted in 1980 and later modified, enables private parties as well as federal and state governments to take action with respect to releases and threatened releases of hazardous substances. This federal statute permits the recovery of response costs from some liable parties and may require liable parties to undertake their own remedial action. Liability under CERCLA may be joint and several with other responsible parties.

The Company has been, and continues to be, involved in litigation involving insurance coverage issues pertaining to environmental claims. The Company believes that some court decisions have interpreted the insurance coverage to be broader than the original intent of the insurers and policyholders. These decisions often pertain to insurance policies that were issued by the Company prior to the mid-1980s. These decisions continue to be inconsistent and vary from jurisdiction to jurisdiction. Environmental claims when submitted rarely indicate the monetary amount being sought by the claimant from the policyholder, and the Company does not keep track of the monetary amount being sought in those few claims which indicate a monetary amount.

The resolution of environmental exposures by the Company generally occurs through settlements with policyholders as opposed to claimants. Generally, the Company strives to extinguish any obligations it may have under any policy issued to the policyholder for past, present and future environmental liabilities and extinguish any pending coverage litigation dispute with the policyholder. This form of settlement is commonly referred to as a "buy-back" of policies for future environmental liability. In addition, many of the agreements have also extinguished any insurance obligation which the

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Company may have for other claims, including but not limited to asbestos and other cumulative injury claims. The Company and its policyholders may also agree to settlements which extinguish any liability arising from known specified sites or claims. Where appropriate, these agreements also include indemnities and hold harmless provisions to protect the Company. The Company's general purpose in executing these agreements is to reduce the Company's potential environmental exposure and eliminate the risks presented by coverage litigation with the policyholder and related costs.

In establishing environmental reserves, the Company evaluates the exposure presented by each policyholder and the anticipated cost of resolution, if any. In the course of this analysis, the Company generally considers the probable liability, available coverage, relevant judicial interpretations and historical value of similar exposures. In addition, the Company considers the many variables presented, such as: the nature of the alleged activities of the policyholder at each site; the number of sites; the total number of potentially responsible parties at each site; the nature of the alleged environmental harm and the corresponding remedy at each site; the nature of government enforcement activities at each site; the ownership and general use of each site; the overall nature of the insurance relationship between the Company and the policyholder, including the role of any umbrella or excess insurance the Company has issued to the policyholder; the involvement of other insurers; the potential for other available coverage, including the number of years of coverage; the role, if any, of non-environmental claims or potential non-environmental claims in any resolution process; and the applicable law in each jurisdiction. The evaluation of the exposure presented by a policyholder can change as information concerning that policyholder and the many variables presented is developed. Conventional actuarial techniques are not used to estimate these reserves.

In its review of environmental reserves, the Company considers: past settlement payments; changing judicial and legislative trends; its reserves for the costs of litigating environmental coverage matters; the potential for policyholders with smaller exposures to be named in new clean-up actions for both on- and off-site waste disposal activities; the potential for adverse development; the potential for additional new claims beyond previous expectations; and the potential higher costs for new settlements.

The duration of the Company's investigation and review of these claims and the extent of time necessary to determine an appropriate estimate, if any, of the value of the claim to the Company vary significantly and are dependent upon a number of factors. These factors include, but are not limited to, the cooperation of the policyholder in providing claim information, the pace of underlying litigation or claim processes, the pace of coverage litigation between the policyholder and the Company and the willingness of the policyholder and the Company to negotiate, if appropriate, a resolution of any dispute pertaining to these claims. Because these factors vary from claim-to-claim and policyholder-by-policyholder, the Company cannot provide a meaningful average of the duration of an environmental claim. However, based upon the Company's experience in resolving these claims, the duration may vary from months to several years.

The Company continues to receive notices from policyholders tendering claims for the first time, frequently under policies issued prior to the mid-1980's. These policyholders continue to present smaller exposures, have fewer sites and are lower tier defendants. Further, in many instances, clean-up costs have been reduced because regulatory agencies are willing to accept risk-based site analyses and more efficient clean-up technologies. Overall net environmental claim payments in 2012 were essentially unchanged from 2011. Over the past several years, the Company has experienced generally favorable trends in the number of new policyholders tendering environmental claims for the first time and in the number of pending declaratory judgment actions relating to environmental matters. The degree to which those favorable trends have continued, however, has been less than anticipated. As a result, in 2012 and 2011, the Company increased its net environmental reserves by \$90 million and \$76 million, respectively. In 2010, the Company increased its net environmental reserves by \$35 million due to a modest upward development in the expected defense and settlement costs for certain of its pending policyholders.

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Net environmental losses paid in 2012, 2011 and 2010 were \$84 million, \$86 million and \$77 million, respectively. At December 31, 2012, approximately 93% of the net environmental reserve (approximately \$323 million) was carried in a bulk reserve and included unresolved environmental claims, incurred but not reported environmental claims and the anticipated cost of coverage litigation disputes relating to these claims. The bulk reserve the Company carries is established and adjusted based upon the aggregate volume of in-process environmental claims and the Company's experience in resolving those claims. The balance, approximately 7% of the net environmental reserve (approximately \$24 million), consists of case reserves.

The following table displays activity for environmental losses and loss expenses and reserves:

(at and for the year ended December 31, in millions)	2012	2011	2010
<b>Beginning reserves:</b>			
Gross	\$ 346	\$ 354	\$ 389
Ceded	(5)	(3)	4
Net	341	351	393
<b>Incurred losses and loss expenses:</b>			
Gross	99	80	45
Ceded	(9)	(4)	(10)
Net	90	76	35
<b>Losses paid:</b>			
Gross	93	88	80
Ceded	(9)	(2)	(3)
Net	84	86	77
<b>Ending reserves:</b>			
Gross	352	346	354
Ceded	(5)	(5)	(3)
Net	\$ 347	\$ 341	\$ 351

**UNCERTAINTY REGARDING ADEQUACY OF ASBESTOS AND ENVIRONMENTAL RESERVES**

As a result of the processes and procedures discussed above, management believes that the reserves carried for asbestos and environmental claims at December 31, 2012 are appropriately established based upon known facts, current law and management's judgment. However, the uncertainties surrounding the final resolution of these claims continue, and it is difficult to determine the ultimate exposure for asbestos and environmental claims and related litigation. As a result, these reserves are subject to revision as new information becomes available and as claims develop. The continuing uncertainties include, without limitation, the risks and lack of predictability inherent in complex litigation, any impact from the bankruptcy protection sought by various asbestos producers and other asbestos defendants, a further increase or decrease in the cost to resolve, and/or the number of, asbestos and environmental claims beyond that which is anticipated, the role of any umbrella or excess policies the Company has issued, the resolution or adjudication of disputes pertaining to the amount of available coverage for asbestos and environmental claims in a manner inconsistent with the Company's previous assessment of these claims, the number and outcome of direct actions against the Company, future developments pertaining to the Company's ability to recover reinsurance for asbestos and environmental claims and the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or through the insolvency of other participating insurers. In addition, uncertainties arise from the insolvency or bankruptcy of policyholders and other defendants. It is also not possible to predict changes in the legal, regulatory

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and legislative environment and their impact on the future development of asbestos and environmental claims. This environment could be affected by changes in applicable legislation and future court and regulatory decisions and interpretations, including the outcome of legal challenges to legislative and/or judicial reforms establishing medical criteria for the pursuit of asbestos claims. It is also difficult to predict the ultimate outcome of complex coverage disputes until settlement negotiations near completion and significant legal questions are resolved or, failing settlement, until the dispute is adjudicated. This is particularly the case with policyholders in bankruptcy where negotiations often involve a large number of claimants and other parties and require court approval to be effective. As part of its continuing analysis of asbestos and environmental reserves, the Company continues to study the implications of these and other developments. (Also see note 16 of notes to the consolidated financial statements in this report).

Because of the uncertainties set forth above, additional liabilities may arise for amounts in excess of the Company's current reserves. In addition, the Company's estimate of claims and claim adjustment expenses may change. These additional liabilities or increases in estimates, or a range of either, cannot now be reasonably estimated and could result in income statement charges that could be material to the Company's operating results in future periods.

**INVESTMENT PORTFOLIO**

The Company's invested assets at December 31, 2012 were \$73.84 billion, of which 93% was invested in fixed maturity and short-term investments, 1% in equity securities, 1% in real estate and 5% in other investments. Because the primary purpose of the investment portfolio is to fund future claims payments, the Company employs a conservative investment philosophy. A significant 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 carrying value of the Company's fixed maturity portfolio at December 31, 2012 was \$65.39 billion. The Company closely monitors the duration of its fixed maturity investments, and investment purchases and sales are executed with the objective of having adequate funds available to satisfy the Company's insurance and debt obligations. The weighted average credit quality of the Company's fixed maturity portfolio, both including and excluding U.S. Treasury securities, was "Aa2" at both December 31, 2012 and 2011. In 2011, Standard & Poor's downgraded the credit rating of securities issued by the U.S. government, which had minimal impact on the overall credit quality of the Company's fixed maturity portfolio at December 31, 2011. Below investment grade securities represented 3.1% of the total fixed maturity investment portfolio at both December 31, 2012 and 2011. The average effective duration of fixed maturities and short-term securities was 3.2 (3.4 excluding short-term securities) at both December 31, 2012 and 2011. See the "Outlook" section in "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations."

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The carrying values of investments in fixed maturities classified as available for sale at December 31, 2012 and 2011 were as follows:

(at December 31, in millions)	Carrying Value	2012 Average Credit Quality(1)	Carrying Value	2011 Average Credit Quality(1)
U.S. Treasury securities and obligations of U.S. government and government agencies and authorities	\$ 2,222	Aaa/Aa1	\$ 2,497	Aaa/Aa1
Obligations of states, municipalities and political subdivisions:				
Pre-refunded	9,025	Aa1	7,332	Aa1
All other	29,656	Aa1	31,690	Aa1
<b>Total obligations of states, municipalities and political subdivisions</b>	<b>38,681</b>		<b>39,022</b>	
Debt securities issued by foreign governments	2,257	Aaa	2,318	Aaa
Mortgage-backed securities, collateralized mortgage obligations, and pass-through securities	2,997	A1	3,515	Aa3
All other corporate bonds and redeemable preferred stock:				
Financial:				
Bank	1,808	A1	1,452	A1
Insurance	433	A1	386	A2
Finance/leasing	39	Baa3	42	Baa3
Brokerage and asset management	34	A2	39	A3
<b>Total financial</b>	<b>2,314</b>		<b>1,919</b>	
Industrial	12,076	A3	9,961	Baa1
Public utility	2,151	A3	2,116	A3
Sovereign corporate securities(2)	1,011	Aaa	1,407	Aaa
Canadian municipal securities	643	Aa1	639	Aa1
Commercial mortgage-backed securities and project loans(3)	453	Aaa	446	Aaa
Asset-backed and other	588	A2	392	Baa1
<b>Total all other corporate bonds and redeemable preferred stock</b>	<b>19,236</b>		<b>16,880</b>	
<b>Total fixed maturities</b>	<b>\$ 65,393</b>	<b>Aa2</b>	<b>\$ 64,232</b>	<b>Aa2</b>

(1) Rated using external rating agencies or by the Company when a public rating does not exist.

(2) Sovereign corporate securities include corporate securities that are backed by a government and include sovereign banks and securities issued under the Temporary Liquidity Guaranty and the Federal Ship Financing Programs.

(3) Included in commercial mortgage-backed securities and project loans at December 31, 2012 and 2011 are \$50 million and \$66 million of securities guaranteed by the U.S. government, respectively, and \$14 million and \$15 million by government sponsored enterprises, respectively.





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The following table sets forth the Company's fixed maturity investment portfolio rated using external ratings agencies or by the Company when a public rating does not exist:

(at December 31, 2012, in millions)	Carrying Value	Percent of Total Carrying Value
Quality Rating:		
Aaa	\$ 28,108	43.0%
Aa	20,768	31.8
A	8,354	12.8
Baa	6,111	9.3
Total investment grade	63,341	96.9
Below investment grade	2,052	3.1
Total fixed maturities	\$ 65,393	100.0%

*Obligations of States, Municipalities and Political Subdivisions*

The Company's fixed maturity investment portfolio at December 31, 2012 and 2011 included \$38.68 billion and \$39.02 billion, respectively, of securities which are obligations of states, municipalities and political subdivisions (collectively referred to as the municipal bond portfolio). The municipal bond portfolio is diversified across the United States, the District of Columbia and Puerto Rico and includes general obligation and revenue bonds issued by states, cities, counties, school districts and similar issuers. Included in the municipal bond portfolio at December 31, 2012 and 2011 were \$9.03 billion and \$7.33 billion, respectively, of advance refunded or escrowed-to-maturity bonds (collectively referred to as pre-refunded bonds), which are bonds for which an irrevocable trust has been established to fund the remaining payments of principal and interest. Such escrow accounts are verified as to their sufficiency by an independent verification agent of the underwriter, issuer or trustee and are almost exclusively comprised of U.S. Treasury securities. Moody's Investors Service has assigned negative outlooks to municipal securities in both the state sector and local government sector within the United States.

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The following table shows the geographic distribution of the \$29.66 billion of municipal bonds at December 31, 2012 that were not pre-refunded.

(at December 31, 2012, in millions)	State General Obligation	Local General Obligation	Revenue	Total Carrying Value	Average Credit Quality(1)
State:					
Texas	\$ 426	\$ 2,572	\$ 1,214	\$ 4,212	Aaa/Aa1
California	46	1,775	411	2,232	Aa2
Washington	273	793	497	1,563	Aa1
Virginia	183	673	681	1,537	Aaa/Aa1
Illinois	161	866	463	1,490	Aa1
Minnesota	306	746	234	1,286	Aaa/Aa1
Florida	345	42	830	1,217	Aa1
Massachusetts	188	28	914	1,130	Aaa/Aa1
Arizona		495	609	1,104	Aa1
North Carolina	239	606	205	1,050	Aaa
Colorado		679	197	876	Aa1
Georgia	201	376	288	865	Aaa/Aa1
Maryland	299	380	151	830	Aaa/Aa1
All Others(2)	1,976	3,498	4,790	10,264	Aa1
<b>Total</b>	<b>\$ 4,643</b>	<b>\$ 13,529</b>	<b>\$ 11,484</b>	<b>\$ 29,656</b>	<b>Aa1</b>

(1) Rated using external rating agencies or by the Company when a public rating does not exist. Ratings shown are the higher of the rating of the underlying issuer or the insurer in the case of securities enhanced by third-party insurance for the payment of principal and interest in the event of issuer default.

(2) No other single state accounted for 2.5% or more of the total pre-refunded municipal bonds.

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The following table displays the funding sources for the \$11.48 billion of municipal bonds identified as revenue bonds in the foregoing table at December 31, 2012.

(at December 31, 2012, in millions)	Carrying Value	Average Credit Quality(1)
Source:		
Water and sewer	\$ 3,886	Aaa/Aa1
Higher education	1,824	Aaa/Aa1
Transportation	1,169	Aa1
Power and utilities	1,071	Aa2
Special tax	883	Aa1
Lease	536	Aa2
Government funded/grant revenue	139	Aaa
Healthcare	98	Aa2
Housing	97	Aaa/Aa1
General fund	61	Aa3
Industrial revenue	51	A1
Property tax	33	Aa2
Other revenue sources	1,636	Aaa/Aa1
<b>Total</b>	<b>\$ 11,484</b>	<b>Aa1</b>

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(1)

Rated using external rating agencies or by the Company when a public rating does not exist.

The Company bases its investment decision on the underlying credit characteristics of the municipal security. While its municipal bond portfolio includes a number of securities that were enhanced by third-party insurance for the payment of principal and interest in the event of an issuer default, the Company does not rely on enhanced credit characteristics provided by such third-party insurance as part of its investing decisions. The downgrade during 2008 and 2009 of credit ratings of insurers of these securities resulted in a corresponding downgrade in the ratings of many such securities to the underlying rating of the respective security. Of the insured municipal securities in the Company's investment portfolio at December 31, 2012, approximately 99% were rated at A3 or above, and approximately 92% were rated at Aa3 or above, without the benefit of insurance. The Company believes that a loss of the benefit of insurance would not result in a material adverse impact on the Company's results of operations, financial position or liquidity, due to the underlying credit strength of the issuers of the securities, as well as the Company's ability and intent to hold the securities. The average credit rating of the underlying issuers of these securities was "Aa2" at December 31, 2012. The average credit rating of the entire municipal bond portfolio was "Aa1" at December 31, 2012 with and without the enhancement provided by third-party insurance.

Table of Contents*Debt Securities Issued by Foreign Governments*

The following table shows the geographic distribution of the Company's long-term fixed maturity investments in debt securities issued by foreign governments at December 31, 2012.

(at December 31, 2012, in millions)	Carrying Value	Average Credit Quality(1)
Foreign Government:		
Canada	\$ 1,025	Aaa
United Kingdom	945	Aaa
Norway	74	Aaa
Germany	70	Aaa
All Others(2)(3)	143	Aa2
<b>Total</b>	<b>\$ 2,257</b>	

(1) Rated using external rating agencies or by the Company when a public rating does not exist.

(2) The Company does not have direct exposure to sovereign debt issued by the Republic of Ireland, Italy, Greece, Portugal or Spain.

(3) No other country accounted for 2.5% or more of total debt securities issued by foreign governments.

The following table shows the Company's Eurozone exposure at December 31, 2012 to all debt securities issued by foreign governments, financial companies, sovereign corporations (including sovereign banks) whose securities are backed by the respective country's government and all other

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corporate securities (comprised of industrial corporations and utility companies) which could be affected if economic conditions deteriorated due to a prolonged recession.

(at December 31, 2012, in millions)	Debt Securities Issued by Foreign Governments				Corporate Securities			
	Average		Financial Average		Sovereign Corporates Average		All Other Average	
	Carrying Value	Credit Quality(1)	Carrying Value	Credit Quality(1)	Carrying Value	Credit Quality(1)	Carrying Value	Credit Quality(1)
<b>Eurozone Periphery</b>								
Spain	\$		\$ 14	Baa3	\$		\$ 36	Baa1
Ireland			2	A3			61	A3
Italy							23	Baa2
Greece							13	Baa2
Portugal								
Subtotal			16				133	
<b>Eurozone Non-Periphery</b>								
Germany	70	Aaa	7	A2	490	Aaa	223	A3
France	36	Aaa/Aa1	28	A2			379	A1
Netherlands			54	Aa3	126	Aaa	249	A2
Austria					43	Aa2		
Finland	18	Aaa					13	Baa3
Belgium							142	A3
Luxembourg							47	Baa1
Subtotal	124		89		659		1,053	
<b>Total</b>	<b>\$ 124</b>		<b>\$ 105</b>		<b>\$ 659</b>		<b>\$ 1,186</b>	

(1) Rated using external rating agencies or by the Company when a public rating does not exist. The table includes \$225 million of short-term securities which have the highest ratings issued by external rating agencies for short-term issuances. For purposes of this table, the short-term securities, which are rated "A-1+" and/or "P-1," are included as "Aaa" rated securities.

In January 2012, Standard & Poor's downgraded the sovereign ratings of nine Eurozone countries, including France (from "AAA" to "AA+"). In November 2012, Moody's downgraded the sovereign rating of France from "Aaa" to "Aa1."

In addition to fixed maturities noted in the foregoing table, the Company has exposure totaling \$276 million to private equity limited partnerships and real estate partnerships (both of which are included in other investments in the Company's consolidated balance sheet) whose primary investing focus is across Europe. The Company has unfunded commitments totaling \$145 million to these partnerships. The Company also has \$4 million of nonredeemable preferred stock (included in equity securities on the Company's consolidated balance sheet) issued by companies in the Eurozone.

*Mortgage-Backed Securities, Collateralized Mortgage Obligations and Pass-Through Securities*

The Company's fixed maturity investment portfolio at December 31, 2012 and 2011 included \$3.00 billion and \$3.52 billion, respectively, of residential mortgage-backed securities including pass-through-securities and collateralized mortgage obligations (CMO), all of which are subject to prepayment risk (either shortening or lengthening of duration). While prepayment risk for securities and its effect on income cannot be fully controlled, particularly when interest rates move dramatically, the Company's investment strategy generally favors securities that reduce this risk within expected



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interest rate ranges. Included in the totals at December 31, 2012 and 2011 were \$1.44 billion and \$1.82 billion, respectively, of GNMA, FNMA and FHLMC (excluding FHA project loans) guaranteed residential mortgage-backed pass-through securities classified as available for sale. Also included in those totals were residential CMOs classified as available for sale with a fair value of \$1.56 billion and \$1.70 billion, at December 31, 2012 and 2011, respectively. Approximately 43% and 38% of the Company's CMO holdings at December 31, 2012 and 2011, respectively, were guaranteed by or fully collateralized by securities issued by GNMA, FNMA or FHLMC. The average credit rating of the \$893 million and \$1.05 billion of non-guaranteed CMO holdings at December 31, 2012 and 2011, respectively, was "B2" and "Ba1," respectively. The average credit rating of all of the above securities was "A1" and "Aa3" at December 31, 2012 and 2011, respectively.

The Company makes investments in residential CMOs that are either guaranteed by GNMA, FNMA or FHLMC, or if not guaranteed, are senior or super-senior positions within their respective securitizations. Both guaranteed and non-guaranteed residential CMOs allocate the distribution of payments from the underlying mortgages among different classes of bondholders. In addition, non-guaranteed residential CMOs provide structures that allocate the impact of credit losses to different classes of bondholders. Senior and super-senior CMOs are protected, to varying degrees, from credit losses as those losses are initially allocated to subordinated bondholders. The Company's investment strategy is to purchase CMO tranches that are expected to offer the most favorable return given the Company's assessment of associated risks. The Company does not purchase residual interests in CMOs.

*Alternative Documentation Mortgages and Sub-Prime Mortgages*

At December 31, 2012 and 2011, the "mortgage-backed securities, collateralized mortgage obligations and pass-through securities" and "asset-backed and other" categories in the foregoing table included collateralized mortgage obligations backed by alternative documentation mortgages and asset-backed securities collateralized by sub-prime mortgages with a collective fair value of \$347 million and \$351 million, respectively (comprising less than 1% of the Company's total fixed maturity investments at both dates). The continued disruption in secondary investment markets provided the Company with the opportunity to selectively acquire additional mortgage-backed securities at discounted prices in recent years. The Company purchased \$11 million and \$128 million of such securities in the years ended December 31, 2012 and 2011, respectively. The Company defines sub-prime mortgage-backed securities as investments in which the underlying loans primarily exhibit one or more of the following characteristics: low FICO scores, above-prime interest rates, high loan-to-value ratios or high debt-to-income ratios. Alternative documentation securitizations are those in which the underlying loans primarily meet the government-sponsored entities' requirements for credit score but do not meet the government-sponsored entities' guidelines for documentation, property type, debt and loan-to-value ratios. The average credit rating on these securities and obligations held by the Company was "Ba1" and "Baa2" at December 31, 2012 and 2011, respectively.

*Commercial Mortgage-Backed Securities and Project Loans*

At December 31, 2012 and 2011, the Company held commercial mortgage-backed securities (including FHA project loans) of \$453 million and \$446 million, respectively. The Company does not believe this portfolio exposes it to a material adverse impact on its results of operations, financial position or liquidity, due to the portfolio's relatively small size and the underlying credit strength of these securities.

*Equity Securities Available for Sale, Real Estate and Short-Term Investments*

See note 1 of notes to the Company's consolidated financial statements for further information about these invested asset classes.

Table of Contents*Other Investments*

At December 31, 2012 and 2011, the carrying value of the Company's other investments was \$3.43 billion and \$3.45 billion, respectively. The Company's other investments are primarily comprised of private equity limited partnerships, hedge funds, real estate partnerships, joint ventures, mortgage loans, venture capital (through direct ownership and limited partnerships) and trading securities, which are subject to more volatility than the Company's fixed maturity investments. These asset classes have historically provided a higher return than fixed maturities but are subject to more volatility. Net investment income provided by these asset classes was \$414 million, \$292 million and \$304 million in 2012, 2011 and 2010, respectively. The increase in 2012 was primarily driven by improved results from the Company's real estate partnerships and hedge fund investments.

*Securities Lending*

The Company has engaged in securities lending activities from which it generates net investment income by lending certain of its investments to other institutions for short periods of time. At December 31, 2012 and 2011, the Company had \$403 million and \$126 million of securities on loan, respectively, as part of a tri-party lending agreement. The average monthly balance of securities on loan during 2012 and 2011 was \$197 million and \$170 million, respectively. Borrowers of these securities provide collateral equal to at least 102% of the market value of the loaned securities plus accrued interest. The Company has not incurred any investment losses in its securities lending program for the years ended December 31, 2012, 2011 and 2010.

*Net Unrealized Investment Gains*

The net unrealized investment gains that were included as a separate component of accumulated other comprehensive income were as follows:

(at December 31, in millions)	2012	2011	2010
Fixed maturities	\$ 4,564	\$ 4,238	\$ 2,650
Equity securities	183	145	147
Other investments	14	16	30
Unrealized investment gains before tax	4,761	4,399	2,827
Tax expense	1,658	1,528	968
Net unrealized investment gains at end of year	\$ 3,103	\$ 2,871	\$ 1,859

Net pretax unrealized investment gains were \$4.76 billion, \$4.40 billion and \$2.83 billion at December 31, 2012, 2011 and 2010, respectively. The Company's fixed maturities portfolio at December 31, 2012 and 2011 experienced an increase in valuation compared with the respective prior year-end, primarily due to the continuing decline in market interest rates.

The following table summarizes, for all fixed maturities and equity securities reported at fair value for which fair value is less than 80% of amortized cost at December 31, 2012, the gross unrealized



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investment loss by length of time those securities have continuously been in an unrealized loss position of greater than 20% of amortized cost:

(in millions)	Period For Which Fair Value Is Less Than 80% of Amortized Cost				Total
	3 Months or Less	Greater Than 3 Months, 6 Months or Less	Greater Than 6 Months, 12 Months or Less	Greater Than 12 Months	
<b>Fixed maturities:</b>					
Mortgage-backed securities	\$	\$	\$	\$	\$
Other		1		3	4
Total fixed maturities		1		3	4
<b>Equity securities</b>					
Total	\$	\$	1 \$	\$	3 \$ 4

These unrealized investment losses at December 31, 2012 represent less than 1% of the combined fixed maturity and equity security portfolios on a pretax basis and less than 1% of shareholders' equity on an after-tax basis.

For fixed maturity investments where fair value is less than the carrying value and the Company did not reach a decision to impair, the Company continues to have the intent and ability to hold such investments to a projected recovery in value, which may not be until maturity.

At both December 31, 2012 and 2011, below investment grade securities comprised 3.1% of the Company's fixed maturity investment portfolio. Included in below investment grade securities at December 31, 2012 were securities in an unrealized loss position that, in the aggregate, had an amortized cost of \$177 million and a fair value of \$168 million, resulting in a net pretax unrealized investment loss of \$9 million. These securities in an unrealized loss position represented less than 1% of both the total amortized cost and the fair value of the fixed maturity portfolio at December 31, 2012 and accounted for 26% of the total gross pretax unrealized investment loss in the fixed maturity portfolio at December 31, 2012.

Table of Contents*Impairment Charges*

Impairment charges included in net realized investment gains in the consolidated statement of income were as follows:

(for the year ended December 31, in millions)	2012	2011	2010
<b>Fixed maturities</b>			
U.S. Treasury securities and obligations of U.S. government and government agencies and authorities	\$	\$	\$
Obligations of states, municipalities and political subdivisions			
Debt securities issued by foreign governments			
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	4	13	4
All other corporate bonds	4	5	9
Redeemable preferred stock			
 Total fixed maturities	 8	 18	 13
<b>Equity securities</b>			
Common stock	3	6	2
Non-redeemable preferred stock	1		1
 Total equity securities	 4	 6	 3
<b>Other investments</b>	3	1	10
 Total	 \$ 15	 \$ 25	 \$ 26

Following are the pretax realized losses on investments sold during the year ended December 31, 2012:

(for the year ended December 31, 2012, in millions)	Loss	Fair Value
Fixed maturities	\$ 9	\$ 171
Equity securities		5
Other		
 Total	 \$ 9	 \$ 176

Purchases and sales of investments are based on cash requirements, the characteristics of the insurance liabilities and current market conditions. The Company identifies investments to be sold to achieve its primary investment goals of assuring the Company's ability to meet policyholder obligations as well as to optimize investment returns, given these obligations.

**CATASTROPHE MODELING**

The Company uses various analyses and methods, including proprietary and third-party computer modeling processes, to analyze catastrophic events and the risks associated with them. The Company uses these analyses and methods to make underwriting and reinsurance decisions designed to manage its exposure to catastrophic events. There are no industry-standard methodologies or assumptions for projecting catastrophe exposure. Accordingly, catastrophe estimates provided by different insurers may not be comparable.

The Company actively monitors and evaluates changes in third-party models and, when necessary, calibrates the catastrophe risk model estimates delivered via its own proprietary modeling processes. The Company considers historical loss experience, recent events, underwriting practices, market share

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analyses and various other factors to account for non-modeled losses to refine its proprietary view of catastrophe risk. These proprietary models are continually updated as new information emerges.

The tables below set forth the probabilities that estimated losses from a single event occurring in a one-year timeframe will equal or exceed the indicated loss amounts (expressed in dollars and as a percentage of the Company's common equity), based on the current version of the proprietary and third-party computer models utilized by the Company at December 31, 2012. For example, on the basis described below the tables, the Company estimates that there is a one percent chance that the Company's loss from a single U.S. hurricane in a one-year timeframe would equal or exceed \$1.4 billion, or 6% of the Company's common equity at December 31, 2012.

Likelihood of Exceedance(1)	Dollars (in billions)	
	Single U.S.	Single U.S.
	Hurricane	and Canadian Earthquake
2.0% (1-in-50)	\$ 1.1	\$ 0.5
1.0% (1-in-100)	\$ 1.4	\$ 0.7
0.4% (1-in-250)	\$ 2.4	\$ 0.9
0.1% (1-in-1,000)	\$ 5.2	\$ 2.0

Likelihood of Exceedance	Percentage of Common Equity(2)	
	Single U.S.	Single U.S.
	Hurricane	and Canadian Earthquake
2.0% (1-in-50)	5%	2%
1.0% (1-in-100)	6%	3%
0.4% (1-in-250)	11%	4%
0.1% (1-in-1,000)	23%	9%

(1) An event that has, for example, a 2% likelihood of exceedance is sometimes described as a "1-in-50 year event." As noted above, however, the probabilities in the table represent the likelihood of losses from a single event equaling or exceeding the indicated threshold loss amount in a one-year timeframe, not over a multi-year timeframe. Also, because the probabilities relate to a single event, the probabilities do not address the likelihood of more than one event occurring in a particular period, and, therefore, the amounts do not address potential aggregate catastrophe losses occurring in a one-year timeframe.

(2) The percentage of common equity is calculated by dividing (a) indicated loss amounts in dollars by (b) total common equity excluding net unrealized investment gains and losses, net of taxes. Net unrealized investment gains and losses can be significantly impacted by both discretionary and other economic factors and are not necessarily indicative of operating trends. Accordingly, the Company's management uses the percentage of common equity calculated on this basis as a metric to evaluate the potential impact of a single hurricane or single earthquake on the Company's financial position for purposes of making underwriting and reinsurance decisions.

The threshold loss amounts in the tables above, which are based on the Company's in-force portfolio at December 31, 2012 and catastrophic reinsurance program at January 1, 2013, are net of reinsurance, after-tax and exclude most loss adjustment expenses, which historically have been less than 10% of loss estimates. The amounts for hurricanes reflect U.S. exposures and include property exposures, property residual market exposures and an adjustment for certain non-property exposures. The hurricane loss amounts are based on the Company's catastrophe risk model estimates and include losses from the hurricane hazards of wind and storm surge. The amounts for earthquakes reflect U.S.

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and Canadian exposures and include property exposures and workers' compensation exposures. The Company does not believe that the inclusion of hurricane or earthquake losses arising from other geographical areas or other exposures would materially change the estimated threshold loss amounts.

Catastrophe modeling relies upon inputs based on experience, science, engineering and history. These inputs reflect a significant amount of judgment and are subject to changes which may result in volatility in the modeled output. Catastrophe modeling output may also fail to account for risks that are outside the range of normal probability or are otherwise unforeseeable. Catastrophe modeling assumptions include, among others, the portion of purchased reinsurance that is collectible after a catastrophic event, which may prove to be materially incorrect. Consequently, catastrophe modeling estimates are subject to significant uncertainty. In the tables above, the uncertainty associated with the estimated threshold loss amounts increases significantly as the likelihood of exceedance decreases. In other words, in the case of a relatively more remote event (e.g., 1-in-1,000), the estimated threshold loss amount is relatively less reliable. Actual losses from an event could materially exceed the indicated threshold loss amount. In addition, more than one such event could occur in any period.

Moreover, the Company is exposed to the risk of material losses from other than property and workers' compensation coverages arising out of hurricanes and earthquakes, and it is exposed to catastrophe losses from perils other than hurricanes and earthquakes, such as tornadoes and other windstorms, hail, wildfires, severe winter weather, floods, volcanic eruptions, tsunamis and acts of terrorism.

For more information about the Company's exposure to catastrophe losses, see "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" and "Item 1A Risk Factors We may be adversely affected if our pricing and capital models provide materially different indications than actual results."

## **CHANGING CLIMATE CONDITIONS**

Severe weather events over the last several years have underscored the unpredictability of future climate trends and created uncertainty regarding insurers' exposures to financial loss as a result of catastrophes and other weather-related events. Some scientists believe that, in recent years, changing climate conditions have added to the unpredictability, frequency and severity of natural disasters. For example, in recent years hurricane activity has impacted areas further inland than previously experienced, thus expanding the Company's potential for losses from hurricanes. Additionally, both the frequency and severity of tornado and hail storms in the United States have been greater in recent years. Further, any reduction in arctic sea ice may contribute to rising sea levels that could impact flooding in coastal areas. Accordingly, if climate conditions are changing, the Company may be subject to increased losses from catastrophes and other weather-related events. Additionally, the Company's catastrophe models may be less reliable due to the increased unpredictability, frequency and severity of severe weather events.

The Company discusses how potentially changing climate conditions may present other issues for its business under "Risk Factors" in Item 1A of this report and under " Outlook" herein. For example, among other things:

Increasingly unpredictable and severe weather conditions could result in increased frequency and severity of claims under policies issued by the Company. See "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" and " Outlook Underwriting Gain/Loss."

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Changing climate conditions could also impact the creditworthiness of issuers of securities in which the Company invests. For example, water supply adequacy could impact the creditworthiness of bond issuers in the Southwestern United States, and more frequent and/or severe hurricanes could impact the creditworthiness of issuers in the Southeastern United States, among other areas. See "Risk Factors Our investment portfolio may suffer reduced returns or material realized or unrealized losses."

Increased regulation adopted in response to potential changes in climate conditions may impact the Company and its customers. For example, state insurance regulation could impact the Company's ability to manage property exposures in areas vulnerable to significant climate driven losses. If the Company is unable to implement risk based pricing, modify policy terms or reduce exposures to the extent necessary to address rising losses related to catastrophes and smaller scale weather events (should those increased losses occur), its business may be adversely affected. See "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."

The full range of potential liability exposures related to climate change continues to evolve. Through the Company's Emerging Issues Committee and its Committee on Climate, Energy and the Environment, the Company works with its business units and corporate groups, as appropriate, to identify and try to assess climate change-related liability issues, which are continually evolving and often hard to fully evaluate. See "Risk Factors The effects of emerging claim and coverage issues on our business are uncertain."

Climate change regulation also could increase the Company's customers' costs of doing business. For example, insureds faced with carbon management regulatory requirements may have less available capital for investment in loss prevention and safety features which may, over time, increase loss exposures. Also, increased regulation may result in reduced economic activity, which would decrease the amount of insurable assets and businesses.

The Company regularly reviews emerging issues, such as changing climate conditions, to consider potential changes to its modeling and the use of such modeling, as well as to help determine the need for new underwriting strategies, coverage modifications or new products.

## **REINSURANCE RECOVERABLES**

Ceded reinsurance involves credit risk, except with regard to mandatory pools for which liability is mostly joint and several, 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 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 and the price of their product offerings. 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.

The Company holds collateral, including trust agreements, escrow funds and letters of credit, under certain reinsurance agreements. The Company has also entered into Master Security Agreements with certain reinsurers. These agreements define conditions that require the reinsurer to provide collateral. The specific conditions and the amounts and form of collateral to be provided by these

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agreements vary based on a number of factors including, but not limited to, the reinsurers' legal structure and trading history with the Company.

The following table summarizes the composition of the Company's reinsurance recoverables:

(at December 31, in millions)	2012	2011
Gross reinsurance recoverables on paid and unpaid claims and claim adjustment expenses	\$ 5,256	\$ 6,255
Allowance for uncollectible reinsurance	(258)	(345)
<b>Net reinsurance recoverables</b>	<b>4,998</b>	<b>5,910</b>
Mandatory pools and associations	2,549	2,020
Structured settlements	3,165	3,225
<b>Total reinsurance recoverables</b>	<b>\$ 10,712</b>	<b>\$ 11,155</b>

The \$912 million decline in net reinsurance recoverables since December 31, 2011 primarily reflected the impact of cash collections, including commutation agreements, and the impact of net favorable prior year reserve development.

The following table presents the Company's top five reinsurer groups by reinsurance recoverable at December 31, 2012 (in millions). Also included is the A.M. Best rating of each reinsurer group at February 19, 2013:

Reinsurer Group	Reinsurance Recoverable	A.M. Best Rating	of Group's Predominant Reinsurer
Munich Re Group	\$ 550	A+	second highest of 16 ratings
Swiss Re Group	517	A+	second highest of 16 ratings
Alleghany Group(1)	302	A	third highest of 16 ratings
XL Capital Group	266	A	third highest of 16 ratings
Berkshire Hathaway Group	258	A++	highest of 16 ratings

(1) In 2012, Alleghany Corporation and Transatlantic Holdings, Inc. completed their merger. As a result, Transatlantic became an operating subsidiary of Alleghany.

At December 31, 2012, the Company held \$1.5 billion of collateral in the form of letters of credit, funds and trust agreements held to fully or partially collateralize certain reinsurance recoverables.

For a discussion of a pending reinsurance dispute pertaining to a portion of the Company's reinsurance recoverable from the Munich Re Group in the foregoing table, see note 16 of notes to the consolidated financial statements.

Also included in reinsurance recoverables are amounts related to structured settlements, which are 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 Company would be required to make such payments if and to the extent the purchased annuities are not covered by state guaranty associations. The following table presents the Company's top five groups

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by structured settlements at December 31, 2012 (in millions). Also included is the A.M. Best rating of the Company's predominant insurer from each insurer group at February 19, 2013:

Group	Structured Settlements	A.M. Best Rating of Group's Predominant Insurer	
Fidelity & Guaranty Life Group	\$ 981	B++	fifth highest of 16 ratings
MetLife Group	474	A+	second highest of 16 ratings
Genworth Financial Group	437	A	third highest of 16 ratings
Symetra Financial Group	256	A	third highest of 16 ratings
John Hancock Group	190	A+	second highest of 16 ratings

Reinsurance companies and life insurance companies have been negatively impacted by turbulent economic conditions, significant catastrophe events and investment portfolio challenges in recent years. A number of such companies have been subjected to downgrades and/or negative outlook changes by various ratings agencies, including those with which the Company conducts business. The Company considers these factors in assessing the adequacy of its allowance for uncollectible amounts.

**OUTLOOK**

The following discussion provides outlook information for certain key drivers of the Company's results of operations and capital position.

*Premiums.* The Company's earned premiums are a function of net written premium volume. Net written premiums comprise both renewal business and new business and are recognized as earned premium over the life of the underlying policies. When business renews, the amount of net written premiums associated with that business may increase or decrease (renewal premium change) as a result of increases or decreases in rate and/or insured exposures, which the Company considers as a measure of units of exposure (such as the number and value of vehicles or properties insured). Net written premiums from both renewal and new business, and therefore earned premiums, are impacted by competitive market conditions as well as general economic conditions, which, particularly in the case of the Business Insurance segment, affect audit premium adjustments, policy endorsements and mid-term cancellations. Net written premiums are also impacted by the structure of reinsurance programs and related costs.

Given the possibility that more active weather patterns such as the Company experienced in a number of recent periods may continue, as well as the possibility that interest rates may remain low for some period of time, along with the current level of profitability in certain of its product lines, the Company has undertaken efforts to improve its underwriting margins. These efforts include seeking improved rates, as well as improved terms and conditions on many of its insurance products, and also include other initiatives, such as reducing operating expenses and acquisition costs. These efforts may not be successful and/or may result in lower retention and new business levels and therefore lower business volumes. In particular, in the Agency Automobile line of business, the Company has undertaken various actions to improve its underwriting margins, which have been negatively impacted by various factors. If these actions are not effective, the Company may need to explore other actions or initiatives to improve its competitive position and profitability in this line of business. Refer to "Part I Item 1A Risk Factors The intense competition that we face could harm our ability to maintain or increase our business volumes and our profitability" in this report.

Nonetheless, the Company currently expects retention levels (the amount of expiring premium that renews, before the impact of renewal premium changes) will remain strong relative to historical experience. The Company also expects to continue to achieve price increases on renewal business during 2013 that generally exceed loss cost trends. In the Business Insurance segment, the Company expects that renewal premium changes during 2013 will be broadly consistent with the higher levels

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attained in the fourth quarter of 2012 and will be driven by both positive renewal rate changes and, subject to the economic uncertainties discussed below, growth in insured exposures. In the Financial, Professional & International Insurance segment, the Company expects that renewal premium changes will modestly improve during 2013 compared to the fourth quarter of 2012. With respect to construction surety, the Company expects written premium volume to be broadly consistent with the levels attained in 2012. In the Personal Insurance segment, the Company expects both Agency Automobile and Agency Homeowners and Other renewal premium changes during 2013 will decline slightly as compared to the fourth quarter of 2012, but are expected to remain positive and exceed underlying loss cost trends, assuming weather patterns consistent with the Company's expectations. Renewal premium changes for both Agency Automobile and Agency Homeowners and Other in 2013 are expected to be driven by both positive renewal rate changes (based on the Company's actions to file for rate increases) and, subject to the economic uncertainties discussed below, growth in insured exposures. The need for state regulatory approval for changes to personal property and casualty insurance prices, as well as competitive market conditions, may impact the timing and extent of renewal premium changes.

The pricing environment for new business generally has less of an impact on underwriting profitability than renewal rate changes, given the volume of new business relative to renewal business. Property and casualty insurance market conditions are expected to remain competitive during 2013 for new business, not only in Business Insurance and Financial, Professional & International Insurance, but especially in Personal Insurance, where price comparison technology used by agents and brokers, sometimes referred to as "comparative raters," has facilitated the process of generating multiple quotes, and thereby increasing price comparison on new business and, increasingly, on renewal business. In addition, the Company launched a new distribution channel in 2009 that markets personal insurance products directly to consumers, which is expected to continue to generate modest growth in premium volume for Personal Insurance during 2013.

Current economic conditions have been somewhat volatile, and there is increased uncertainty as to whether the U.S. or the global economy will grow modestly, remain stagnant or enter a recession. Economic growth experienced in 2011 and 2012 may or may not continue, or may continue at a slower rate for an extended period of time. In addition, some economic conditions, such as the commercial and residential real estate environment and employment rates, may continue to be weak. Future actions or inactions of the United States government, including a failure to increase the government debt limit or a shutdown of the federal government, could increase the actual or perceived risk that the U.S. may not ultimately pay its obligations when due and may disrupt financial markets. Further, general uncertainty regarding the U.S. Federal budget and taxes has added to the uncertainty regarding economic conditions generally.

If weak economic conditions persist or deteriorate, the resulting low levels of economic activity could impact exposure changes at renewal and the Company's ability to write business at acceptable rates. Additionally, low levels of economic activity could adversely impact audit premium adjustments, policy endorsements and mid-term cancellations after policies are written. All of the foregoing, in turn, could adversely impact net written premiums during 2013, and, since earned premiums lag net written premiums, earned premiums could be adversely impacted following 2013.

*Underwriting Gain/Loss.* The Company's underwriting gain/loss can be significantly impacted by catastrophe losses and net favorable or unfavorable prior year reserve development, as well as underlying underwriting margins.

Catastrophe and other weather-related losses are inherently unpredictable from period to period. The Company experienced significant catastrophe and other weather-related losses in a number of recent periods which adversely impacted its results of operations. The Company's results of operations



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would continue to be adversely impacted if significant catastrophe and other weather-related losses were to occur during 2013.

For the last several years, the Company's results have included significant amounts of net favorable prior year reserve development, although at lower levels in some recent years, driven by better than expected loss experience in all of the Company's segments. The lower level of net favorable prior year reserve development in a number of recent periods may have been in part due to the Company's reserve estimation process incorporating those factors that led to the higher levels of net favorable prior year reserve development in previous years. If that trend continues, the better than expected loss experience may continue at these recent lower levels, or even lower levels. However, given the inherent uncertainty in estimating claims and claim adjustment expense reserves, loss experience could develop such that the Company recognizes higher or lower levels of favorable prior year reserve development, no favorable prior year reserve development or unfavorable prior year reserve development in future periods. In addition, the ongoing review of prior year claims and claim adjustment expense reserves, or other changes in current period circumstances, may result in the Company revising current year loss estimates upward or downward in future periods of the current year.

In Business Insurance, the Company expects that the anticipated impact of increases in renewal premium changes, partially offset by an expected modest increase in underlying losses, and assuming weather patterns consistent with the Company's expectations, will likely result in underlying underwriting margins during 2013 that are higher than in 2012. In Financial, Professional & International Insurance, the Company expects that the anticipated impact of lower underlying losses due to recent underwriting actions in the segment and increases in renewal premium changes in Bond & Financial Products will likely result in underlying underwriting margins during 2013 that are modestly higher than in 2012. In Personal Insurance, the Company anticipates underlying underwriting margins during 2013 that are broadly consistent with 2012. In Agency Automobile, the Company anticipates an improvement in underlying underwriting margins during 2013 due to the anticipated impact of continued positive renewal premium changes, partially offset by loss cost trends. In Agency Homeowners and Other, the Company anticipates a decline in underlying underwriting margins during 2013, reflecting a return to non-catastrophe weather-related loss levels consistent with the Company's expectations. Also in Personal Insurance, the Company's direct to consumer initiative, as discussed above, 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 this book of business grows and matures.

*Investment Portfolio.* The Company expects to continue to focus its investment strategy on maintaining a high-quality investment portfolio and a relatively short average effective duration. The average effective duration of fixed maturities and short-term securities was 3.2 (3.4 excluding short-term securities) at December 31, 2012. 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 continually evaluates its investment alternatives and mix. Currently, the majority of the Company's investments are comprised of 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 also invests much smaller amounts in equity securities, real estate, private equity limited partnerships, hedge funds, real estate partnerships, 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 the potential for higher degrees of risk, including less stable rates of return and less liquidity.

Net investment income is a material contributor to the Company's results of operations. Interest rates remain at very low levels by historical standards. Based on the current interest rate environment,

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the Company estimates that the impact of lower reinvestment yields on the Company's fixed maturity portfolio could, in 2013, result in approximately \$30 million of lower after-tax net investment income from that portfolio on a quarterly basis as compared to the corresponding quarter of 2012. Given recent general economic and investment market conditions, the Company expects investment income from the non-fixed maturity portfolio for 2013 to be lower than in 2012. If general economic conditions and/or investment market conditions deteriorate in 2013, the Company could also experience a reduction in net investment income and/or significant realized investment losses, including impairments. For further discussion of the Company's investment portfolio, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Investment Portfolio" in this report. For a discussion of the risks to the Company's business during or following a financial market disruption and risks to the Company's investment portfolio, see the risk factors entitled "During or following a period of financial market disruption or economic downturn, our business could be materially and adversely affected" and "Our investment portfolio may suffer reduced returns or material realized or unrealized losses" included in "Risk Factors" in Part I, Item 1A of this report.

*Capital Position.* The Company believes it has a strong capital position and, as part of its ongoing efforts to create shareholder value, expects to continue to return capital not needed to support its business operations to its shareholders. In recent years, the Company has returned capital to its shareholders, comprising dividends to common shareholders and common share repurchases, in amounts that have exceeded its operating income. The Company now expects that, generally over time, the combination of dividends to common shareholders and common share repurchases will likely not exceed operating income. In addition, actual amounts of common share repurchases will also depend on a variety of additional factors, including corporate and regulatory requirements, maintaining capital levels commensurate with the Company's existing ratings from independent rating agencies, share price, funding of the Company's qualified pension plan, strategic initiatives and other market conditions. For information regarding the Company's common share repurchases in 2012, see "Liquidity and Capital Resources" in this report.

The Company had a net after-tax unrealized investment gain of \$2.98 billion in its fixed maturity investment portfolio at December 31, 2012. While the Company does not attempt to predict future interest rate movements, a rising interest rate environment would reduce the market value of fixed maturity investments and, therefore, reduce shareholders' equity, and a declining interest rate environment would have the opposite effects.

Many of the statements in this "Outlook" section are forward-looking statements, which are subject to risks and uncertainties that are often difficult to predict and beyond the Company's control. Actual results could differ materially from those expressed or implied by such forward-looking statements. Further, such forward-looking statements speak only as of the date of this report and the Company undertakes no obligation to update them. See "Forward-Looking Statements." For a discussion of potential risks and uncertainties that could impact the Company's results of operations or financial position, see "Item 1A Risk Factors" and "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates" in this report.

## **LIQUIDITY AND CAPITAL RESOURCES**

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet the cash requirements of its business operations and to satisfy general corporate purposes when needed. The liquidity requirements of the Company have been met primarily by funds generated from premiums, fees, income received on investments and investment maturities. Cash provided from these sources is used primarily for claims and claim adjustment expense payments, operating expenses, debt servicing, taxes, shareholder dividends and, in recent years, for common share repurchases. The timing and amount of catastrophe claims are inherently unpredictable. Such claims increase liquidity requirements. The timing and amount of reinsurance recoveries may be affected by reinsurer solvency and

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reinsurance coverage disputes. Additionally, the variability of asbestos-related claim payments, as well as the volatility of potential judgments and settlements arising out of litigation, may also result in increased liquidity requirements. It is the opinion of the Company's management that the Company's future liquidity needs will be adequately met from all of the above sources.

At December 31, 2012, total cash and short-term invested assets aggregating \$2.03 billion and having a weighted average maturity of 76 days were held in the United States by the holding company. These assets are sufficient to meet the holding company's current liquidity requirements and are in excess of the Company's minimum target level, comprising the Company's estimated annual pretax interest expense and common shareholder dividends, and currently totaling approximately \$1.1 billion. These liquidity requirements primarily include shareholder dividends, debt service and contributions to its qualified domestic pension plan from time to time.

The holding company is not dependent on dividends or other forms of repatriation from its foreign operations to support its liquidity needs. U.S. income taxes have not been recognized on \$755 million of the Company's foreign operations' undistributed earnings as of December 31, 2012, as such earnings are intended to be permanently reinvested in those operations. Furthermore, taxes paid to foreign governments on these earnings may be used as credits against the U.S. tax on dividend distributions if such earnings were to be distributed to the holding company. The amount of undistributed earnings from foreign operations and related taxes on those undistributed earnings were not material to the Company's financial position or liquidity at December 31, 2012.

The Company has a shelf registration statement with the Securities and Exchange Commission which permits it to issue securities from time to time. The Company also has a \$1.0 billion line of credit facility with a syndicate of financial institutions that expires in June 2013. This line of credit also supports the Company's \$800 million commercial paper program, of which \$100 million was outstanding at December 31, 2012. The Company is not reliant on its commercial paper program to meet its operating cash flow needs.

The Company currently utilizes uncollateralized letters of credit issued by major banks with an aggregate limit of approximately \$392 million to provide much of the capital needed to support its obligations at Lloyd's. If uncollateralized letters of credit are not available at a reasonable price or at all in the future, the Company can collateralize these letters of credit or may have to seek alternative means of supporting its obligations at Lloyd's, which could include utilizing holding company funds on hand.

**Operating Activities**

Net cash flows provided by operating activities were \$3.23 billion, \$2.17 billion and \$3.05 billion in 2012, 2011 and 2010, respectively. Cash flows in 2012 primarily reflected a decrease in losses paid related to catastrophes, a lower level of paid losses related to asbestos claims and operations in runoff and a higher level of collected premiums, partially offset by an increase in paid losses related to non-catastrophe ongoing business (including the impact of increased loss costs). Cash flows in 2011 reflected an increase in losses paid related to catastrophes and ongoing business (including the impact of increased loss costs), a higher level of contributions to the Company's qualified domestic pension plan and lower receipts related to net investment income as compared with 2010. These factors were partially offset by a higher level of collected premiums, a lower level of paid operating expenses and a lower level of paid losses related to asbestos claims and operations in runoff. In the years ended December 31, 2012, 2011 and 2010, the Company contributed \$217 million, \$185 million and \$35 million, respectively, to its qualified domestic pension plan.

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**Investing Activities**

Net cash flows used by investing activities in 2012 were \$972 million, compared with net cash flows provided by investing activities of \$1.15 billion and \$2.11 billion in 2011 and 2010, respectively. The Company's consolidated total investments at December 31, 2012 increased by \$1.14 billion from year-end 2011, driven by operating cash flows of \$3.23 billion and a \$362 million increase in net pretax unrealized appreciation of investments in 2012, partially offset by the impact of the Company's common share repurchases of \$1.47 billion under its share repurchase authorization, common shareholder dividends of \$694 million and debt repayments of \$258 million.

On December 5, 2012, the Company increased its ownership in J. Malucelli Participações em Seguros e Resseguros S.A, its Brazilian joint venture (JMalucelli), through the exercise of a pre-existing option. As a result, the Company increased its ownership to 49.5% of the venture. JMalucelli is currently the market leader in surety in Brazil based on market share. The Company's investment was funded with cash provided internally from an operating subsidiary of the Company.

The Company's investment portfolio is managed to support its insurance operations; accordingly, the portfolio is positioned to meet obligations to policyholders. As such, the primary goals of the Company's asset-liability management process are to satisfy the insurance liabilities and maintain sufficient liquidity to cover fluctuations in projected liability cash flows. 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. Although this is not an exact cash flow match in each period, the substantial amount by which the market 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.

**Financing Activities**

Net cash flows used in financing activities were \$2.15 billion, \$3.31 billion and \$5.22 billion in 2012, 2011 and 2010, respectively. The totals in each year reflected common share repurchases, dividends to shareholders and the repayment of debt, partially offset by the proceeds from employee stock option exercises and, in 2010, the issuance of debt.

*Debt Transactions.*

*2012.* On May 29, 2012, the Company purchased and retired \$8.5 million aggregate principal amount of its 6.25% fixed-to-floating rate junior subordinated debentures due March 15, 2067 in an open market transaction. The Company's \$250 million, 5.375% senior notes matured on June 15, 2012 and were paid from existing holding company liquidity.

*2011.* On June 1, 2011, the Company repaid the remaining \$9 million principal balance on its 7.22% real estate non-recourse debt.

*2010.* On November 1, 2010, the Company issued \$500 million aggregate principal amount 3.90% senior notes that will mature on November 1, 2020, and \$750 million aggregate principal amount 5.35% senior notes that will mature on November 1, 2040. The net proceeds of these issuances, after original issuance discount and the deduction of underwriting expenses and commissions and other expenses, were approximately \$496 million and \$738 million, respectively. Interest on the senior notes is payable semi-annually in arrears on November 1 and May 1 of each year. The senior notes are redeemable in whole at any time or in part from time to time, at the Company's option, at a redemption price equal to the greater of (a) 100% of the principal amount of senior notes to be redeemed or (b) the sum of the present values of the remaining scheduled payments of principal and interest on the senior notes to be redeemed (exclusive of interest accrued to the date of redemption) discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the

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then current Treasury rate (as defined) plus 15 basis points for the 2020 senior notes and 20 basis points for the 2040 notes.

Prior to November 2010, the Company was subject to a replacement capital covenant that it had granted to the holders of its 6.75% senior notes due June 20, 2036 (the senior notes). The replacement capital covenant restricted the Company's ability to repurchase its \$1.00 billion in outstanding 6.25% fixed-to-floating rate junior subordinated debentures due March 15, 2067 (the debentures). In November 2010, the Company paid approximately \$4 million to holders of the senior notes to terminate the replacement capital covenant. Following the termination, the Company purchased approximately \$885 million aggregate principal amount of the debentures. A \$60 million pretax loss was recognized in 2010 related to these transactions.

On September 16, 2010, the Company repaid the remaining \$4 million principal balance on its 7.81% private placement senior notes. On August 23, 2010, the Company's \$21 million, 7.415% medium-term notes matured and were fully paid. On April 15, 2010, the Company's \$250 million, 8.125% senior notes matured and were fully paid. All of these debt payments were made from internally-generated funds.

The amount of debt obligations, other than commercial paper, that becomes due in 2013 is \$500 million. In 2014, no debt obligations become due. In 2015, the amount of debt obligations, other than commercial paper, that comes due is \$400 million. The Company may refinance maturing debt through funds generated internally or, depending on market conditions, through funds generated externally, including as a result of the issuance of debt or other securities.

*Dividends.* Dividends paid to shareholders were \$694 million, \$665 million and \$673 million in 2012, 2011 and 2010, respectively. The declaration and payment of future dividends to holders of the Company's common stock will be at the discretion of the Company's board of directors and will depend upon many factors, including the Company's financial position, earnings, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints and other factors as the board of directors deems relevant. Dividends will be paid by the Company only if declared by its board of directors out of funds legally available, subject to any other restrictions that may be applicable to the Company. On January 22, 2013, the Company announced that it declared a regular quarterly dividend of \$0.46 per share, payable March 29, 2013 to shareholders of record on March 8, 2013.

*Share Repurchases.* The Company's board of directors has approved common share repurchase authorizations under which repurchases may be made from time to time in the open market, pursuant to pre-set trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934, in private transactions or otherwise. The authorizations do not have a stated expiration date. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including the Company's financial position, earnings, share price, catastrophe losses, funding of the Company's qualified pension plan, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, other investment opportunities (including mergers and acquisitions), market conditions and other factors. The following table summarizes repurchase activity in 2012 and remaining repurchase capacity at December 31, 2012.

Quarterly Period Ending (in millions, except per share amounts)	Number of shares purchased	Cost of shares repurchased	Average price paid per share	Remaining capacity under share repurchase authorization
March 31, 2012	6.0	\$ 350	\$ 58.73	\$ 3,259
June 30, 2012	5.6	350	\$ 62.40	\$ 2,909
September 30, 2012	5.4	350	\$ 65.00	\$ 2,559
December 31, 2012	5.4	400	\$ 73.00	\$ 2,159
<b>Total</b>	<b>22.4</b>	<b>\$ 1,450</b>	<b>\$ 64.64</b>	<b>\$ 2,159</b>

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From the inception of the first authorization in May 2006 through December 31, 2012, the Company repurchased a cumulative total of 362.4 million shares for a total cost of \$18.84 billion, or an average of \$51.99 per share.

In 2012, 2011 and 2010, the Company acquired 0.9 million, 1.4 million and 1.3 million shares, respectively, of common stock from employees as treasury stock primarily to cover payroll withholding taxes related to the vesting of restricted stock awards and exercises of stock options.

*Conversion of Preferred Stock to Common Stock.* In May 2011, the Company's board of directors authorized the redemption of the Company's preferred stock held by The Travelers 401(k) Savings Plan (the Savings Plan) and gave notice of that redemption to the appropriate fiduciaries of the Savings Plan. Following a fiduciary review, the Savings Plan exercised its right to convert each preferred share into eight shares of the Company's common stock. As a result, all preferred shares outstanding on June 7, 2011 (190,083 shares) were converted into a total of 1.52 million shares of the Company's common stock.

**Capital Resources**

Capital resources reflect the overall financial strength of the Company and its ability to borrow funds at competitive rates and raise new capital to meet its needs. The following table summarizes the components of the Company's capital structure at December 31, 2012 and 2011.

(at December 31, in millions)	2012	2011
Debt:		
Short-term	\$ 600	\$ 350
Long-term	5,761	6,269
Net unamortized fair value adjustments and debt issuance costs	(11)	(14)
<b>Total debt</b>	<b>6,350</b>	<b>6,605</b>
Shareholders' equity:		
Common stock and retained earnings, less treasury stock	23,169	22,472
Accumulated other comprehensive income	2,236	2,005
<b>Total shareholders' equity</b>	<b>25,405</b>	<b>24,477</b>
<b>Total capitalization</b>	<b>\$ 31,755</b>	<b>\$ 31,082</b>

Total capitalization at December 31, 2012 was \$31.76 billion, \$673 million higher than at December 31, 2011 primarily reflecting the impact of net income of \$2.47 billion and an increase in net unrealized appreciation of investments, partially offset by common share repurchases under the Company's share repurchase authorization totaling \$1.45 billion, shareholder dividends of \$700 million and debt repayments of \$258 million.

The following table provides a reconciliation of total capitalization excluding net unrealized gains on investments to total capitalization presented in the foregoing table.

(at December 31, dollars in millions)	2012	2011
Total capitalization excluding net unrealized gains on investments	\$ 28,652	\$ 28,211
Net unrealized gain on investments, net of taxes	3,103	2,871
<b>Total capitalization</b>	<b>\$ 31,755</b>	<b>\$ 31,082</b>
Debt-to-total capital ratio	20.0%	21.3%
Debt-to-total capital ratio excluding net unrealized gains on investments	22.2%	23.4%

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The debt-to-total capital ratio excluding net unrealized gains on investments is calculated by dividing (a) debt by (b) total capitalization excluding net unrealized gains and losses on investments, net of taxes. Net unrealized gains and losses on investments can be significantly impacted by both discretionary and other economic factors and are not necessarily indicative of operating trends. Accordingly, in the opinion of the Company's management, the debt-to-total capital ratio calculated on this basis provides another useful metric for investors to understand the Company's financial leverage position. The Company's debt-to-total capital ratio of 22.2% at December 31, 2012 calculated on this basis was within the Company's target range of 15% to 25%.

*Line of Credit Agreement.* The Company is party to a three-year, \$1.0 billion revolving credit agreement with a syndicate of financial institutions that expires in June 2013. Pursuant to the credit agreement covenants, the Company must maintain a minimum consolidated net worth (generally defined as shareholders' equity plus certain trust preferred and mandatorily convertible securities, reduced for goodwill and other intangible assets) of \$14.35 billion. The Company must also maintain a ratio of total debt to the sum of total debt plus consolidated net worth of not greater than 0.40 to 1.00. In addition, the credit agreement contains other customary restrictive covenants as well as certain customary events of default, including with respect to a change in control, which is defined to include the acquisition of 35% or more of the Company's voting stock and certain changes in the composition of the Company's board of directors. At December 31, 2012, the Company was in compliance with these covenants. Generally, the cost of borrowing under this agreement will range from LIBOR plus 100 basis points to LIBOR plus 175 basis points depending on the Company's credit ratings. At December 31, 2012, that cost would have been LIBOR plus 125 basis points had there been any amounts outstanding under the credit agreement. This line of credit also supports the Company's commercial paper program.

*Shelf Registration.* The Company has filed with the Securities and Exchange Commission a universal shelf registration statement for the potential offering and sale of securities to replace the Company's previous registration statement that had expired in the normal course of business. The Company may offer these securities from time to time at prices and on other terms to be determined at the time of offering.

*Share Repurchase Authorization.* At December 31, 2012, the Company had \$2.16 billion of capacity remaining under its share repurchase authorization approved by the board of directors.

**Contractual Obligations**

The following table summarizes, as of December 31, 2012, the Company's future payments under contractual obligations and estimated claims and claim-related payments. The table excludes short-term obligations and includes only liabilities at December 31, 2012 that are expected to be settled in cash.

The table below includes the amount and estimated future timing of claims and claim-related payments. The amounts do not represent the exact liability, but instead represent estimates, generally utilizing actuarial projections techniques, at a given accounting date. These estimates include expectations of what the ultimate settlement and administration of claims will cost based on the Company's assessment of facts and circumstances then known, review of historical settlement patterns, estimates of trends in claims severity, frequency, legal theories of liability and other factors. Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation or deflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be significant reporting lags between the occurrence of the policyholder event and the time it is actually reported to the insurer. The future cash flows related to the items contained in the table below required estimation of both amount (including severity considerations) and timing. Amount and timing are frequently estimated separately. An estimation of both amount and timing of future cash flows

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related to claims and claim-related payments is generally reliable only in the aggregate with some unavoidable estimation uncertainty.

The contractual obligations related to debt, operating leases, purchase obligations, long-term unfunded investment commitments, estimated claims and claim-related payments (gross of the estimated reinsurance recoveries) and liabilities related to unrecognized tax benefits, at December 31, 2012 were as follows:

Payments Due by Period (in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
<b>Debt</b>					
Senior notes	\$ 5,900	\$ 500	\$ 400	\$ 850	\$ 4,150
Junior subordinated debentures	361				361
<b>Total debt principal</b>	<b>6,261</b>	<b>500</b>	<b>400</b>	<b>850</b>	<b>4,511</b>
<b>Interest</b>	<b>5,243</b>	<b>355</b>	<b>685</b>	<b>601</b>	<b>3,602</b>
<b>Total long-term debt obligations(1)</b>	<b>11,504</b>	<b>855</b>	<b>1,085</b>	<b>1,451</b>	<b>8,113</b>
<b>Operating leases(2)</b>	<b>666</b>	<b>164</b>	<b>259</b>	<b>154</b>	<b>89</b>
<b>Purchase obligations</b>					
Information systems administration and maintenance commitments(3)	146	59	50	37	
Other purchase commitments(4)	99	76	18	3	2
<b>Total purchase obligations</b>	<b>245</b>	<b>135</b>	<b>68</b>	<b>40</b>	<b>2</b>
<b>Long-term unfunded investment commitments(5)</b>	<b>1,270</b>	<b>268</b>	<b>370</b>	<b>428</b>	<b>204</b>
<b>Estimated claims and claim-related payments</b>					
Claims and claim adjustment expenses(6)	48,845	11,505	11,894	6,727	18,719
Claims from large deductible policies(7)					
Loss-based assessments(8)	196	38	45	19	94
Reinsurance contracts accounted for as deposits(9)	1	1			
Payout from ceded funds withheld(10)	221	28	59	30	104
<b>Total estimated claims and claim-related payments</b>	<b>49,263</b>	<b>11,572</b>	<b>11,998</b>	<b>6,776</b>	<b>18,917</b>
<b>Liabilities related to unrecognized tax benefits(11)</b>	<b>657</b>	<b>657</b>			
<b>Total</b>	<b>\$ 63,605</b>	<b>\$ 13,651</b>	<b>\$ 13,780</b>	<b>\$ 8,849</b>	<b>\$ 27,325</b>

(1) The Company's \$107 million remaining aggregate principal amount of 6.25% fixed-to-floating rate debentures bear interest at an annual rate of 6.25% from the date of issuance to, but excluding, March 15, 2017 and at a rate of three-month LIBOR plus 2.215% thereafter. The table above includes interest payments through the scheduled maturity date of March 15, 2037. Interest payments beginning March 15, 2017 through March 15, 2037 were calculated using the three-month LIBOR rate as of December 31, 2012.

See note 8 of notes to the Company's consolidated financial statements for a further discussion of outstanding indebtedness. Because the amounts reported in the foregoing table include principal and interest, the total long-term debt obligations will not agree with the amounts reported in note 8.

(2) Represents agreements entered into in the ordinary course of business to lease office space, equipment and furniture.



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- (3) Includes agreements with vendors to purchase system software administration and maintenance services.
- (4) Includes commitments to vendors entered into in the ordinary course of business for goods and services including property, plant and equipment, office supplies, archival services, etc.
- (5) Represents estimated timing for fulfilling unfunded commitments for private equity limited partnerships and real estate partnerships.
- (6) The amounts in "Claims and claim adjustment expenses" in the table above represent the estimated timing of future payments for both reported and unreported claims incurred and related claim adjustment expenses, gross of reinsurance recoverables, excluding structured settlements expected to be paid by annuity companies.

The Company has entered into reinsurance agreements to protect itself from potential losses in excess of the amount it is prepared to accept as described in note 5 of notes to the Company's consolidated financial statements.

In order to qualify for reinsurance accounting, a reinsurance agreement must indemnify the insurer from insurance risk, i.e., the agreement must transfer amount and timing risk. Since the timing and amount of cash inflows from such reinsurance agreements are directly related to the underlying payment of claims and claim adjustment expenses by the insurer, reinsurance recoverables are recognized in a manner consistent with the liabilities (the estimated liability for claims and claim adjustment expenses) relating to the underlying reinsured contracts. The presence of any feature that can delay timely reimbursement of claims by a reinsurer results in the reinsurance contract being accounted for as a deposit rather than reinsurance (see below). The assumptions used in estimating the amount and timing of the reinsurance recoverables are consistent with those used in estimating the amount and timing of the related liabilities.

Reinsurance agreements that do not transfer both amount and timing risk are accounted for as deposits and included in "Reinsurance contracts accounted for as deposits" in the table above.

The estimated future cash inflows from the Company's reinsurance contracts that qualify for reinsurance accounting are as follows:

(in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
<b>Reinsurance recoverables</b>	<b>\$ 7,247</b>	<b>\$ 1,834</b>	<b>\$ 1,468</b>	<b>\$ 1,003</b>	<b>\$ 2,942</b>

The Company manages its business and evaluates its liabilities for claims and claim adjustment expense on a net of reinsurance basis. The estimated cash flows on a net of reinsurance basis are as follows:

(in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
<b>Claims and claim adjustment expenses, net</b>	<b>\$ 41,598</b>	<b>\$ 9,671</b>	<b>\$ 10,426</b>	<b>\$ 5,724</b>	<b>\$ 15,777</b>

For business underwritten by non-U.S. operations, future cash flows related to reported and unreported claims incurred and related claim adjustment expenses were translated at the spot rate on December 31, 2012.

The amounts reported in the table above and in the table of reinsurance recoverables above are presented on a nominal basis and have not been adjusted to reflect the time value of money. Accordingly, the amounts above will differ from the Company's balance sheet to the extent that the liability for claims and claim adjustment expenses and the related reinsurance recoverables have been discounted in the balance sheet. (See note 1 of notes to the Company's consolidated financial statements.)

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(7) Workers' compensation large deductible policies provide third party coverage in which the Company typically is responsible for paying the entire loss under such policies and then seeks reimbursement from the insured for the deductible amount. "Claims from large deductible policies" represent the estimated future payment for claims and claim related expenses below the deductible amount, net of the estimated recovery of the deductible. The liability and the related deductible receivable for unpaid claims are presented in the consolidated balance sheet as "contractholder payables" and "contractholder receivables," respectively. Most deductibles for such policies are paid directly from the policyholder's escrow which is periodically replenished by the policyholder. The payment of the loss amounts above the deductible are reported within "Claims and claim adjustment expenses" in the above table. Because the timing of the collection of the deductible (contractholder receivables) occurs shortly after the payment of the deductible to a claimant (contractholder payables), these cash flows offset each other in the table.

The estimated timing of the payment of the contractholder payables and the collection of contractholder receivables for workers' compensation policies is presented below:

(in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
<b>Contractholder payables/receivables</b>	<b>\$ 4,806</b>	<b>\$ 1,168</b>	<b>\$ 1,306</b>	<b>\$ 710</b>	<b>\$ 1,622</b>

(8) The amounts in "Loss-based assessments" relate to estimated future payments of second-injury fund assessments which would result from payment of current claim liabilities. Second injury funds cover the cost of any additional benefits for aggravation of a pre-existing condition. For loss-based assessments, the cost is shared by the insurance industry and self-insureds, funded through assessments to insurance companies and self-insureds based on losses. Amounts relating to second-injury fund assessments are included in "other liabilities" in the consolidated balance sheet.

(9) The amounts in "Reinsurance contracts accounted for as deposits" represent estimated future nominal payments for reinsurance agreements that are accounted for as deposits. Amounts payable under deposit agreements are included in "other liabilities" in the consolidated balance sheet. The amounts reported in the table are presented on a nominal basis and have not been adjusted to reflect the time value of money. Accordingly, the amounts above will differ from the Company's balance sheet to the extent that deposit values in the balance sheet have been discounted using deposit accounting.

(10) The amounts in "Payout from ceded funds withheld" represent estimated payments for losses and return of funds held related to certain reinsurance arrangements whereby the Company holds a portion of the premium due to the reinsurer and is allowed to pay claims from the amounts held.

(11) The Company's current liabilities related to unrecognized tax benefits from uncertain tax positions are \$657 million. Offsetting these liabilities are deferred tax assets of \$594 million associated with the temporary differences that would exist if these positions become realized.

The above table does not include an analysis of liabilities reported for structured settlements for which the Company has purchased annuities and remains contingently liable in the event of default by the company issuing the annuity. The Company is not reasonably likely to incur material future payment obligations under such agreements. In addition, the Company is not currently subject to any minimum funding requirements for its qualified pension plan. Accordingly, future contributions are not included in the foregoing table.

**Dividend Availability**

The Company's principal insurance subsidiaries are domiciled in the state of Connecticut. The insurance holding company laws of Connecticut applicable to the Company's subsidiaries requires notice to, and approval by, the state insurance commissioner for the declaration or payment of any

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dividend that, together with other distributions made within the preceding twelve months, exceeds the greater of 10% of the insurer's capital and surplus as of the preceding December 31, or the insurer'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 the Company's subsidiaries are domiciled generally contain similar, although in some instances somewhat more restrictive, limitations on the payment of dividends. A maximum of \$2.05 billion is available by the end of 2013 for such dividends without prior approval of the Connecticut Insurance Department. The Company may choose to accelerate the timing within 2013 and/or increase the amount of dividends from its insurance subsidiaries in 2013, which could result in certain dividends being subject to approval by the Connecticut Insurance Department.

The holding company is not dependent on dividends or other forms of repatriation from its foreign operations to support its liquidity needs. The undistributed earnings of the Company's foreign operations are not material and are intended to be permanently reinvested in those operations.

The holding company received \$1.96 billion of dividends in 2012, all of which was received from its U.S. insurance subsidiaries.

**Pension and Other Postretirement Benefit Plans**

The Company sponsors a qualified non-contributory defined benefit pension plan (the Qualified Plan), which covers substantially all U.S. domestic employees and provides benefits primarily under a cash balance formula. In addition, the Company sponsors: a nonqualified defined benefit pension plan which covers certain highly-compensated employees, pension plans for employees of its foreign subsidiaries, and a postretirement health and life insurance benefit plan for employees satisfying certain age and service requirements and for certain retirees.

The Qualified Plan is subject to regulations under the Employee Retirement Income Act of 1974 as amended (ERISA), which requires plans to meet minimum standards of funding and requires such plans to subscribe to plan termination insurance through the Pension Benefit Guaranty Corporation (PBGC). The Company does not have a minimum funding requirement for the Qualified Plan for 2013 and does not anticipate having a minimum funding requirement in 2014. The Company has significant discretion in making contributions above those necessary to satisfy the minimum funding requirements. The Company made discretionary contributions to the Qualified Plan of \$217 million, \$185 million, and \$35 million in 2012, 2011 and 2010, respectively. In determining future contributions, the Company will consider the performance of the plan's investment portfolio, the effects of interest rates on the projected benefit obligation of the plan and the Company's other capital requirements. The Company has not determined whether or not additional discretionary funding will be made in the current year or beyond. However, the Company currently believes, subject to actual plan performance and funded status at the time, that it may make discretionary pension contributions of approximately \$75 million to \$100 million annually over the next few years.

The Qualified Plan assets are managed to maximize long-term total return. The Company's overall strategy is to achieve a mix of approximately 85% to 90% of investments for long-term growth and 10% to 15% for near-term benefit payments with a wide diversification of asset types, fund strategies and fund managers. The current target allocations for plan assets are 55% to 65% equity securities and 20% to 40% fixed income securities, with the remainder allocated to short-term securities. For 2013, the Company plans to apply an expected long-term rate of return on plan assets of 7.50%, the same rate as in 2012. The rates of return reflect the Company's current expectations of long-term returns on the plan's invested assets, taking into account the current low level of long-term interest rates as well as the Federal Reserve's commentary in January 2013 regarding its expectation to maintain interest rates at their current low levels until the national unemployment rate drops to 6.5%. The Company's expected long-term rate of return on plan assets also contemplates a return to more normal levels of long-term interest rates in the future.

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For further discussion of the pension and other postretirement benefit plans, see note 14 of notes to the consolidated financial statements.

**Risk-Based Capital**

The NAIC has Risk-Based Capital (RBC) requirements for property casualty companies to be used as minimum capital requirements by the NAIC and states to identify companies that merit further regulatory action. The formulas have not been designed to differentiate among adequately capitalized companies that operate with levels of capital above the RBC requirements. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank these companies. At December 31, 2012, all of the Company's insurance subsidiaries had adjusted capital in excess of amounts requiring any company or regulatory action.

**Off-Balance Sheet Arrangements**

The Company has entered into certain contingent obligations for guarantees related to the sale of business entities, certain investments, third-party loans related to certain investments, certain insurance policy obligations of former insurance subsidiaries and various other indemnifications. See note 16 of notes to the Company's consolidated financial statements. The Company does not expect these arrangements will have a material effect on the Company's financial position, changes in financial position, revenues and expenses, results of operations, liquidity, capital expenditures or capital resources.

**CRITICAL ACCOUNTING ESTIMATES**

The Company considers its most significant accounting estimates to be those applied to claims and claim adjustment expense reserves and related reinsurance recoverables, investment valuation and impairments, and goodwill and other intangible assets impairments.

**Claims and Claim Adjustment Expense Reserves**

Gross claims and claim adjustment expense reserves by product line were as follows:

(at December 31, in millions)	2012			2011		
	Case	IBNR	Total	Case	IBNR	Total
General liability	\$ 5,525	\$ 9,109	\$ 14,634	\$ 5,571	\$ 9,657	\$ 15,228
Commercial property	992	638	1,630	1,025	643	1,668
Commercial multi-peril	2,018	1,723	3,741	2,153	1,792	3,945
Commercial automobile	2,343	1,241	3,584	2,388	1,121	3,509
Workers' compensation	9,684	7,589	17,273	9,649	7,348	16,997
Fidelity and surety	479	934	1,413	500	1,029	1,529
Personal automobile	1,980	722	2,702	2,038	736	2,774
Homeowners and personal other	1,335	809	2,144	778	814	1,592
International and other	2,216	1,551	3,767	2,370	1,741	4,111
Property-casualty	26,572	24,316	50,888	26,472	24,881	51,353
Accident and health	34		34	39		39
<b>Claims and claim adjustment expense reserves</b>	<b>\$ 26,606</b>	<b>\$ 24,316</b>	<b>\$ 50,922</b>	<b>\$ 26,511</b>	<b>\$ 24,881</b>	<b>\$ 51,392</b>

The \$470 million decrease in gross claims and claim adjustment expense reserves since December 31, 2011 primarily reflected the impact of net favorable prior year reserve development and payments related to significant catastrophe losses incurred in 2011 as well as operations in runoff

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(including asbestos and environmental claims), partially offset by the increase in loss cost trends and catastrophe losses incurred in 2012.

Asbestos and environmental reserves are included in the General liability, Commercial multi-peril and International and other lines in the foregoing summary table. Asbestos and environmental reserves are discussed separately; see "Asbestos Claims and Litigation", "Environmental Claims and Litigation" and "Uncertainty Regarding Adequacy of Asbestos and Environmental 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 (IBNR). Claims and claim adjustment expense reserves do not represent an exact calculation of liability, but instead represent management estimates, generally utilizing actuarial expertise and projection techniques, at a given accounting date. These estimates are expectations of what the ultimate settlement and administration of claims will cost upon final resolution in the future, based on the Company's assessment of facts and circumstances then known, review of historical settlement patterns, estimates of trends in claims severity and frequency, expected interpretations of legal theories of liability and other factors. In establishing gross claims and claim adjustment expense reserves, the Company also considers salvage and subrogation. Estimated recoveries from reinsurance are included in "Reinsurance Recoverables" as an asset on the Company's consolidated balance sheet. The claims and claim adjustment expense reserves are reviewed regularly by qualified actuaries employed by the Company.

The process of estimating claims and claim adjustment expense reserves involves a high degree of judgment and is subject to a number of variables. These variables can be affected by both internal and external events, such as changes in claims handling procedures, changes in individuals involved in the reserve estimation process, economic inflation, legal 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. Estimation difficulties also differ significantly by product line due to differences in claim complexity, the volume of claims, the potential severity of individual claims, the determination of occurrence date for a claim and reporting lags (the time between the occurrence of the policyholder event and when it is actually reported to the insurer). Informed judgment is applied throughout the process, including the application of various individual experiences and expertise to multiple sets of data and analyses. The Company continually refines its estimates in a regular ongoing process as historical loss experience develops and additional claims are reported and settled. The Company rigorously attempts to consider all significant facts and circumstances known at the time claims and claim adjustment expense reserves are established. Due to the inherent uncertainty underlying these estimates including, but not limited to, the future settlement environment, final resolution of the estimated liability for claims and claim adjustment expenses may be higher or lower than the related claims and claim adjustment expense reserves at the reporting date. Therefore, actual paid losses, as claims are settled in the future, may be materially different than the amount currently recorded favorable or unfavorable.

Because establishment of claims and claim adjustment expense reserves is an inherently uncertain process involving estimates, currently established claims and claim adjustment expense reserves may change. The Company reflects adjustments to the reserves in the results of operations in the period the estimates are changed.

There are also additional risks which impact the estimation of ultimate costs for catastrophes. For example, the estimation of reserves related to hurricanes, tornadoes and other catastrophic events can be affected by the inability of the Company and its insureds to access portions of the impacted areas, the complexity of factors contributing to the losses, the legal and regulatory uncertainties and the nature of the information available to establish the reserves. Complex factors include, but are not limited to: determining whether damage was caused by flooding versus wind; evaluating general liability

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and pollution exposures; estimating additional living expenses; estimating the impact of demand surge, infrastructure disruption, fraud, the effect of mold damage and business interruption costs; and reinsurance collectibility. The timing of a catastrophe, such as at or near the end of a reporting period, can also affect the information available to the Company in estimating reserves for that reporting period. The estimates related to catastrophes are adjusted as actual claims emerge.

A portion of the Company's gross claims and claim adjustment expense reserves (totaling \$3.04 billion at December 31, 2012) are for asbestos and environmental claims and related litigation. While the ongoing review of asbestos and environmental claims and associated liabilities considers the inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability and the risks inherent in complex litigation and other uncertainties, in the opinion of the Company's management, it is possible that the outcome of the continued uncertainties regarding these claims could result in liability in future periods that differs from current reserves by an amount that could be material to the Company's future operating results. See the preceding discussion of "Asbestos Claims and Litigation" and "Environmental Claims and Litigation."

General Discussion

The process for estimating the liabilities for claims and claim adjustment expenses begins with the collection and analysis of claim data. Data on individual reported claims, both current and historical, including paid amounts and individual claim adjuster estimates, are grouped by common characteristics (components) and evaluated by actuaries in their analyses of ultimate claim liabilities by product line. Such data is occasionally supplemented with external data as available and when appropriate. The process of analyzing reserves for a component is undertaken on a regular basis, generally quarterly, in light of continually updated information.

Multiple estimation methods are available for the analysis of ultimate claim liabilities. Each estimation method has its own set of assumption variables and its own advantages and disadvantages, with no single estimation method being better than the others in all situations and no one set of assumption variables being meaningful for all product line components. The relative strengths and weaknesses of the particular estimation methods when applied to a particular group of claims can also change over time. Therefore, the actual choice of estimation method(s) can change with each evaluation. The estimation method(s) chosen are those that are believed to produce the most reliable indication at that particular evaluation date for the claim liabilities being evaluated.

In most cases, multiple estimation methods will be valid for the particular facts and circumstances of the claim liabilities being evaluated. This will result in a range of reasonable estimates for any particular claim liability. The Company uses such range analyses to back test whether previously established estimates for reserves at the reporting segments are reasonable, given subsequent information. Reported values found to be closer to the endpoints of a range of reasonable estimates are subject to further detailed reviews. These reviews may substantiate the validity of management's recorded estimate or lead to a change in the reported estimate.

The exact boundary points of these ranges are more qualitative than quantitative in nature, as no clear line of demarcation exists to determine when the set of underlying assumptions for an estimation method switches from being reasonable to unreasonable. As a result, the Company does not believe that the endpoints of these ranges are or would be comparable across companies. In addition, potential interactions among the different estimation assumptions for different product lines make the aggregation of individual ranges a highly judgmental and inexact process.

Property-casualty insurance policies are either written on a claims-made or on an occurrence basis. Claims-made policies generally cover, subject to requirements in individual policies, claims reported during the policy period. Policies that are written on an occurrence basis require that the insured

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demonstrate that a loss occurred in the policy period, even if the insured reports the loss many years later.

Most general liability policies are written on an occurrence basis. These policies are subject to substantial loss development over time as facts and circumstances change in the years following the policy issuance. The occurrence form, which accounts for much of the reserve development in asbestos and environmental exposures, is also used to provide coverage for construction general liability, including construction defect. Occurrence-based forms of insurance for general liability exposures require substantial projection of various trends, including future inflation, judicial interpretations and societal litigation trends (e.g., size of jury awards and propensity of individuals to pursue litigation), among others.

A basic premise in most actuarial analyses is that past patterns demonstrated in the data will repeat themselves in the future, absent a material change in the associated risk factors discussed below. To the extent a material change affecting the ultimate claim liability is known, such change is quantified to the extent possible through an analysis of internal company data and, if available and when appropriate, external data. Such a measurement is specific to the facts and circumstances of the particular claim portfolio and the known change being evaluated. Significant structural changes to the available data, product mix or organization can materially impact the reserve estimation process.

Informed judgment is applied throughout the reserving process. This includes the application of various individual experiences and expertise to multiple sets of data and analyses. In addition to actuaries, experts involved with the reserving process also include underwriting and claims personnel and lawyers, as well as other company management. Therefore, management may have to consider varying individual viewpoints as part of its estimation of claims and claim adjustment expense reserves. It is also likely that during periods of significant change, such as a merger, consistent application of informed judgment becomes even more complicated and difficult.

The variables discussed above in this general discussion have different impacts on reserve estimation uncertainty for a given product line, depending on the length of the claim tail, the reporting lag, the impact of individual claims and the complexity of the claim process for a given product line.

Product lines are generally classifiable as either long tail or short tail, based on the average length of time between the event triggering claims under a policy and the final resolution of those claims. Short tail claims are reported and settled quickly, resulting in less estimation variability. The longer the time before final claim resolution, the greater the exposure to estimation risks and hence the greater the estimation uncertainty.

A major component of the claim tail is the reporting lag. The reporting lag, which is the time between the event triggering a claim and the reporting of the claim to the insurer, makes estimating IBNR inherently more uncertain. In addition, the greater the reporting lag, the greater the proportion of IBNR to the total claim liability for the product line. Writing new products with material reporting lags can result in adding several years' worth of IBNR claim exposure before the reporting lag exposure becomes clearly observable, thereby increasing the risk associated with pricing and reserving such products. The most extreme example of claim liabilities with long reporting lags are asbestos claims.

For some lines, the impact of large individual claims can be material to the analysis. These lines are generally referred to as being "low frequency/high severity," while lines without this "large claim" sensitivity are referred to as "high frequency/low severity." Estimates of claim liabilities for low frequency/high severity lines can be sensitive to the impact of a small number of potentially large claims. As a result, the role of judgment is much greater for these reserve estimates. In contrast, for high frequency/low severity lines the impact of individual claims is relatively minor and the range of reasonable reserve estimates is narrower and more stable.

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Claim complexity can also greatly affect the estimation process by impacting the number of assumptions needed to produce the estimate, the potential stability of the underlying data and claim process, and the ability to gain an understanding of the data. Product lines with greater claim complexity, such as for certain surety and construction exposures, have inherently greater estimation uncertainty.

Actuaries have to exercise a considerable degree of judgment in the evaluation of all these factors in their analysis of reserves. The human element in the application of actuarial judgment is unavoidable when faced with material uncertainty. Different actuaries may choose different assumptions when faced with such uncertainty, based on their individual backgrounds, professional experiences and areas of focus. Hence, the estimates selected by the various actuaries may differ materially from each other.

Lastly, significant structural changes to the available data, product mix or organization can also materially impact the reserve estimation process. Events such as mergers increase the inherent uncertainty of reserve estimates for a period of time, until stable trends re-establish themselves within the new organization.

Risk factors

The major causes of material uncertainty ("risk factors") generally will vary for each product line, as well as for each separately analyzed component of the product line. In a few cases, such risk factors are explicit assumptions of the estimation method, but in most cases, they are implicit. For example, a method may explicitly assume that a certain percentage of claims will close each year, but will implicitly assume that the legal interpretation of existing contract language will remain unchanged. Actual results will likely vary from expectations for each of these assumptions, causing actual paid losses, as claims are settled in the future, to be different in amount than the reserves being estimated currently.

Some risk factors will affect more than one product line. Examples include changes in claim department practices, changes in settlement patterns, regulatory and legislative actions, court actions, timeliness of claim reporting, state mix of claimants and degree of claimant fraud. The extent of the impact of a risk factor will also vary by components within a product line. Individual risk factors are also subject to interactions with other risk factors within product line components.

The effect of a particular risk factor on estimates of claim liabilities cannot be isolated in most cases. For example, estimates of potential claim settlements may be impacted by the risk associated with potential court rulings, but the final settlement agreement typically does not delineate how much of the settled amount is due to this and other factors.

The evaluation of data is also subject to distortion from extreme events or structural shifts, sometimes in unanticipated ways. For example, the timing of claims payments in one geographic region will be impacted if claim adjusters are temporarily reassigned from that region to help settle catastrophe claims in another region.

While some changes in the claim environment are sudden in nature (such as a new court ruling affecting the interpretation of all contracts in that jurisdiction), others are more evolutionary. Evolutionary changes can occur when multiple factors affect final claim values, with the uncertainty surrounding each factor being resolved separately, in stepwise fashion. The final impact is not known until all steps have occurred.

Sudden changes generally cause a one-time shift in claim liability estimates, although there may be some lag in reliable quantification of their impact. Evolutionary changes generally cause a series of shifts in claim liability estimates, as each component of the evolutionary change becomes evident and estimable.



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Actuarial methods for analyzing and estimating claims and claim adjustment expense reserves

The principal estimation and analysis methods utilized by the Company's actuaries to evaluate management's existing estimates for prior accident periods are the paid development method, the case incurred development method, the Bornhuetter-Ferguson (BF) method, and average value analysis combined with the reported claim development method. The BF method is usually utilized for more recent accident periods, with a transition to other methods as the underlying claim data becomes more voluminous and therefore more credible. These are typically referred to as conventional actuarial methods. (See Glossary for an explanation of these methods).

While these are the principal methods utilized throughout the Company, actuaries evaluating a particular component for a product line have available to them the full range of methods developed within the casualty actuarial profession. The Company's actuaries are also continually monitoring developments within the profession for advances in existing techniques or the creation of new techniques that might improve current and future estimates.

Some components of product line reserves are susceptible to relatively infrequent large claims that can materially impact the total estimate for that component. In such cases, the Company's actuarial analysis generally isolates and analyzes separately such large claims. The reserves excluding such large claims are generally analyzed using the conventional methods described above. The reserves associated with large claims are then analyzed utilizing various methods, such as:

Estimating the number of large claims and their average values based on historical trends from prior accident periods, adjusted for the current environment and supplemented with actual data for the accident year analyzed to the extent available.

Utilizing individual claim adjuster estimates of the large claims, combined with continual monitoring of the aggregate accuracy of such claim adjuster estimates. (This monitoring may lead to supplemental adjustments to the aggregate of such claim estimates.)

Utilizing historic longer-term average ratios of large claims to small claims, and applying such ratios to the estimated ultimate small claims from conventional analysis.

Ground-up analysis of the underlying exposure (typically used for asbestos and environmental).

The results of such methodologies are subjected to various reasonability and diagnostic tests, including paid-to-incurred loss ratios, implied incurred-loss-to-earned-premium ratios and non-zero claim severity trends. An actual versus expected analysis is also performed comparing actual loss development to expected development embedded within management's best estimate. Additional analyses may be performed based on the results of these diagnostics, including the investigation of other actuarial methods.

The methods described above are generally utilized to evaluate management's existing estimate for prior accident periods. For the initial estimate of the current accident year, the available claim data is typically insufficient to produce a reliable indication. Hence, the initial estimate for an accident year is generally based on a loss ratio projection method, which uses the earned premium for the current year multiplied by a projected loss ratio. The projected loss ratio is determined through an analysis of prior periods' experience, using loss trend, rate level differences, mix of business changes and other known or observed factors influencing the current accident year relative to prior accident years. The exact number of prior accident years utilized varies by product line component, based on the volume of business for that component and the reliability of an individual accident year estimate.

Management's estimates

At least once per quarter, certain members of Company management meet with the Company's actuaries to review the latest claims and claim adjustment expense reserve analyses. Based on these

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analyses, management determines whether its ultimate claim liability estimates should be changed. In doing so, it must evaluate whether the new data provided represents credible actionable information or an anomaly that will have no effect on estimated ultimate claim liability. For example, as described above, payments may have decreased in one geographic region due to fewer claim adjusters being available to process claims. The resulting claim payment patterns would be analyzed to determine whether or not the change in payment pattern represents a change in ultimate claim liability.

Such an assessment requires considerable judgment. It is frequently not possible to determine whether a change in the data is an anomaly until sometime after the event. Even if a change is determined to be permanent, it is not always possible to reliably determine the extent of the change until sometime later. The overall detailed analyses supporting such an effort can take several months to perform. This is because the underlying causes of the trends observed need to be evaluated, which may require the gathering or assembling of data not previously available. It may also include interviews with experts involved with the underlying processes. As a result, there can be a time lag between the emergence of a change and a determination that the change should be reflected in the Company's estimated claim liabilities. The final estimate selected by management in a reporting period is based on these various detailed analyses of past data, adjusted to reflect any new actionable information.

The Audit Committee of the Board of Directors is responsible for providing oversight of reserving propriety, and annually reviews the process by which the Company establishes reserves.

Discussion of Product Lines

The following section details reserving considerations and common risk factors by product line. There are many additional risk factors that may impact ultimate claim costs. Each risk factor presented will have a different impact on required reserves. Also, risk factors can have offsetting or compounding effects on required reserves. For example, in workers' compensation, the use of expensive medical procedures that result in medical cost inflation may enable workers to return to work faster, thereby lowering indemnity costs. Thus, in almost all cases, it is impossible to discretely measure the effect of a single risk factor and construct a meaningful sensitivity expectation.

In order to provide information on reasonably possible reserving changes by product line, the historical changes in year-end claims and claim adjustment expense reserves over a one-year period are provided for the U.S. product lines. This information is provided for both the Company and the industry for the nine most recent years, and is based on the most recent publicly available data for the reported line(s) that most closely match the individual product line being discussed. These changes were calculated, net of reinsurance, from statutory annual statement data found in Schedule P of those statements, and represent the reported reserve development on the beginning-of-the-year claim liabilities divided by the beginning claim liabilities, all accident years combined, excluding non-defense related claim adjustment expense. Data presented for the Company includes history for the entire Travelers group (U.S. companies only), whether or not the individual subsidiaries were originally part of SPC or TPC. This treatment is required by the statutory reporting instructions promulgated by state regulatory authorities for Schedule P. Comparable data for non-U.S. companies is not available.

General Liability

General liability is generally considered a long tail line, as it takes a relatively long period of time to finalize and settle claims from a given accident year. The speed of claim reporting and claim settlement is a function of the specific coverage provided, the jurisdiction and specific policy provisions such as self-insured retentions. There are numerous components underlying the general liability product line. Some of these have relatively moderate payment patterns (with most of the claims for a given accident year closed within five to seven years), while others can have extreme lags in both reporting and payment of claims (e.g., a reporting lag of a decade or more for "construction defect" claims).

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While the majority of general liability coverages are written on an "occurrence" basis, certain general liability coverages (such as those covering directors and officers or professional liability) are typically insured on a "claims-made" basis.

General liability reserves are generally analyzed as two components: primary and excess/umbrella, with the primary component generally analyzed separately for bodily injury and property damage. Bodily injury liability payments reimburse the claimant for damages pertaining to physical injury as a result of the policyholder's legal obligation arising from non-intentional acts such as negligence, subject to the insurance policy provisions. In some cases the damages can include future wage loss (which is a function of future earnings power and wage inflation) and future medical treatment costs. Property damage liability payments result from damages to the claimant's private property arising from the policyholder's legal obligation for non-intentional acts. In most cases, property damage losses are a function of costs as of the loss date, or soon thereafter.

In addition, sizable or unique exposures are reviewed separately. These exposures include asbestos, environmental, other mass torts, construction defect and large unique accounts that would otherwise distort the analysis. These unique categories often require a very high degree of judgment and require reserve analyses that do not rely on conventional actuarial methods.

Defense costs are also a part of the insured costs covered by liability policies and can be significant, sometimes greater than the cost of the actual paid claims. For some products this risk is mitigated by policy language such that the insured portion of defense costs erodes the amount of policy limit available to pay the claim. Such "defense within the limits" policies are most common for "claims-made" products. When defense costs are outside of the limits, amounts paid for defense costs do not erode the policy limits.

This line is typically the largest source of reserve estimate uncertainty in the United States (excluding assumed reinsurance contracts covering the same risk). Major contributors to this reserve estimate uncertainty include the reporting lag (i.e., the length of time between the event triggering coverage and the actual reporting of the claim), the number of parties involved in the underlying tort action, whether the "event" triggering coverage is confined to only one time period or is spread over multiple time periods, the potential dollars involved (in the individual claim actions), whether such claims were reasonably foreseeable and intended to be covered at the time the contracts were written (i.e., coverage dispute potential), and the potential for mass claim actions. Claims with longer reporting lags result in greater inherent risk. This is especially true for alleged claims with a latency feature, particularly where courts have ruled that coverage is spread over multiple policy years, hence involving multiple defendants (and their insurers and reinsurers) and multiple policies (thereby increasing the potential dollars involved and the underlying settlement complexity). Claims with long latencies also increase the potential recognition lag (i.e., the lag between writing a type of policy in a certain market and the recognition that such policies have potential mass tort and/or latent claim exposure).

The amount of reserve estimate uncertainty also varies significantly by component for the general liability product line. The components in this product line with the longest latency, longest reporting lags, largest potential dollars involved and greatest claim settlement complexity are asbestos and environmental. Components that include latency, reporting lag and/or complexity issues, but to a materially lesser extent than asbestos and environmental, include construction defect and other mass tort actions. Many components of general liability are not subject to material latency or claim complexity risks and hence have materially less uncertainty than the previously mentioned components. In general, policies providing coverage with shorter reporting lags, fewer parties involved in settlement negotiations, only one policy potentially triggered per claim, fewer potential settlement dollars, reasonably foreseeable (and stable) potential hazards/claims and no mass tort potential result in much less reserve estimate uncertainty than policies without those characteristics.

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In addition to the conventional actuarial methods mentioned in the general discussion section, the company utilizes various report year development and S-curve methods for the construction defect components of this product line. The Construction Defect report year development analysis is supplemented with projected claim counts and average values for IBNR claim counts. For components with greater lags in claim reporting, such as excess and umbrella components of this product line, the company relies more heavily on the BF method than on the paid and case incurred development methods.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required general liability reserves (beyond those included in the general discussion section) include:

General liability risk factors

Changes in claim handling philosophies

Changes in policy provisions or court interpretation of such provisions

New theories of liability

Trends in jury awards

Changes in the propensity to sue, in general with specificity to particular issues

Changes in the propensity to litigate rather than settle a claim

Changes in statutes of limitations

Changes in the underlying court system

Distortions from losses resulting from large single accounts or single issues

Changes in tort law

Shifts in lawsuit mix between federal and state courts

Changes in claim adjuster office structure (causing distortions in the data)

The potential impact of inflation on loss costs

Changes in settlement patterns

General liability book of business risk factors

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Changes in policy provisions (e.g., deductibles, policy limits, endorsements)

Changes in underwriting standards

Product mix (e.g., size of account, industries insured, jurisdiction mix)

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for general liability (excluding asbestos and environmental), a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.5% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line, excluding estimated asbestos and environmental amounts, over the last nine years has varied from -8% to 10% (averaging -1%) for the Company and from -5% to 6% (averaging -1%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. Because the high end of the Company's range of historical adverse development comes from certain businesses that the Company has since exited, the Company believes that the industry's range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. General liability reserves (excluding asbestos and environmental) represent approximately 24% of the Company's total claims and claim adjustment expense reserves.

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The Company's change in reserve estimate for this product line, excluding estimated asbestos and environmental amounts, was -3% for 2012, -8% for 2011 and -5% for 2010. The 2012 change was primarily concentrated in excess coverages for accident years 2009 and prior and reflected what the Company believes are more favorable legal and judicial environments than what the Company previously expected. Also contributing to the 2012 change was better than expected results for management liability business, primarily for the errors & omissions and fiduciary products for accident years 2007 and prior. The 2011 change was concentrated in excess coverages for accident years 2005-2008 and reflected what the Company believes are more favorable legal and judicial environments than what the Company previously expected. The 2010 change was primarily concentrated in excess coverages for accident years 2006 and prior and reflected what the Company believes are more favorable legal and judicial environments than what the Company previously expected.

**Commercial Property**

Commercial property is generally considered a short tail line with a simpler and faster claim reporting and adjustment process than liability coverages, and less uncertainty in the reserve setting process (except for more complex business interruption claims). It is generally viewed as a moderate frequency, low to moderate severity line, except for catastrophes and coverage related to large properties. The claim reporting and settlement process for property coverage claim reserves is generally restricted to the insured and the insurer. Overall, the claim liabilities for this line create a low estimation risk, except possibly for catastrophes and business interruption claims.

Commercial property reserves are typically analyzed in two components, one for catastrophic or other large single events, and another for all other events. Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required property reserves (beyond those included in the general discussion section) include:

Commercial property risk factors

Physical concentration of policyholders

Availability and cost of local contractors

For the more severe catastrophic events, "demand surge" inflation, which refers to significant short-term increases in building material and labor costs due to a sharp increase in demand for those materials and services

Local building codes

Amount of time to return property to full usage (for business interruption claims)

Frequency of claim re-openings on claims previously closed

Court interpretation of policy provisions (such as occurrence definition, or wind versus flooding)

Lags in reporting claims (e.g., winter damage to summer homes, hidden damage after an earthquake, hail damage to roofs and/or equipment on roofs)

Court or legislative changes to the statute of limitations

Commercial property book of business risk factors

Policy provisions mix (e.g., deductibles, policy limits, endorsements)

Changes in underwriting standards

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for property, a 1% increase (decrease) in

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incremental paid loss development for each future calendar year could result in a 1.1% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -34% to -5% (averaging -18%) for the Company, and from -14% to 2% (averaging -9%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Commercial property reserves represent approximately 3% of the Company's total claims and claim adjustment expense reserves.

Since commercial property is considered a short tail coverage, the one year change for commercial property can be more volatile than that for the longer tail product lines. This is due to the fact that the majority of the reserve for commercial property relates to the most recent accident year, which is subject to the most uncertainty for all product lines. This recent accident year uncertainty is relevant to commercial property because of weather-related events which, notwithstanding 2010 and 2011 experience, tend to be concentrated in the second half of the year, and generally are not completely resolved until the following year. Reserve estimates associated with major catastrophes may take even longer to resolve. The reserve estimates for this product line are also potentially subject to material changes due to uncertainty in measuring ultimate losses for significant catastrophes such as the events of September 11, 2001, Hurricane Katrina and Storm Sandy.

The Company's change in reserve estimate for this product line was -22% for 2012, -5% for 2011 and -25% for 2010. The 2012 change primarily reflected better than expected development for accident years 2009 through 2011, driven by favorable loss development related to catastrophe losses incurred in 2011, and by higher subrogation and salvage recoveries for accident years 2009 through 2011. The 2011 change primarily reflected better than expected development in the 2008 and 2009 accident years for certain large national property and ocean marine exposures. The 2010 change primarily occurred in the 2008 and 2009 accident years as a result of better than expected loss development in Industry-Focused Underwriting and Target Risk Underwriting.

**Commercial Multi-Peril**

Commercial multi-peril provides a combination of property and liability coverage typically for small businesses and, therefore, includes both short and long tail coverages. For property coverage, it generally takes a relatively short period of time to close claims, while for the other coverages, generally for the liability coverages, it takes a longer period of time to close claims.

The reserving risk for this line is dominated by the liability coverage portion of this product, except occasionally in the event of catastrophic or large single losses. The reserving risk for this line differs from that of the general liability product line and the property product line due to the nature of the customer. Commercial multi-peril is generally sold to smaller-sized accounts, while the customer profile for general liability and commercial property includes larger customers.

See "Commercial property risk factors" and "General liability risk factors," discussed above, with regard to reserving risk for commercial multi-peril.

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for commercial multi-peril (excluding asbestos and environmental), a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.2% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -19% to 5% (averaging -6%) for the Company, and from -6% to 3%



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(averaging -2%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Commercial multi-peril reserves (excluding asbestos and environmental reserves) represent approximately 7% of the Company's total claims and claim adjustment expense reserves.

As discussed above, this line combines general liability and commercial property coverages and it has been impacted in the past by many of the same events as those two lines.

The Company's change in reserve estimate for this product line was -1% for 2012, 5% for 2011 and 1% for 2010. The 2011 change reflected unfavorable loss development driven by late reporting of hail claims incurred in 2010.

**Commercial Automobile**

The commercial automobile product line is a mix of property and liability coverages and, therefore, includes both short and long tail coverages. The payments that are made quickly typically pertain to auto physical damage (property) claims and property damage (liability) claims. The payments that take longer to finalize and are more difficult to estimate relate to bodily injury claims. In general, claim reporting lags are minor, claim complexity is not a major issue, and the line is viewed as high frequency, low to moderate severity. Overall, the claim liabilities for this line create a moderate estimation risk.

Commercial automobile reserves are typically analyzed in four components: bodily injury liability; property damage liability; collision claims; and comprehensive claims. These last two components have minimum reserve risk and fast payouts and, accordingly, separate risk factors are not presented.

The Company utilizes the conventional actuarial methods mentioned in the general discussion above in estimating claim liabilities for this line. This is supplemented with detailed custom analyses where needed.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required commercial automobile reserves (beyond those included in the general discussion section) include:

**Bodily injury and property damage liability risk factors**

Trends in jury awards

Changes in the underlying court system

Changes in case law

Litigation trends

Frequency of claims with payment capped by policy limits

Change in average severity of accidents, or proportion of severe accidents

Changes in auto safety technology

Subrogation opportunities

Changes in claim handling philosophies

Frequency of visits to health providers

Number of medical procedures given during visits to health providers

Types of health providers used

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Types of medical treatments received

Changes in cost of medical treatments

Degree of patient responsiveness to treatment

Commercial automobile book of business risk factors

Changes in policy provisions (e.g., deductibles, policy limits, endorsements, etc.)

Changes in mix of insured vehicles (e.g., long haul trucks versus local and smaller vehicles, fleet risks versus non-fleets)

Changes in underwriting standards

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for commercial automobile, a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.2% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -10% to 7% (averaging -3%) for the Company, and from -3% to 2% (averaging -1%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Commercial automobile reserves represent approximately 7% of the Company's total claims and claim adjustment expense reserves.

The Company's change in reserve estimate for this product line was 7% for 2012, 5% for 2011 and -1% for 2010. The 2012 change reflected higher than expected severity in the bodily injury coverage primarily for accident years 2010 and 2011. The 2011 change reflected worse than expected severity for the 2009 and 2010 accident years.

**Workers' Compensation**

Workers' compensation is generally considered a long tail coverage, as it takes a relatively long period of time to finalize claims from a given accident year. While certain payments such as initial medical treatment or temporary wage replacement for the injured worker are made quickly, some other payments are made over the course of several years, such as awards for permanent partial injuries. In addition, some payments can run as long as the injured worker's life, such as permanent disability benefits and on-going medical care. Despite the possibility of long payment tails, the reporting lags are generally short, settlements are generally not complex, and most of the liability can be considered high frequency with moderate severity. The largest reserve risk generally comes from the low frequency, high severity claims providing lifetime coverage for medical expense arising from a worker's injury, as such claims are subject to greater inflation risk. Overall, the claim liabilities for this line create a somewhat greater than moderate estimation risk.

Workers' compensation reserves are typically analyzed in three components: indemnity losses, medical losses and claim adjustment expenses.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required workers' compensation reserves (beyond those included in the general discussion section) include:

Indemnity risk factors

Time required to recover from the injury



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Degree of available transitional jobs

Degree of legal involvement

Changes in the interpretations and processes of the workers' compensation commissions' oversight of claims(1)

Future wage inflation for states that index benefits

Changes in the administrative policies of second injury funds

Medical risk factors

Changes in the cost of medical treatments (including prescription drugs) and underlying fee schedules ("inflation")

Frequency of visits to health providers

Number of medical procedures given during visits to health providers

Types of health providers used

Type of medical treatments received

Use of preferred provider networks and other medical cost containment practices

Availability of new medical processes and equipment

Changes in the use of pharmaceutical drugs

Degree of patient responsiveness to treatment

General workers' compensation risk factors

Frequency of claim reopenings on claims previously closed

Mortality trends of injured workers with lifetime benefits and medical treatment

Degree of cost shifting between workers' compensation and health insurance, including Medicare

Workers' compensation book of business risk factors

Product mix

Injury type mix

Changes in underwriting standards

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for workers' compensation, a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.3% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -2% to 1% (averaging 0%) for the Company, and from -1% to 2% (averaging 0%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Workers'

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(1)

These are administrative bodies that evaluate whether or not a given claim for workers' compensation benefits is valid. Their duties include the determination of whether a given injury arose out of the scope of employment or the determination of the degree of injury where disputes exist.

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compensation reserves represent approximately 34% of the Company's total claims and claim adjustment expense reserves.

The Company's change in reserve estimate for this product line was -2% in 2012, 0% in 2011 and -1% for 2010. The 2012 change was primarily driven by better than expected frequency and severity related to lifetime medical claims for accident years 2008 and prior.

**Fidelity and Surety**

Fidelity is generally considered a short tail coverage. It takes a relatively short period of time to finalize and settle fidelity claims. The volatility of fidelity reserves is generally related to the type of business of the insured, the size and complexity of the insured's business operations, amount of policy limit and attachment point of coverage. The uncertainty surrounding reserves for small, commercial insureds is typically less than the uncertainty for large commercial or financial institutions. The high frequency, low severity nature of small commercial fidelity losses provides for stability in loss estimates, whereas the low frequency, high severity nature of losses for large insureds results in a wider range of ultimate loss outcomes. Actuarial techniques that rely on a stable pattern of loss development are generally not applicable to low frequency, high severity policies.

Surety has certain components that are generally considered short tail coverages with short reporting lags, although large individual construction and commercial surety contracts can result in a long settlement tail, based on the length and complexity of the construction project or commercial transaction being insured. (Large construction projects can take many years to complete.) The frequency of losses in surety generally correlates with economic cycles as the primary cause of surety loss is the inability of an insured contractor to fulfill its contractual obligations. The Company actively seeks to mitigate this exposure to loss through disciplined risk selection and adherence to underwriting standards. The volatility of surety losses is generally related to the type of business performed by the insured, the type of bonded obligation, the amount of limit exposed to loss and the amount of assets available to the insurer to mitigate losses, such as unbilled contract funds, collateral, first and third party indemnity, and other security positions of an insured's assets. Certain classes of surety claims are very high severity, low frequency in nature. These can include large construction contractors involved with one or multiple large, complex projects as well as certain large commercial surety exposures. Other claim factors affecting reserve variability of surety include litigation related to amounts owed by and due the insured (e.g., salvage and subrogation efforts) and the results of financial restructuring of an insured.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required fidelity and surety reserves (beyond those included in the general discussion section) include:

Fidelity risk factors

Type of business of insured

Policy limit and attachment points

Third-party claims

Coverage litigation

Complexity of claims

Growth in insureds' operations

Surety risk factors

Economic trends, including the general level of construction activity

Concentration of reserves in a relatively few large claims

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Type of business insured

Type of obligation insured

Cumulative limits of liability for insured

Assets available to mitigate loss

Defective workmanship/latent defects

Financial strategy of insured

Changes in statutory obligations

Geographic spread of business

Fidelity and Surety book of business risk factors

Changes in policy provisions (e.g., deductibles, limits, endorsements)

Changes in underwriting standards

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for fidelity and surety, a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.3% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -11% to 138% (averaging 10%) for the Company, and from -13% to 24% (averaging 2%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. Because the high end of the Company's range was due to acquired business in 2004, the Company believes that the industry's range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Fidelity and surety reserves represent approximately 3% of the Company's total claims and claim adjustment expense reserves.

In general, developments on single large claims (both adverse and favorable) are a primary source of changes in reserve estimates for this product line.

The Company's change in reserve estimate for this product line was -8% for 2012, -11% for 2011 and -6% for 2010. The 2012 change reflected better than expected results primarily for the contract surety line of business for accident years 2008 and prior. The 2011 change primarily reflected better than expected development for accident years 2008 and prior for the contract surety business. The 2010 change was driven by better than expected loss development due to lower than expected claim activity and loss severity, primarily for the contract surety business in this product line for the 2008 and prior accident years.

Personal Automobile

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Personal automobile includes both short and long tail coverages. The payments that are made quickly typically pertain to auto physical damage (property) claims and property damage (liability) claims. The payments that take longer to finalize and are more difficult to estimate relate to bodily injury claims. Reporting lags are relatively short and the claim settlement process for personal automobile liability generally is the least complex of the liability products. It is generally viewed as a high frequency, low to moderate severity product line. Overall, the claim liabilities for this line create a moderate estimation risk.

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Personal automobile reserves are typically analyzed in five components: bodily injury liability, property damage liability, no-fault losses, collision claims and comprehensive claims. These last two components have minimum reserve risk and fast payouts and, accordingly, separate factors are not presented.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required personal automobile reserves (beyond those included in the general reserve discussion section) include:

Bodily injury and property damage liability risk factors

Trends in jury awards

Changes in the underlying court system and its philosophy

Changes in case law

Litigation trends

Frequency of claims with payment capped by policy limits

Change in average severity of accidents, or proportion of severe accidents

Subrogation opportunities

Degree of patient responsiveness to treatment

Changes in claim handling philosophies

No-fault risk factors (for selected states and time periods)

Effectiveness of no-fault laws

Frequency of visits to health providers

Number of medical procedures given during visits to health providers

Types of health providers used

Types of medical treatments received

Changes in cost of medical treatments

Degree of patient responsiveness to treatment

Personal automobile book of business risk factors

Changes in policy provisions (e.g., deductibles, policy limits, endorsements, etc.)

Changes in underwriting standards

Changes in the use of credit data for rating and underwriting

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for personal automobile, a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.1% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line over the last nine years has varied from -9% to 3% (averaging -3%) for the Company, and from -4% to -1% (averaging -2%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line.

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Personal automobile reserves represent approximately 5% of the Company's total claims and claim adjustment expense reserves.

The Company's change in reserve estimate for this product line was 2% for 2012, 3% for 2011 and 0% for 2010. The 2012 change was primarily driven by higher than expected bodily injury severity for accident year 2011. The 2011 change reflected worse than expected severity for the 2007-2010 accident years.

**Homeowners and Personal Lines Other**

Homeowners is generally considered a short tail coverage. Most payments are related to the property portion of the policy, where the claim reporting and settlement process is generally restricted to the insured and the insurer. Claims on property coverage are typically reported soon after the actual damage occurs, although delays of several months are not unusual. The resulting settlement process is typically fairly short term, although exceptions do exist.

The liability portion of the homeowners policy generates claims which take longer to pay due to the involvement of litigation and negotiation, but with generally small reporting lags.

Overall, the line is generally high frequency, low to moderate severity (except for catastrophes), with simple to moderate claim complexity.

Homeowners reserves are typically analyzed in two components: non-catastrophe related losses and catastrophe loss payments.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required homeowners reserves (beyond those included in the general discussion section) include:

Non-catastrophe risk factors

Salvage opportunities

Amount of time to return property to residential use

Changes in weather patterns

Local building codes

Litigation trends

Trends in jury awards

Court interpretation of policy provisions (such as occurrence definition, or wind versus flooding)

Lags in reporting claims (e.g., winter damage to summer homes, hidden damage after an earthquake, hail damage to roofs and/or equipment on roofs)

Court or legislative changes to the statute of limitations

Catastrophe risk factors

Physical concentration of policyholders

Availability and cost of local contractors

Local building codes

Quality of construction of damaged homes

Amount of time to return property to residential use

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For the more severe catastrophic events, "demand surge" inflation, which refers to significant short-term increases in building material and labor costs due to a sharp increase in demand for those materials and services

Homeowners book of business risk factors

Policy provisions mix (e.g., deductibles, policy limits, endorsements, etc.)

Degree of concentration of policyholders

Changes in underwriting standards

Changes in the use of credit data for rating and underwriting

Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for homeowners and personal lines other, a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.1% increase (decrease) in claims and claim adjustment expense reserves.

Historically, the one-year change in the reserve estimate for this product line (excluding the umbrella line of business, which for statutory reporting purposes is included with the general liability line of business) over the last nine years has varied from -31% to 3% (averaging -11%) for the Company, and from -8% to -2% (averaging -5%) for the industry overall. The Company's year-to-year changes are driven by, and are based on, observed events during the year. The Company believes that its range of historical outcomes is illustrative of reasonably possible one-year changes in reserve estimates for this product line. Homeowners and personal lines other reserves represent approximately 4% of the Company's total claims and claim adjustment expense reserves.

This line combines both liability and property coverages; however, the majority of the reserves relate to property. While property is considered a short tail coverage, the one year change for property can be more volatile than that for the longer tail product lines. This is due to the fact that the majority of the reserve for property relates to the most recent accident year, which is subject to the most uncertainty for all product lines. This recent accident year uncertainty is relevant to property because of weather related events which, notwithstanding 2010 and 2011 experience, tend to be concentrated in the second half of the year, and generally are not completely resolved until the following year. Reserve estimates associated with major catastrophes may take even longer to resolve.

The Company's change in reserve estimate for this product line (excluding the umbrella line of business) was -11% for 2012, -7% for 2011 and 2% for 2010. The 2012 change reflected better than expected loss development related to catastrophe losses incurred in 2011 and non-catastrophe losses incurred in accident years 2010 and 2011. The 2011 change reflected better than expected loss development related to catastrophe losses incurred in the first half of 2010. The 2010 change reflected unfavorable loss development in the 2009 accident year for the homeowners' line of business that was driven by higher than anticipated late-reported claims related to storms in 2009.

**International and other**

International and other includes products written by the Company's international operations, as well as all other products not explicitly discussed above. The principal component of "other" claim reserves is assumed reinsurance written on an excess-of-loss basis, which may include reinsurance of non-U.S. exposures, and is runoff business.

International and other claim liabilities result from a mix of coverages, currencies and jurisdictions/countries. The common characteristic is the need to customize the analysis to the individual component, and the inability to rely on data characterizations and reporting requirements in the U.S. statutory reporting framework.

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Due to changes in the business mix for this line over time, the recently incurred claim liabilities are relatively short term (due to both the products and the jurisdictions involved, e.g., the Republic of Ireland and the United Kingdom), while the older liabilities include some from runoff operations that are extremely long tail (e.g., U.S. excess liabilities reinsured through the London market, and several underwriting pools in runoff). The speed of claim reporting and claim settlement is a function of the specific coverage provided, the jurisdiction, the distribution system (e.g., underwriting pool versus direct) and the proximity of the insurance sale to the insured hazard (e.g., insured and insurer located in different countries). In particular, liabilities arising from the underwriting pools in runoff may result in significant reporting lags, settlement lags and claim complexity, due to the need to coordinate with other pool members or co-insurers through a broker or lead-insurer for claim settlement purposes.

International and other reserves are generally analyzed by program/pool, country and general coverage category (e.g., U.S. Liability excess of loss reinsurance, or General Liability Municipalities by country). The business is also generally split by direct versus assumed reinsurance for a given coverage/jurisdiction. Where the underlying insured hazard is outside the United States, the underlying coverages are generally similar to those described under the General Liability and Commercial Property discussion above, provided that reserves relating to insured hazards outside the United States are analyzed taking into account differences in the legal environment and differences in terms and conditions, including, for example and where applicable, that in some jurisdictions there are no aggregate policy limits on certain liability coverages. Where the underlying hazard is within the U.S., the coverage involved is typically that of General Liability and Commercial Property, but on an excess or excess-of-loss reinsurance basis. Excess exposure requires the insured to "prove" not only claims under the policy, but also the prior payment of claims reaching up to the excess policy's attachment point.

Examples of common risk factors, or perceptions thereof, that could change and, thus, affect the required International and other reserves (beyond those included in the general discussion section) include:

International and other risk factors

Changes in claim handling procedures, including those of the primary carriers

Changes in policy provisions or court interpretation of such provision

New theories of liability

Trends in jury awards

Changes in the propensity to sue

Changes in statutes of limitations

Changes in the underlying court system

Distortions from losses resulting from large single accounts or single issues

Changes in tort law

Changes in claim adjuster office structure (causing distortions in the data)

International and other book of business risk factors



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Changes in policy provisions (e.g., deductibles, policy limits, endorsements, "claims-made" language)

Changes in underwriting standards

Product mix (e.g., size of account, industries insured, jurisdiction mix)

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Unanticipated changes in risk factors can affect reserves. As an indicator of the causal effect that a change in one or more risk factors could have on reserves for International and other (excluding asbestos and environmental), a 1% increase (decrease) in incremental paid loss development for each future calendar year could result in a 1.2% increase (decrease) in claims and claim adjustment expense reserves. International and other reserves (excluding asbestos and environmental) represent approximately 7% of the Company's total claims and claim adjustment expense reserves.

International and other represents a combination of different product lines, some of which are in runoff. Comparative historical information is not available for international product lines as insurers domiciled outside of the U.S. do not file U.S. statutory reports. Comparative historical information on runoff business is not indicative of reasonably possible one-year changes in the reserve estimate for this mix of runoff business. Accordingly, the Company has not included comparative analyses for International and other.

**Reinsurance Recoverables**

The following table summarizes the composition of the Company's reinsurance recoverables:

(at December 31, in millions)	2012	2011
Gross reinsurance recoverables on paid and unpaid claims and claim adjustment expenses	\$ 5,256	\$ 6,255
Allowance for uncollectible reinsurance	(258)	(345)
<b>Net reinsurance recoverables</b>	<b>4,998</b>	<b>5,910</b>
Mandatory pools and associations	2,549	2,020
Structured settlements	3,165	3,225
<b>Total reinsurance recoverables</b>	<b>\$ 10,712</b>	<b>\$ 11,155</b>

The \$912 million decline in net reinsurance recoverables since December 31, 2011 primarily reflected the impact of cash collections, including commutation agreements, and the impact of net favorable prior year reserve development.

Amounts recoverable from reinsurers are estimated in a manner consistent with the associated claim liability. The Company evaluates and monitors the financial condition of its reinsurers under voluntary reinsurance arrangements to minimize its exposure to significant losses from reinsurer insolvencies. In addition, in the ordinary course of business, the Company becomes involved in coverage disputes with its reinsurers. Some of these disputes could result in lawsuits and arbitrations brought by or against the reinsurers to determine the Company's rights and obligations under the various reinsurance agreements. The Company employs dedicated specialists and aggressive strategies to manage reinsurance collections and disputes.

Some of the reinsurance agreements that the Company entered into as part of its catastrophe bond programs are dual trigger contracts. All of these contracts meet the requirements to be accounted for as reinsurance in accordance with guidance for accounting for reinsurance contracts. The Company's catastrophe bond programs are described in more detail in "Item 1 Business Catastrophe Reinsurance."

The Company reports its reinsurance recoverables net of an allowance for estimated uncollectible reinsurance recoverables. The allowance is based upon the Company's ongoing review of amounts outstanding, length of collection periods, changes in reinsurer credit standing, disputes, applicable coverage defenses and other relevant factors. Accordingly, the establishment of reinsurance recoverables and the related allowance for uncollectible reinsurance recoverables is also an inherently uncertain process involving estimates. From time to time, as a result of the long-tailed nature of the underlying liabilities, coverage complexities and potential for disputes, the Company considers the

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commutation of reinsurance contracts. Changes in estimated reinsurance recoverables and commutation activity could result in additional income statement charges.

Recoverables attributable to structured settlements relate primarily to personal injury claims, of which workers' compensation claims comprise a significant portion, for which the Company has purchased annuities and remains contingently liable in the event of a default by the companies issuing the annuities. Recoverables attributable to mandatory pools and associations relate primarily to workers' compensation service business. These recoverables are supported by the participating insurance companies' obligation to pay a pro rata share based on each company's voluntary market share of written premium in each state in which it is a pool participant. In the event a member of a mandatory pool or association defaults on its share of the pool's or association's obligations, the other members' share of such obligation increases proportionally.

On August 17, 2010, in a reinsurance dispute in New York state court captioned *United States Fidelity & Guaranty Company v. American Re-Insurance Company, et al.*, the trial court granted summary judgment for United States Fidelity and Guaranty Company (USF&G), a subsidiary of the Company, and denied summary judgment for American Re-Insurance Company, a subsidiary of Munich Re (American Re), and three other reinsurers. By order dated October 22, 2010, the trial court corrected certain clerical errors and made certain clarifications to the August 17, 2010 order. On October 25, 2010, judgment was entered against American Re and the other three insurers, awarding USF&G \$420 million, comprising \$251 million ceded under the terms of the disputed reinsurance contract plus interest of 9% amounting to \$169 million as of that date. The judgment, including the award of interest, was appealed by the reinsurers to the New York Supreme Court, Appellate Division, First Department. On January 24, 2012, the Appellate Division affirmed the judgment. On January 30, 2012, the reinsurers filed a motion with the Appellate Division seeking permission to appeal its decision to the New York Court of Appeals, and on March 12, 2012, the Appellate Division granted the reinsurers' motion. On February 7, 2013, the Court of Appeals issued an opinion that largely affirmed the summary judgment in USF&G's favor, while modifying in part the summary judgment with respect to two discrete issues and remanding the case to the trial court for determination of those issues. The Company believes it has a meritorious position on each of these issues and intends to pursue its claim vigorously. At December 31, 2012, the claim totaled \$470 million, comprising \$251 million of reinsurance recoverable plus interest which had grown to \$219 million as of that date. Interest will continue to accrue at 9% until the claim is paid. The \$251 million of reinsurance recoverable owed to USF&G under the terms of the disputed reinsurance contract has been reported as part of reinsurance recoverables in the Company's consolidated balance sheet. The interest that would be owed as part of any judgment ultimately entered in favor of USF&G is treated for accounting purposes as a gain contingency in accordance with FASB Topic 450, *Contingencies*, and accordingly has not been recognized in the Company's consolidated financial statements.

**Investment Valuation and Impairments**

***Fair Value Measurements***

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in the fair value accounting guidance. The framework is based on the inputs used in valuation, gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the fair value accounting guidance hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The level in the fair value hierarchy

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within which the fair value measurement is reported is based on the lowest level input that is significant to the measurement in its entirety. The three levels of the hierarchy are as follows:

Level 1 Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Level 3 Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the inputs that market participants would use.

***Valuation of Investments Reported at Fair Value in Financial Statements***

The fair value of a financial instrument is the estimated amount at which the instrument could be exchanged in an orderly transaction between knowledgeable, unrelated, willing parties, i.e., not in a forced transaction. The estimated fair value of a financial instrument may differ from the amount that could be realized if the security was sold in an immediate sale, e.g., a forced transaction. Additionally, the valuation of investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur.

For investments that have quoted market prices in active markets, the Company uses the unadjusted quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy. The Company receives the quoted market prices from a third party, nationally recognized pricing service (pricing service). When quoted market prices are unavailable, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly used for its fixed maturity investments. The fair value estimates provided from this pricing service are included in the amount disclosed in Level 2 of the hierarchy. If quoted market prices and an estimate from a pricing service are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third-party market participant would be willing to pay in an arm's length transaction.

***Fixed Maturities***

The Company utilizes a pricing service to estimate fair value measurements for approximately 98% of its fixed maturities. The pricing service utilizes market quotations for fixed maturity securities that have quoted prices in active markets. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value measurements for these securities using its proprietary pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings and matrix pricing. Additionally, the pricing service uses an Option Adjusted Spread model to develop prepayment and interest rate scenarios.

The pricing service evaluates each asset class based on relevant market information, relevant credit information, perceived market movements and sector news. The market inputs utilized in the pricing evaluation, listed in the approximate order of priority, include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the

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asset class and the market conditions. Depending on the security, the priority of the use of inputs may change or some market inputs may not be relevant. For some securities, additional inputs may be necessary.

The pricing service utilized by the Company has indicated that they will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If the pricing service discontinues pricing an investment, the Company would be required to produce an estimate of fair value using some of the same methodologies as the pricing service but would have to make assumptions for market-based inputs that are unavailable due to market conditions.

The fair value estimates of most fixed maturity investments are based on observable market information rather than market quotes. Accordingly, the estimates of fair value for such fixed maturities, other than U.S. Treasury securities, provided by the pricing service are included in the amount disclosed in Level 2 of the hierarchy. The estimated fair value of U.S. Treasury securities is included in the amount disclosed in Level 1 as the estimates are based on unadjusted market prices.

The Company reviews the estimates of fair value provided by the pricing service and compares the estimates to the Company's knowledge of the market to determine if the estimates obtained are representative of the prices in the market. In addition, the Company has periodic discussions with the pricing service to discuss any changes in their process and reactions to overall markets. The Company produces a report monthly that lists all price changes from the previous month in excess of 10%. The Company reviews the report and will challenge any prices deemed not to be representative of fair value. In addition, the Company has implemented various other processes including randomly selecting purchased or sold securities and comparing execution prices to the estimates from the pricing service as well as reviewing reports that contain securities whose valuation did not change from their previous valuation (stale price review). The Company also uses an additional independent pricing service to further test the primary pricing service's valuation of the Company's fixed maturity portfolio. These processes have not highlighted any significant issues with the fair value estimates received from the pricing service.

The Company also holds certain fixed maturity investments which are not priced by the pricing service and, accordingly, estimates the fair value of such fixed maturities using an internal matrix that is based on market information regarding interest rates, credit spreads and liquidity. The underlying source data for calculating the matrix of credit spreads relative to the U.S. Treasury curve are the BofA Merrill Lynch U.S. Corporate Index and the BofA Merrill Lynch BB U.S. High Yield Index. The Company includes the fair value estimates of these corporate bonds in Level 2, since all significant inputs are market observable.

While the vast majority of the Company's municipal bonds and corporate bonds are included in Level 2, the Company holds a number of municipal bonds and corporate bonds which are not valued by the pricing service and, accordingly, estimates the fair value of these bonds using an internal pricing matrix with some unobservable inputs that are significant to the valuation. Due to the limited amount of observable market information, the Company includes the fair value estimates for these particular bonds in Level 3. The fair value of the fixed maturities for which the Company used an internal pricing matrix was \$102 million and \$88 million at December 31, 2012 and 2011, respectively. Additionally, the Company holds a small amount of other fixed maturity investments that have characteristics that make them unsuitable for matrix pricing. For these fixed maturities, the Company obtains a quote from a broker (primarily the market maker). The fair value of the fixed maturities for which the Company received a broker quote was \$128 million and \$162 million at December 31, 2012 and 2011, respectively. Due to the disclaimers on the quotes that indicate that th