

TRAVELERS COMPANIES, INC.
Form 10-K
February 21, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2007

or

**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.)

**385 Washington Street,
St. Paul, MN 55102**
(Address of principal executive offices) (Zip Code)

(651) 310-7911
(Registrant's telephone number, including area code)

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

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

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

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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 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, 2007, the aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates was \$35,046,780,054.

As of February 15, 2008, 620,330,308 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 2008 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

The Travelers Companies, Inc.
Annual Report on Form 10-K
For Fiscal Year Ended December 31, 2007

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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, known as The St. Paul Companies, Inc. (SPC) prior to its merger with Travelers Property Casualty Corp. (TPC) in 2004, 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 385 Washington Street, St. Paul, Minnesota 55102, and the telephone number is (651) 310-7911. The Company also maintains executive offices in New York, NY and Hartford, CT. The term "TRV" in this document refers to The Travelers Companies, Inc., the parent holding company excluding subsidiaries.

On April 1, 2004, TPC merged with a subsidiary of SPC, as a result of which TPC became a wholly-owned subsidiary of SPC, and SPC changed its name to The St. Paul Travelers Companies, Inc. For accounting purposes, this transaction was accounted for as a reverse acquisition with TPC treated as the accounting acquirer. Accordingly, this transaction was accounted for as a purchase business combination, using TPC's historical financial information and applying fair value estimates to the acquired assets, liabilities and commitments of SPC as of April 1, 2004. Beginning on April 1, 2004, the results of operations and financial position of SPC were consolidated with TPC's results of operations and financial position.

On February 26, 2007, The St. Paul Travelers Companies, Inc. changed its name to The Travelers Companies, Inc. and began trading on the New York Stock Exchange under the new stock symbol "TRV."

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 method of distribution, i.e. 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 970 property casualty organizations in the United States, comprising approximately 2,300 property and casualty companies. Of those organizations, the top 150 accounted for approximately 91% of the consolidated industry's total net written premiums in 2006. 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 that 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;

ratings assigned by independent rating agencies;

local presence;

geographic scope of business;

overall financial strength;

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 surplus expands and contracts primarily in conjunction with profit levels generated by the industry. Capital raised by debt and equity offerings also increases a company's surplus.

Geographic Distribution

The following table shows the geographic distribution of the Company's consolidated direct written premiums for the year ended December 31, 2007:

State	% of Total
New York	9.7%
California	8.4
Texas	7.5
Florida	5.1
Pennsylvania	4.8
Massachusetts	4.2
New Jersey	4.1
Illinois	3.7
Georgia	3.1
All other domestic(1)	42.2
Total domestic	92.8
International	7.2
Consolidated total	100.0%

(1)

No other single state accounted for 3.0% or more of the total direct written premiums written in 2007 by the Company's domestic operations.

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:

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

Commercial Accounts serves primarily mid-sized businesses for property and casualty products, including property, general liability, commercial multi-peril, commercial auto and workers' compensation insurance.

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National Accounts comprises three business units. The largest provides casualty products and services to large companies, with particular emphasis on workers' compensation, general liability and automobile liability, generally utilizing loss-sensitive products such as collateralized deductibles or self-insured programs. National Accounts also includes Discover Re, which provides property and casualty insurance products on an unbundled basis using third-party administrators for insureds who utilize programs such as collateralized deductibles, captive reinsurers and self-insurance. In addition, National Accounts includes the commercial residual market business, which primarily offers workers' compensation products and services to the involuntary market.

Industry-Focused Underwriting. The following units serve 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, commercial auto, property and inland marine coverages, and other risk management solutions.

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

Public Sector Services markets insurance products and services to public entities including municipalities, counties, Indian Nation gaming and selected special government districts such as water and sewer utilities. The policies written by this unit typically cover property, commercial auto, general liability and errors and omissions 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 insure drilling rigs, natural gas facilities, and production and gathering platforms, and cover risks including physical damage, liability and business interruption.

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 assets, 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 does not write the primary casualty coverage, or where other business units within the Company prefer to outsource the underwriting of umbrella and excess coverage based on the expertise and/or limit capacity of Excess Casualty.

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 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 Accounts provides insurance to U.S. companies with foreign property and liability exposures (home-foreign), and 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 and golf services.

Business Insurance also includes the Special Liability Group (which manages the Company's asbestos and environmental liabilities); the assumed reinsurance, health care, and certain international and other runoff operations; policies written by the Company's Gulf operation (Gulf), which is in runoff; and the Company's Personal Catastrophe Risk operation, which was sold in November 2005. These are collectively referred to as Business Insurance Other. The Personal Catastrophe Risk operation accounted for the majority of net written premiums in Business Insurance Other in 2005. Certain business previously written by Gulf is now being written in the Specialized Distribution market and in the Financial, Professional & International Insurance segment. Gulf provided specialty coverages including management and professional liability, excess and surplus lines, environmental, umbrella and fidelity. Gulf also provided insurance products specifically designed for financial institutions, the entertainment industry and sports organizations.

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 product lines and markets referred to in the table, see "Principal Markets and Methods of Distribution" and "Product Lines," respectively.

(for the year ended December 31, in millions)	2007	2006	2005	% of Total 2007
By market:				
Select Accounts	\$ 2,711	\$ 2,663	\$ 2,722	24.0%
Commercial Accounts	2,518	2,376	2,330	22.2
National Accounts	1,056	1,135	1,230	9.3
Industry-Focused Underwriting	2,301	2,196	2,080	20.3
Target Risk Underwriting	1,665	1,629	1,482	14.7
Specialized Distribution	1,015	1,022	908	9.0
	<hr/>	<hr/>	<hr/>	<hr/>
Total Business Insurance Core	11,266	11,021	10,752	99.5
Business Insurance Other	52	25	247	0.5
	<hr/>	<hr/>	<hr/>	<hr/>
Total Business Insurance by market	\$ 11,318	\$ 11,046	\$ 10,999	100.0%
	<hr/>	<hr/>	<hr/>	<hr/>
By product line:				
Commercial multi-peril	\$ 3,066	\$ 3,083	\$ 3,000	27.1%
Workers' compensation	2,267	2,135	2,080	20.0
Commercial automobile	2,011	2,013	2,024	17.8
Property	1,990	1,939	1,927	17.5
General liability	1,943	1,857	1,922	17.2
Other	41	19	46	0.4
	<hr/>	<hr/>	<hr/>	<hr/>
Total Business Insurance by product line	\$ 11,318	\$ 11,046	\$ 10,999	100.0%
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Principal Markets and Methods of Distribution

Business Insurance distributes its products through approximately 7,600 independent agencies and brokers located throughout the United States that are serviced by approximately 90 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 matters, each agency's or broker's financial strength, staff experience and strategic fit with its operating and marketing plans. Once an agency or broker is appointed, Business Insurance carefully monitors its performance.

Select Accounts is a leading provider of property casualty products to small businesses. It serves firms with generally fewer than 50 employees. Products offered by Select Accounts are guaranteed cost policies, including packaged products covering property and liability exposures. Products are sold through independent agents and brokers, who are often the same agents and brokers that sell the Company's Commercial Accounts and Personal Insurance products.

Select Accounts offers its independent agents a system for small businesses that helps them connect all aspects of sales and service through a comprehensive service platform. Components of the platform include agency automation capabilities and service centers that function as an extension of an agency's customer service operations, both of which are highly utilized by agencies. Agencies accounting for approximately 48% of this group's net written premium have chosen to take advantage of Select Accounts' service centers, which offer agencies a wide range of services, including coverage and billing

inquiries, policy changes, the assistance of licensed service professionals and extended hours of operations.

Commercial Accounts sells a broad range of property and casualty insurance products through a large network of independent agents and brokers. Commercial Accounts' primarily targets 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 group is comprised of three business units. The largest unit sells a variety of casualty products and services to large companies. National Accounts clients for the most part select loss-sensitive products in connection with a large deductible or self-insured program and, to a much lesser extent, a retrospectively rated or a guaranteed cost insurance policy. Through a network of field offices, the Company's underwriting specialists work closely with national and regional brokers to tailor insurance programs to meet clients' needs. Workers' compensation accounted for approximately 77% of sales to National Accounts customers during 2007, based on direct written premiums and fees. National Accounts generated \$293 million of fee income in 2007, excluding commercial residual market business discussed below.

National Accounts includes the Company's Discover Re operation, which principally provides commercial auto liability, general liability, workers' compensation and property coverages. It serves retail brokers and insureds who utilize programs such as collateralized deductibles, captive reinsurers and self-insurance.

In addition, National Accounts includes the Company's commercial residual market business. The Company's commercial residual market business sells claims and policy management services to workers' compensation pools throughout the United States. The Company services approximately 36% of the total workers' compensation assigned risk market. The Company is one of very few servicing carriers that operate nationally. Assigned risk plan contracts generated \$151 million in fee income in 2007.

Many National Accounts customers require insurance-related services in addition to or in lieu of pure risk coverage, primarily for workers' compensation and, to a lesser extent, general liability and commercial automobile exposures. These types of services include risk management services, such as claims administration, loss control and risk management information services, and are generally offered in connection with large deductible or self-insured programs. These services generate fee income rather than net written premiums.

Industry-Focused Underwriting markets a wide array of property and casualty products and services tailored to targeted industry segments. Unique marketing and underwriting groups are focused on individual industry segments of significant size and complexity that require unique underwriting, claim, risk management or other insurance-related products and services. The following Industry-Focused units, which are described in more detail earlier in this report, have been established: Construction, Technology, Public Sector Services, Oil & Gas, and Agribusiness.

Products are distributed primarily through the same agents and brokers servicing Select Accounts and Commercial Accounts, although there may be more business written with agents that also specialize in servicing the needs of certain of these industries.

Target Risk Underwriting services a wide customer base with unique and specialized insurance products and services. These specialized units have expertise in meeting customers' specialized property and casualty coverage requirements. These units include National Property, Inland Marine, Ocean Marine, Excess Casualty, Boiler & Machinery, and Global Accounts, which are described in more detail later in this report.

Products are distributed primarily through the same agents and brokers servicing Select Accounts and Commercial Accounts, as well as specialized agents and brokers with expertise in certain of these products.

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. 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 that conforms to underwriting guidelines that have been specifically designed for each facility or program.

Pricing and Underwriting

Pricing levels for Business Insurance property and casualty insurance products are generally developed based upon an expectation of estimated losses, the expenses of producing, issuing and servicing business and managing claims, and a reasonable allowance for profit. Business Insurance has a disciplined approach to underwriting and risk management that emphasizes profitable growth rather than premium volume or market share.

Business Insurance has developed an underwriting and pricing methodology that incorporates underwriting, claims, engineering, actuarial and product development disciplines for particular industries. This approach is designed to maintain high quality underwriting and pricing discipline. It utilizes proprietary data gathered and analyzed with respect to its Business Insurance business over many years. The underwriters and engineers use this information to assess and evaluate risks prior to quotation. This information provides specialized knowledge about specific industry segments. This methodology enables Business Insurance to streamline its risk selection process and develop pricing parameters that will not compromise its underwriting integrity.

For smaller businesses, Select Accounts uses a process based on industry classifications to allow agents and field underwriting representatives to make underwriting and pricing decisions within predetermined classifications, because underwriting criteria and pricing tend to be more standardized for these smaller exposures.

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, 2007, contractholder receivables and payables on unpaid losses associated with large deductible policies were each approximately \$6.69 billion. Retrospectively rated policies are also 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 \$230 million at December 31, 2007. Significant collateral, primarily letters of credit and, to a lesser extent, cash collateral trusts and surety bonds, 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.

The Company continually monitors its exposure to natural and manmade peril catastrophic losses and attempts to manage such exposure. In order to manage the Company's exposure to catastrophe losses, Business Insurance limits the writing of new property business and selectively takes underwriting action on existing business in some markets. In addition, the Company has tightened underwriting standards, implemented price increases in some catastrophe-prone areas and put in place deductibles specific to hurricane-, wind- and hail-prone areas. The Company uses various analyses and methods, including sophisticated computer modeling techniques, to analyze underwriting risks of business in hurricane-prone, earthquake-prone and target risk areas. The Company relies upon this analysis to make underwriting decisions designed to manage its exposure on catastrophe-exposed business. The Company also utilizes reinsurance to manage its aggregate exposures to catastrophes. See " Reinsurance."

Product Lines

Commercial Multi-Peril provides a combination of property and liability coverage. Property insurance covers damages such as those caused by fire, wind, hail, earthquake, water, theft, vandalism and terrorism, and protects businesses from financial loss due to business interruption resulting from a covered loss. Liability coverage insures businesses against third parties from accidents occurring on their premises or arising out of their operations, such as injuries sustained from products sold.

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, cost-effective quality care and customer service in this market. 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;

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.

Property provides coverage for loss of or damage to buildings, inventory and equipment from natural disasters, including hurricanes, windstorms, earthquakes, hail, and severe winter weather. Also covered are manmade events such as theft, 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 Acts." 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, which provides coverage for goods in transit and unique, one-of-a-kind exposures.

General Liability provides coverage for liability exposures including bodily injury and property damage arising from products sold and general business operations. 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. Errors and omissions insurance for professionals (such as lawyers, accountants, doctors and other health care providers) is sometimes also known as professional liability insurance.

Net Retention Policy

The following discussion reflects the Company's retention policy with respect to the Business Insurance segment as of January 1, 2008. For third party liability, Business Insurance generally limits its net retention to a maximum of \$15.7 million per insured, per occurrence after reinsurance. The net retained amount per risk for property exposures is generally limited to \$15 million, after reinsurance. The Company generally retains its workers' compensation exposures. Individual risk reinsurance treaties often have aggregate limits which could cap recoveries for a series of large losses. The Company also 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, 2007:

State	% of Total
California	11.6%
New York	7.8
Texas	7.6
Florida	5.5
Illinois	4.7
Pennsylvania	4.0
Massachusetts	4.0
New Jersey	3.8
All others(1)	51.0
<hr/>	
Total	100.0%

(1) No other single state accounted for 3.0% or more of the total direct written premiums written in 2007 by the domestic operations of the Business Insurance segment.

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 level of service provided. A company's success in

the competitive commercial insurance landscape is largely measured by its ability to provide insurance and services at a price that is 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 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 it with defined underwriting policies, a broad array of products, competitive prices and one of the most efficient automated environments in the industry. 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 written through independent agents and brokers, although some companies use direct writing. Competitors in this market are primarily national property casualty insurance companies willing to 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. Improved efficiency through automation and shortened response time to customer needs is key to success in this market.

The National Accounts group is comprised of three business units:

National Accounts business is typically written through national brokers and, to a lesser extent, regional brokers. Insurance companies compete in this market based on price, product offerings, claim and loss prevention services, managed care cost containment and risk management information systems. National Accounts also offers a large nationwide network of localized claim service centers which provide greater flexibility in claims adjusting and allows National Accounts to more quickly respond to the needs of its customers.

Discover Re competes with traditional providers of commercial insurance coverages, as well as other underwriters of property and casualty insurance in the alternative risk transfer market, such as risk retention groups, self-insurance plans, captives managed by others, and a variety of other risk-financing vehicles and mechanisms.

National Accounts' residual market business competes for state contracts to provide claims and policy management services. These contracts, which generally have three-year terms, are selected by state agencies through a bid process based on the quality of service and price. National Accounts services approximately 36% 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, proprietary coverage forms, specialized risk control and loss handling services, and 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. In either case, these businesses have 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 businesses, the competitive strategy is market leadership attained through focused industry knowledge applied to insurance and risk needs.

FINANCIAL, PROFESSIONAL & INTERNATIONAL INSURANCE

The Financial, Professional & International Insurance segment includes surety and financial liability coverages, which require a primarily credit-based underwriting process, as well as property and casualty products that are primarily marketed on an international basis. The segment includes the following businesses:

Bond & Financial Products provides a wide range of customers with bond and insurance products and risk management services. The range of coverages includes surety and fidelity bonds for construction and general commercial enterprises; professional liability and management liability for public corporations, private companies and not-for-profit organizations for losses caused by the negligence or misconduct of named directors and officers; professional liability for a variety of professionals, such as lawyers, design professionals and real estate agents for liability from errors and omissions committed in the course of professional conduct or practice; and a full range of property, auto, liability, fidelity and professional/management liability insurance for financial institutions, with a special focus on community banks.

International includes business written through domestic operations in the United Kingdom, Canada and the Republic of Ireland and business written as a corporate member at Lloyd's. International, through its operations in the United Kingdom, Canada and Ireland, offers specialized insurance and risk management services to several customer groups, including those in the technology, public services, and financial and professional services industry sectors. These operations primarily underwrite 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) and property exposures. International, through its Lloyd's syndicate (Syndicate 5000), for which the Company provides 100% of the capital, underwrites five principal lines of business - aviation, marine, global property, accident and special risks, and power and utilities.

Selected Market and Product Information

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

(for the year ended December 31, in millions)	2007	2006	2005	% of Total 2007
By market:				
Bond & Financial Products	\$ 2,228	\$ 2,255	\$ 2,117	64.3%
International	1,237	1,138	1,042	35.7
Total Financial, Professional & International Insurance by market	\$ 3,465	\$ 3,393	\$ 3,159	100.0%
By product line:				
Fidelity and surety	\$ 1,152	\$ 1,125	\$ 1,026	33.2%
General liability	942	1,006	981	27.2
International	1,237	1,138	1,042	35.7
Other	134	124	110	3.9
Total Financial, Professional & International Insurance by product line	\$ 3,465	\$ 3,393	\$ 3,159	100.0%

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In March 2007, the Company completed the sale of its Mexican surety subsidiary, Afianzadora Insurgentes, S.A. de C.V., which accounted for \$25 million, \$78 million and \$78 million of net written premiums for the years ended December 31, 2007, 2006 and 2005, respectively. The impact of this transaction was not material to the Company's results of operations or financial position.

Principal Markets and Methods of Distribution

Within the Financial, Professional & International Insurance segment, Bond & Financial Products distributes the majority of its products in the United States through approximately 6,400 of the same independent agencies and brokers that distribute the Business Insurance segment's products. These brokers and independent agencies are located throughout the United States. Bond & Financial Products, in conjunction with the Business Insurance segment, continues to make significant 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 matters, 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 agents using subsidiaries in Canada and the United Kingdom.

The International market distributes its products through brokers in the domestic markets of each of the three countries in which it operates, the United Kingdom, Canada and the Republic of Ireland. 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.

Pricing and Underwriting

Pricing levels for Financial, Professional & International Insurance property and casualty insurance products are generally developed based upon an estimation of expected losses, the expenses of producing, issuing and servicing business and managing claims, and a reasonable allowance for profit. Financial, Professional & International Insurance has a disciplined approach to underwriting and risk management that emphasizes profitable growth rather than premium volume or market share.

Financial, Professional & International Insurance has developed an underwriting and pricing methodology that incorporates 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 or industry issues. The underwriters use proprietary data gathered and analyzed over many years to assess and evaluate risks prior to quotation, and then use proprietary forms to tailor insurance coverage to insureds within the target markets. This methodology enables Financial, Professional & International Insurance to streamline its risk selection process and develop pricing parameters that will not compromise its underwriting integrity.

The Company continually monitors its exposure to natural and manmade peril catastrophic losses and attempts to manage such exposure. The Company uses various analyses and methods, including sophisticated computer modeling techniques, to analyze underwriting risks of business in hurricane-prone, earthquake-prone and target risk areas. The Company relies upon this analysis to make underwriting decisions designed to manage its exposure on catastrophe-exposed business. The Company also utilizes reinsurance to manage its aggregate exposures to catastrophes. See " Reinsurance."

Product Lines

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. In addition to the business written in the United States, this product line includes surety business written in the following subsidiaries of the Company: Travelers Guarantee (Canada) and Travelers Casualty and Surety Company of Europe (United Kingdom).

General Liability provides coverage for liability exposures including bodily injury and property damage arising from products sold and general business operations. 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. Errors and omissions insurance for professionals (such as lawyers, accountants, architects and engineers) is sometimes also known as professional liability insurance.

International provides coverage through domestic operations in the United Kingdom, Canada and the Republic of Ireland, and through the Company's operations at Lloyd's. The coverage provided in those markets includes 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 (similar to property in the United States), personal accident and kidnap and ransom. Personal accident provides financial protection in the event of death or disablement due to accidental bodily injury, while kidnap and ransom provide 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 in the United States.

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

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, 2008. 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 up to \$12.1 million per policy after reinsurance. For surety protection, the Company generally retains up to \$55 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 range from \$3 million to \$15 million. Individual risk reinsurance treaties often have aggregate limits which could cap recoveries for a series of large losses. The Company also 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 Financial, Professional & International's direct written premiums for the states, or for locations outside of the United States, that accounted for the majority of premium volume for the year ended December 31, 2007:

State	% of Total
New York	5.9%
California	5.7
Texas	4.3
Florida	3.7
All other domestic(1)	44.5
<hr/>	
Total domestic	64.1
Total international	35.9
<hr/>	
Total	100.0%

(1) No other single state within the United States accounted for 3.0% or more of the total direct written premiums written in 2007 by the Financial, Professional & International Insurance segment.

Competition

The competitive landscape in which the Financial, Professional & International Insurance segment 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 willing to 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 national, mid-sized and small businesses and organizations, as well as individuals, and distributes them through both national and wholesale brokers, regional brokers and retail agents. 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 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. Products are generally distributed through a relatively small broker base whose customer groups align with the Company's targeted 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. Lloyd's syndicates are increasingly capitalized by corporate capital, much of which is provided by large international insurance enterprises. Competition is again based on price and product offerings. The Company focuses on lines it believes it can underwrite effectively and profitably with an

emphasis on short-tail insurance lines. The Company underwrites through five principal lines of business at Lloyd's: aviation, marine, global property, accident and special risks, and power and utilities.

PERSONAL INSURANCE

Personal Insurance writes a broad range of property and casualty insurance covering personal risks. The primary coverages in Personal Insurance are automobile and homeowners insurance sold to individuals. These products are distributed through independent agents, sponsoring organizations such as employee and affinity groups, joint marketing arrangements with other insurers, and direct marketing.

Selected Product and Distribution Channel Information

The following table sets forth net written premiums for Personal Insurance 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)	2007	2006	2005	% of Total 2007
By product line:				
Personal automobile	\$ 3,628	\$ 3,692	\$ 3,477	53.1%
Homeowners and other	3,207	3,019	2,751	46.9
 Total Personal Insurance	 \$ 6,835	 \$ 6,711	 \$ 6,228	 100.0%

In April 2007, the Company completed the sale of its subsidiary, Mendota Insurance Company, and its wholly-owned subsidiaries, Mendakota Insurance Company and Mendakota Insurance Agency, Inc. These subsidiaries primarily offered nonstandard automobile coverage and accounted for \$49 million, \$187 million and \$137 million of net written premiums in the years ended December 31, 2007, 2006 and 2005, respectively. The sale was not material to the Company's results of operations or financial position.

Principal Markets and Methods of Distribution

Personal Insurance products are distributed primarily through approximately 8,400 independent agents located throughout the United States, supported by personnel in eleven marketing regions, three single state companies and six service centers. In selecting new independent agencies to distribute its products, Personal Insurance considers, among other matters, each agency's profitability, financial stability, staff experience and strategic fit with Personal Insurance's operating and marketing plans. Once an agency is appointed, Personal Insurance carefully monitors its performance. While the principal markets for Personal Insurance's insurance products are in states along the East Coast, in the South and Texas, Personal Insurance continues to expand its geographic presence across the United States.

Personal Insurance operates single state companies in Massachusetts, New Jersey and Florida with products marketed primarily through independent agents. These states represented approximately 17% of Personal Insurance direct written premiums in 2007. The companies were established to manage complex markets in Massachusetts and New Jersey and property catastrophe exposure in Florida. The companies in Massachusetts and New Jersey have dedicated resources in underwriting, claim, finance, legal and service functions. The company in Florida has dedicated resources for claim, finance and legal functions.

Personal Insurance uses a consistent operating model with agents outside of the single state companies discussed above. The model provides technological alternatives to agents to maximize their ease of doing business. Personal Insurance agents quote and issue approximately 98% of Personal Insurance's new business policies directly from their agencies by leveraging either their own agency management system or using Personal Insurance's proprietary quote and issuance systems which allow agents to rate, quote and issue policies on line. All of these quote and issue platforms interface with Personal Insurance's underwriting and rating systems, which edit transactions for compliance with Personal Insurance's underwriting and pricing programs. Business processed by agents on these platforms is subject to consultative review by Personal Insurance's in-house underwriters. Personal Insurance also provides a download capability that refreshes the individual agency system databases of approximately 6,800 agents each day with updated policy information.

Personal Insurance continues to develop functionality to provide its agents with a comprehensive array of online service capabilities packaged together in an easy-to-use agency service portal, including customer service, marketing and claim functionality. Agencies can also choose to shift the ongoing service responsibility for Personal Insurance's customers to one of the Company's four Customer Care Centers, where the Company renders customer service on behalf of an agency by providing a comprehensive array of direct customer service needs, including response to billing and coverage inquiries, and policy changes. Approximately 1,300 agents take advantage of this service alternative.

Personal Insurance also markets through additional distribution channels, including sponsoring organizations such as employers and consumer associations, and direct marketing. 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. A number of well-known corporations make the Company's product offerings available to their employees primarily through a payroll deduction payment process. The Company has significant relationships with the majority of the American Automobile Association (AAA) clubs in the United States and other affinity groups that make available Personal Insurance's product offerings to their members. In addition, since 1995, the Company has had a marketing agreement with GEICO to underwrite homeowners business for their auto customers. This agreement has added profitable business and helped to geographically diversify the homeowners line of business.

Pricing and Underwriting

Pricing levels for Personal Insurance property and casualty insurance products are generally developed based upon an expectation of estimated losses, the expenses of producing, issuing and servicing business and managing claims, and a reasonable allowance for profit. The Company has a disciplined approach to underwriting and risk management that emphasizes profitable growth rather than growth in premium volume or market share alone.

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 is analyzed with respect to Personal Insurance's business over many years. Personal Insurance uses a variety of proprietary and vendor produced risk differentiation models to facilitate its pricing segmentation. Personal Insurance's product managers establish underwriting guidelines integrated with its filed pricing and rating plans, which enable Personal Insurance to execute its risk selection and pricing processes.

Pricing for personal automobile insurance is driven by changes in the frequency of claims and by inflation in the cost of automobile repairs, medical care and litigation of liability claims. As a result, the profitability of the business is largely dependent on promptly identifying and rectifying disparities between premium levels and projected claim costs, and obtaining approval from state regulatory authorities when necessary for filed rate changes.

Pricing in the homeowners business is also driven by changes in the frequency of claims and by inflation in the cost of building supplies, labor and household possessions. Most homeowners policies offer, but do not require, automatic increases in coverage to reflect growth in replacement costs. In addition to the normal risks associated with any multiple peril coverage, the profitability and pricing of homeowners insurance is affected by the incidence of natural disasters, particularly those related to weather and earthquakes. In order to manage the Company's exposure to catastrophe losses, Personal Insurance limits the writing of new homeowners business and selectively takes underwriting action on existing business in some markets. In addition, the Company has tightened underwriting standards, implemented price increases in some catastrophe-prone areas and put in place deductibles specific to hurricane and wind- and hail-prone areas. Personal Insurance uses computer-modeling techniques to assess its level of exposure to loss in hurricane and earthquake catastrophe-prone areas. 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.

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. 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 and/or social responsibilities. The Company also may choose to write business it might not otherwise write for strategic purposes, such as improving access to other underwriting opportunities.

Independent agents either utilize one of the Company's automated quote and issue systems or they submit applications to the Company's service centers for underwriting review, quote, and issuance. Automated transactions are edited by the Company's systems and issued if they conform to established guidelines. Exceptions are reviewed by underwriters in the Company's business centers. Audits are conducted by an internal peer review team across all of the Company's independent agency generated business on a systematic sampling basis. Each agent is assigned to a specific employee or team of employees responsible for working with the agent on business plan development, marketing, and overall growth and profitability. The Company uses agency level management information to analyze and understand results and to identify problems and opportunities.

The Personal Insurance products sold through additional marketing channels utilize the same issuance systems discussed previously and exceptions are underwritten by the Company's employees. Underwriters work with Company management on business plan development, marketing, and overall growth and profitability. Channel-specific production and claim information is used to analyze results and identify problems and opportunities.

Product Lines

The primary coverages in Personal Insurance are personal automobile and homeowners insurance sold to individuals. Personal Insurance had approximately 7.2 million policies in force at December 31, 2007.

Personal Automobile provides coverage for liability to others for both bodily injury and property damage and for physical damage to an insured's own vehicle from collision and various other perils. 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 wide variety of perils (excluding flooding), as well as coverage for personal liability. The Company writes homeowners insurance for dwellings, condominiums and rental property contents. The Company also writes coverage for personal watercraft, personal articles such as jewelry, and umbrella liability protection.

Net Retention Policy

The following discussion reflects the Company's retention policy with respect to the Personal Insurance segment as of January 1, 2008. Personal Insurance retains the first \$5 million of umbrella policies and purchases facultative reinsurance for limits over \$5 million. For personal property insurance, there is a \$7 million maximum retention per risk. The Company also 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 Personal Insurance's direct written premiums for the states that accounted for the majority of premium volume for the year ended December 31, 2007:

State	% of Total
New York	15.4%
Texas	9.1
Pennsylvania	7.5
New Jersey	5.9
Massachusetts	5.9
Florida	5.3
Connecticut	4.8
Georgia	4.7
Virginia	4.5
California	4.4
Maryland	3.5
South Carolina	3.2
All others(1)	25.8
Total	100.0%

(1) No other single state accounted for 3.0% or more of the total direct written premiums written in 2007 by the Personal Insurance segment.

Competition

Personal lines insurance is written by hundreds of insurance companies of varying sizes. Although national companies write the majority of the business, Personal Insurance also faces competition from local and regional companies. Personal Insurance primarily competes based on service, ease of doing business, price, perceived 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 and the level of service, including claims handling, as well as the level of automation and the development of long-term relationships with individual agents. 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. In addition to its traditional independent agency distribution, Personal Insurance has broadened its distribution of products by marketing to sponsoring organizations, including employee and affinity groups, through joint marketing arrangements with other insurers and direct marketing. Personal Insurance believes that its continued focus on underwriting and pricing segmentation, claim settlement effectiveness strategies and expense management practices enable Personal Insurance to price its products competitively in all of its distribution channels.

CLAIMS MANAGEMENT

The Company's claims function is managed through its Claim Services operations. With nearly 13,000 employees, Claim 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 independent adjusters and appraisers, investigators and attorneys, are available for use as appropriate.

Field claim management teams located in 28 claim centers and 88 satellite and specialty-only offices in 46 states are organized to maintain focus on the specific claim characteristics unique to the businesses within the Business Insurance, Financial, Professional & International Insurance, and Personal Insurance segments. Claim teams with specialized skills, resources, and workflows are matched to the unique exposures of those businesses with local claim 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. In addition to the field teams, claim staff is dedicated to each of Personal Insurance's single state companies in Florida, Massachusetts and New Jersey. This structure permits the Company to maintain the economies of scale of a larger, established company while retaining the agility to respond promptly to the needs of customers, brokers, agents and underwriters. Claims management for International is generally provided locally by staff in the respective international location due to local knowledge of applicable laws and regulations.

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 that 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.

Claim Services uses advanced technology, management information, and data analysis to assist the Company in reviewing its claim practices and results to evaluate and improve its performance. The Company's claim 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. In 2007, the Company opened its 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 its investments to ensure a consistent optimization between outcomes, cost and service.

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During 2006, Claim Services refined its catastrophic response strategy to increase the Company's ability to respond to a significant catastrophic event using its own personnel, placing less reliance on independent adjusters and appraisers. During 2007, the Company continued to develop a larger dedicated catastrophe response team and trained a larger 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.

The Company is also a leader in bringing effective claim solutions that provide superior customer service. One example of this is the Company's auto claim service that features two Company-owned auto repair facilities and selected independently-owned auto repair facilities with Company appraisers on site to complete an estimate, handle all rental arrangements and monitor the repair process from start to finish. By managing the claim in this way, the Company can help ensure prompt, quality results and create a differentiated, superior claim experience for customers.

Another strategic advantage is TravCompSM, a workers' compensation claim resolution and medical management program that assists adjusters in the prompt investigation and effective management of workers' compensation claims. Innovative medical and claims management technologies permit nurse, medical and claims professionals to share appropriate vital information that supports prompt investigation, effective return to work and claim resolution strategies. These technologies, together with effective matching of professional skills and authority to specific claim issues, have resulted in more efficient management of workers' compensation claims with lower medical, wage replacement costs and loss adjustment expenses.

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 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 and the price of their product offerings. After reinsurance is purchased, the Company has a 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 4 of notes to the Company's consolidated financial statements.

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;

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 Item 3, "Legal Proceedings."

Catastrophe Reinsurance

Catastrophes can be caused by various natural and man-made events including hurricanes, windstorms, earthquakes, hail, severe winter weather, explosions and fires. 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 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 losses resulting from catastrophes in the Northeastern United States.

General Catastrophe Reinsurance Treaty. The general catastrophe reinsurance treaty covers the accumulation of net property losses arising out of one occurrence. The treaty only provides coverage for terrorism events in limited circumstances and excludes entirely losses arising from nuclear, biological, chemical or radiological attacks. 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. For business underwritten in Canada, the United Kingdom, 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.

The following table summarizes the Company's coverage under its General Catastrophe Treaty, effective for the period July 1, 2007 through June 30, 2008:

Layer of Loss	Reinsurance Coverage In-Force
\$0 - \$1 billion	Loss 100% retained by the Company
\$1 billion - \$1.50 billion	23.6% (\$118 million) of loss covered by treaty; 76.4% (\$382 million) of loss retained by Company
\$1.50 billion - \$2.25 billion	60.9% (\$457 million) of loss covered by Treaty; 39.1% (\$293 million) of loss retained by Company
Greater than \$2.25 billion	100% of loss retained by 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.

Catastrophe Bond Program. In May 2007, the Company announced the establishment of a multi-year catastrophe bond program to provide reinsurance protection for losses resulting from hurricanes and certain other catastrophes. The Company may obtain reinsurance under the program by entering into one or more reinsurance agreements with Longpoint Re Ltd. (Longpoint Re), a newly formed independent Cayman Islands insurance company. Longpoint Re successfully completed an offering to unrelated investors under the program of \$500 million aggregate principal amount of catastrophe bonds on May 8, 2007. In connection with the offering, the Company and Longpoint Re entered into a three-year reinsurance agreement providing up to \$500 million of reinsurance from losses resulting from certain hurricane events in the Northeastern United States (from New Jersey to Maine). The reinsurance agreement entered into by the Company and Longpoint Re 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 Property Claim Services, a division of Insurance Services Offices, Inc. Amounts payable to the Company under the reinsurance agreement will be determined by the index-based losses, which are designed to approximate the Company's actual losses from any covered event. The Company's actual loss experience may differ from the index-based losses; however, reinsurance recoverables will not exceed actual losses. The principal amount of the catastrophe bonds will be reduced by any amounts paid to the Company under the reinsurance agreement. 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 \$2.25 billion. The full coverage amount of \$500 million is available on a proportional basis until index-based losses reach a maximum \$3.0 billion limit. The index-based losses attachment point and maximum limit will be reset annually to maintain a probability of loss on the catastrophe bonds equal to the initial modeled probability of loss.

Northeast 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 treaty which provides up to \$250 million of coverage, subject to a \$2.25 billion retention, for losses arising from hurricanes, earthquakes and winter storm or freeze losses from Virginia to Maine for the period July 1, 2007 through June 30, 2008. Losses from a covered event (occurring over several days) anywhere in the United States may be used to satisfy the retention. Recoveries under the catastrophe bond program described above (if any) would be first applied to reduce losses subject to this treaty.

Florida Hurricane Catastrophe Fund (FHCF). The Company participates in the FHCF, which is a state-mandated catastrophe reinsurance fund that provides reimbursement to insurers for a portion of their residential catastrophic hurricane losses. The FHCF is primarily funded by premiums from insurance companies that write residential property business in Florida and, if those are insufficient, assessments on all Florida property and casualty lines of business, excluding accident and health, the National Flood Insurance Program, workers' compensation and medical malpractice insurance. The FHCF's resources are limited to these contributions and to its borrowing capacity at the time of a significant catastrophe in Florida. Based on current expected reimbursements for 2004 and 2005 losses, the state of Florida levied a 1% assessment effective January 1, 2007 for all of the Company's relevant policyholders as discussed above. The Company holds no liability for this pass-through assessment, since the Company is only liable for the assessments collected from insureds. In January 2007, the Governor of Florida signed into law legislation that expanded the capacity of the FHCF from \$16 billion to \$28 billion, with an option for the FHCF Board of Governors to add an additional \$4 billion of capacity. Additionally, participating companies have the option to select lower attachment points to the FHCF in \$1 billion increments ranging from \$6 billion to \$3 billion. No individual company elected this option for lower attachment points. The Company's participation as of June 2007 (the most recent date for which data is available) accounted for less than 0.7% of the FHCF. This additional capacity is also funded primarily by premiums and relies on the same assessment and borrowing process described above. If there are hurricanes in 2008, the cash resources of the FHCF may not be sufficient to meet its obligations and continuing assessments may be necessary. The current projected FHCF bonding for future events is adequate to cover its statutory capacity, assuming the bonds are purchased.

Terrorism Risk Insurance Acts. On November 26, 2002, the Terrorism Risk Insurance Act of 2002 (the Terrorism Act) was enacted into Federal law and established the Terrorism Risk Insurance Program (the Program), a temporary Federal program in the Department of the Treasury, that provided for a system of shared public and private compensation for insured losses resulting from acts of terrorism or war committed by or on behalf of a foreign interest. The Program was scheduled to terminate on December 31, 2005. In December 2005, the Terrorism Risk Insurance Extension Act of 2005 (the Terrorism Extension Act) was enacted into Federal law, reauthorizing the Program through December 31, 2007, while reducing the Federal role under the Program. In December 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 was enacted into Federal law,

extending coverage to include domestic acts of terrorism and reauthorizing the Program through 2014. The three acts are hereinafter collectively referred to as "the Acts."

In order for a loss to be covered under the Program (subject losses), the loss must meet certain aggregate industry loss minimums and must be the result of an event that is certified as an act of terrorism by the U.S. Secretary of the Treasury. The aggregate industry loss minimum was \$100 million in 2007 and will remain at \$100 million through 2014. The original Program excluded from participation certain of the following types of insurance: Federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, and reinsurance. The Terrorism Extension Act exempted from coverage certain additional types of insurance, including commercial automobile, professional liability (other than directors and officers'), surety, burglary and theft, and farm-owners multi-peril. In the case of a war declared by Congress, only workers' compensation losses are covered by the Acts. The Acts generally require that all commercial property casualty insurers licensed in the United States participate in the Program. Under the Program, a participating insurer is entitled to be reimbursed by the Federal Government for a percentage of subject losses, after an insurer deductible, subject to an annual cap. The Federal reimbursement percentage was 85% in 2007 and will remain at 85% through 2014.

The deductible is calculated by applying the deductible percentage to the insurer's direct earned premiums for covered lines from the calendar year immediately preceding the applicable year. The deductible under the Program was 15% for 2005, 17.5% for 2006 and 20% for 2007, and will remain at 20% through 2014. The Company's estimated deductible under the Program is \$2.25 billion for 2008. The annual cap limits the amount of aggregate subject losses for all participating insurers to \$100 billion. Once subject losses have reached the \$100 billion aggregate during a program year, Congress shall determine the sources of funds, if any, available for losses that exceed the \$100 billion cap. The Company had no terrorism-related losses in 2007, 2006 or 2005. Given the unpredictable frequency and severity of terrorism losses, as well as the limited terrorism coverage in the Company's own reinsurance program, future losses from acts of terrorism, particularly those involving nuclear, biological, chemical or radiological events, could be material to the Company's operating results, financial position and/or liquidity in future periods. The Company will continue to manage this type of catastrophic risk by monitoring and controlling terrorism risk aggregations to the best of its ability.

CLAIMS AND CLAIM ADJUSTMENT EXPENSE RESERVES

Claims and claim adjustment expense reserves (loss 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) 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 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

Included in the claims and claim adjustment expense reserves in the consolidated balance sheet are certain reserves discounted to the present value of estimated future payments. The liabilities for losses for most long-term disability payments under workers' compensation insurance and workers' compensation excess insurance, which totaled \$2.09 billion and \$1.98 billion at December 31, 2007 and 2006, respectively, were discounted using a rate of 5% at December 31, 2007 and 2006. Reserves for certain assumed reinsurance business were discounted using a rate of 7% at both December 31, 2007 and 2006, and totaled \$33 million and \$37 million at December 31, 2007 and 2006, respectively.

Claims and Claim Adjustment Expense Development Table

The table that follows sets forth the year-end reserves from 1997 through 2007 and the subsequent changes in those reserves, presented on a historical basis. The original estimates, cumulative amounts paid and reestimated reserves in the table for the years 1997 through 2003 have not been restated to reflect the acquisition of SPC in 2004. The table includes SPC reserves beginning at December 31, 2004.

In addition, the original estimates, cumulative amounts paid and reestimated reserves in the table for the years 1997 to 2000 have not been restated to reflect the acquisition of Northland and Commercial Guaranty Casualty. Beginning in 2001, the table includes the reserve activity of Northland and Commercial Guaranty Casualty. 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 1997 to 2007 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 1997 included \$4 million for a loss that is finally paid in 2005 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 1997 to 2004 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." 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, workers' compensation indemnity reserves (tabular reserves) 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.

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(at December 31, in millions)

	1997	1998	1999	2000	2001(a)	2002(a)	2003(a)	2004(a)	2005(a)(b)	2006(a)(b)	2007(a)(b)
Reserves for claims and claim adjustment expense originally estimated	\$ 21,406	\$ 20,763	\$ 19,983	\$ 19,435	\$ 20,197	\$ 23,268	\$ 24,055	\$ 41,446	\$ 42,895	\$ 42,844	\$ 43,098
Cumulative amounts paid as of											
One year later	4,025	4,159	4,082	4,374	5,018	5,170	4,651	8,871	8,632	7,417	
Two years later	6,882	6,879	6,957	7,517	8,745	8,319	8,686	14,666	13,837		
Three years later	8,850	9,006	9,324	10,218	11,149	11,312	11,541	18,733			
Four years later	10,480	10,809	11,493	12,000	13,402	13,548	13,708				
Five years later	11,915	12,565	12,911	13,603	15,115	15,229					
Six years later	13,376	13,647	14,172	14,958	16,473						
Seven years later	14,306	14,697	15,301	16,063							
Eight years later	15,225	15,681	16,206								
Nine years later	16,061	16,480									
Ten years later	16,753										
Reserves reestimated as of											
One year later	21,083	20,521	19,736	19,394	23,228	23,658	24,222	41,706	42,466	42,172	
Two years later	20,697	20,172	19,600	22,233	24,083	24,592	25,272	42,565	42,311		
Three years later	20,417	19,975	22,302	22,778	25,062	25,553	26,042	42,940			
Four years later	20,168	22,489	22,612	23,871	25,953	26,288	26,501				
Five years later	22,570	22,593	23,591	24,872	26,670	26,731					
Six years later	22,625	23,492	24,559	25,521	27,179						
Seven years later	23,530	24,446	25,114	26,039							
Eight years later	24,425	24,908	25,664								
Nine years later	24,832	25,435									
Ten years later	25,321										
Cumulative deficiency (redundancy) (a)(b)	3,915	4,672	5,681	6,604	6,982	3,463	2,446	1,494	(584)	(672)	
Gross liability end of year	\$ 30,138	\$ 29,411	\$ 28,854	\$ 28,312	\$ 30,617	\$ 33,628	\$ 34,474	\$ 58,984	\$ 61,007	\$ 59,202	\$ 57,619
Reinsurance recoverables	8,732	8,648	8,871	8,877	10,420	10,360	10,419	17,538	18,112	16,358	14,521
Net liability end of year	\$ 21,406	\$ 20,763	\$ 19,983	\$ 19,435	\$ 20,197	\$ 23,268	\$ 24,055	\$ 41,446	\$ 42,895	\$ 42,844	\$ 43,098
Gross reestimated liability-latest	\$ 34,227	\$ 34,669	\$ 35,659	\$ 36,806	\$ 39,552	\$ 38,435	\$ 37,464	\$ 60,642	\$ 60,535	\$ 58,158	
Reestimated reinsurance recoverables-latest	8,906	9,234	9,995	10,767	12,373	11,704	10,963	17,702	18,224	15,986	
Net reestimated liability-latest	\$ 25,321	\$ 25,435	\$ 25,664	\$ 26,039	\$ 27,179	\$ 26,731	\$ 26,501	\$ 42,940	\$ 42,311	\$ 42,172	
Gross cumulative deficiency (redundancy)	\$ 4,089	\$ 5,258	\$ 6,805	\$ 8,494	\$ 8,935	\$ 4,807	\$ 2,990	\$ 1,658	\$ (472)	\$ (1,044)	

Included in the cumulative deficiency by year is the following impact of unfavorable prior year reserve development related to asbestos and environmental claims and claim adjustment expenses, in millions:

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Asbestos										
Gross	\$ 6,062	\$ 5,927	\$ 5,799	\$ 5,612	\$ 5,329	\$ 1,669	\$ 1,644	\$ 1,030	\$ 196	\$ (1)
Net	\$ 4,405	\$ 4,339	\$ 4,282	\$ 4,232	\$ 4,043	\$ 1,098	\$ 1,074	\$ 987	\$ 156	\$ 0
Environmental										

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Gross	\$	1,136	\$	1,013	\$	874	\$	799	\$	741	\$	587	\$	528	\$	307	\$	290	\$	182
Net	\$	939	\$	889	\$	832	\$	768	\$	722	\$	572	\$	513	\$	335	\$	305	\$	185

- (a) Includes reserves of The Northland Company and its subsidiaries and Commercial Guaranty Lloyds Insurance Company, which were acquired from Citigroup on October 1, 2001. Also includes reserves of Commercial Guaranty Casualty Insurance Company, which was contributed to TPC by Citigroup on October 3, 2001. At December 31, 2001, these gross reserves were \$867 million, and net reserves were \$633 million.
- (b) For years prior to 2004, excludes SPC reserves, which were acquired on April 1, 2004. Accordingly, the reserve development (net reserves for claims and claim adjustment expenses reestimated 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, includes SPC reserves and subsequent development recorded by SPC. At December 31, 2004, SPC gross reserves were \$23,274 million, and net reserves were \$15,959 million.

Reserves on Statutory Accounting Basis

At December 31, 2007, 2006 and 2005, 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 \$30 million higher, \$104 million lower and \$296 million lower, 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 accounting for retroactive reinsurance is a significant factor in the difference in reserves. 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 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 intercompany property and casualty reinsurance pooling arrangements. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool's capital and surplus rather than just on its own capital and surplus. Under such arrangements, the members share substantially all insurance business that is written and allocate the combined premiums, losses and expenses.

On October 1, 2007, retroactive to January 1, 2007, the Northland Pool was commuted and terminated. Four members of the former Northland Pool, consisting of Northland Insurance Company, Northfield Insurance Company, Northland Casualty Company and American Equity Specialty Insurance Company, became members of the Travelers Reinsurance Pool, the Company's primary reinsurance pool. The fifth member of the former Northland Pool, American Equity Insurance Company, became a 100% reinsured affiliate of the Travelers Reinsurance Pool. Additionally, the individual 100% quota share reinsurance agreements for three former 100% reinsured affiliated companies of the Travelers Reinsurance Pool (St. Paul Guardian Insurance Company, St. Paul Mercury Insurance Company and Fidelity and Guaranty Insurance Underwriters, Inc.) were commuted and terminated. These three companies also became members of the Travelers Reinsurance Pool. All of these transactions were retroactive to January 1, 2007. In addition, on October 1, 2007, Discover Reinsurance Company was merged into The Travelers Indemnity Company.

RATINGS

Ratings are an important factor in setting 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: claims-paying (or financial strength) ratings which assess an insurer's ability to meet its financial obligations to policyholders and debt ratings which assess a company's prospects for repaying its debts and assist lenders in setting interest rates and terms for a company's short- and long-term borrowing needs. 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.

The Company's insurance operations could be negatively impacted by a downgrade in one or more of the Company's financial strength ratings. If this were to occur, the Company could experience a reduced demand for certain products in certain markets. Additionally, the Company's ability to access the capital markets could be impacted by a downgrade in one or more of the Company's debt ratings. If this were to occur, the Company could incur higher borrowing costs.

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 Guarantee Company of Canada and St. Paul Travelers Insurance Company Limited as of February 21, 2008. The table also presents S&P's Lloyd's Syndicate Assessment rating for St. Paul Travelers Syndicate Management Syndicate 5000. The table presents the position of each rating in the applicable agency's rating scale.

	<u>A.M. Best</u>	<u>Moody's</u>	<u>S&P</u>	<u>Fitch</u>
Travelers Reinsurance Pool (a)(b)	A+ (2nd of 16)	Aa3 (4th of 21)	AA- (4th of 21)	AA (3rd of 24)
Travelers C&S Co. of America	A+ (2nd of 16)	Aa3 (4th of 21)	AA- (4th of 21)	AA (3rd of 24)
First Floridian Auto and Home Ins. Co.	A- (4th of 16)			AA (3rd of 24)
First Trenton Indemnity Company	A (3rd of 16)			AA (3rd of 24)
The Premier Insurance Co. of MA	A (3rd of 16)			
Travelers C&S Co. of Europe, Ltd.	A+ (2nd of 16)	Aa3 (4th of 21)	AA- (4th of 21)	
Travelers Guarantee Company of Canada	A (3rd of 16)			
Travelers Insurance Company Limited	A (3rd of 16)			
Travelers Syndicate Management Limited Syndicate 5000			3- (9 of 15)	

(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, Athena Assurance Company, St. Paul Protective Insurance Company, St. Paul Medical Liability 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: Atlantic Insurance Company, 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. In addition, Seaboard Surety Company, an affiliated company, is 90% reinsured by The Travelers Indemnity Company, one of the pool participants noted in (a) above.

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Debt Ratings

The following table summarizes the current debt, preferred stock and commercial paper ratings of the Company and its subsidiaries as of February 21, 2008. The table also presents the position of each rating in the applicable agency's rating scale.

	<u>A.M. Best</u>	<u>Moody's</u>	<u>S&P</u>	<u>Fitch</u>
Senior debt	a- (7th of 22)	A3 (7th of 21)	A- (7th of 22)	A (6th of 24)
Subordinated debt	bbb+ (8th of 22)	Baa1 (8th of 21)	BBB (9th of 22)	A- (7th of 24)
Junior subordinated debt	bbb (9th of 22)	Baa1 (8th of 21)	BBB- (10th of 22)	A- (7th of 24)
Trust preferred securities	bbb (9th of 22)	Baa1 (8th of 21)	BBB- (10th of 22)	A- (7th of 24)
Preferred stock	bbb (9th of 22)	Baa2 (9th of 21)	BBB- (10th of 22)	
Commercial paper.	AMB-1 (2nd of 6)	P-2 (2nd of 3)	A-2 (3rd of 10)	F-1 (2nd of 7)

Rating Agency Actions

The following rating agency actions were taken with respect to the Company in 2007 and through February 21, 2008:

On March 5, 2007, A.M. Best assigned a debt rating of "bbb" to the \$1.0 billion junior subordinated debentures due 2067 issued by the Company in March 2007.

On March 5, 2007, Moody's assigned a debt rating of "Baa1" to the \$1.0 billion junior subordinated debentures due 2067 issued by the Company in March 2007.

On March 5, 2007, S&P assigned a debt rating of "BBB" to the \$1.0 billion junior subordinated debentures due 2067 issued by the Company in March 2007.

On March 5, 2007, Fitch announced that it expected to assign a debt rating of "BBB+" to the \$1.0 billion junior subordinated debentures due 2067 issued by the Company in March 2007. Subsequently, on April 11, 2007, Fitch assigned the "BBB+" debt rating to these junior subordinated debentures.

On May 2, 2007, Moody's affirmed all ratings for the Company and changed the outlook for all ratings to "positive" from "stable."

On May 21, 2007, Fitch upgraded its long-term issuer and senior debt ratings of the Company to "A" from "A-"; its junior subordinated debt ratings and trust preferred securities ratings both to "A-" from "BBB+"; and its commercial paper ratings to "F-1" from "F-2." Additionally, Fitch upgraded its insurer financial strength (IFS) rating on the Company's insurance company subsidiaries to "AA" from "AA-". The ratings outlook was stable.

On May 23, 2007, Fitch announced that it expected to assign a debt rating of "A" to the Company's aggregate \$1.5 billion senior unsecured notes due 2012, 2017 and 2037. Subsequently, on May 25, 2007, Fitch assigned the "A" debt rating to these senior notes. The outlook for the ratings was stable.

On May 23, 2007, A.M. Best assigned a debt rating of "a-" to the Company's aggregate \$1.5 billion senior unsecured notes due 2012, 2017 and 2037. The outlook for the ratings was stable.

On May 23, 2007, Moody's assigned a debt rating of "A3" to the Company's aggregate \$1.5 billion senior unsecured notes due 2012, 2017 and 2037. The outlook for the ratings was positive.

On May 23, 2007, S&P assigned a debt rating of "A-" to the Company's aggregate \$1.5 billion senior unsecured notes due 2012, 2017 and 2037. The outlook for the ratings was stable.

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On June 18, 2007, A.M. Best affirmed all ratings of the Company. The outlook was stable.

On June 25, 2007, S&P assigned its interactive Lloyd's Syndicate Assessment (LSA) of "3-" to The St. Paul Travelers Syndicate Management Syndicate 5000. The outlook was stable.

On October 2, 2007, A.M. Best upgraded the financial strength ratings to "A+" from "A" and issuer credit ratings to "aa-" from "a" for Northland Insurance Company, Northfield Insurance Company, Northland Casualty Company, American Equity Specialty Insurance Company and American Equity Insurance Company, formerly members of the Northland Pool. In addition, Fidelity and Guaranty Insurance Underwriters, Inc., St. Paul Guardian Insurance Company and St. Paul Mercury Insurance Company financial strength ratings of "A+" and issuer credit ratings of "aa-" were affirmed. The outlook for all ratings was stable. Concurrently, A.M. Best withdrew the financial strength rating of "A" and issuer credit rating of "a" and assigned a category NR-5 (Not Formally Followed) to the Former Northland Pool. A.M. Best also withdrew the financial strength rating of "A-" and the issuer credit rating of "a-" of Discover Reinsurance Company in connection with the merger of Discover Reinsurance Company into Travelers Indemnity Company.

On October 17, 2007, A.M. Best affirmed the financial strength rating of "A" and issuer credit rating of "a+" of St. Paul Travelers Insurance Company Limited. The ratings outlook remained stable.

On November 20, 2007, Moody's announced that it was reviewing its ratings of the Company for a possible upgrade.

INVESTMENT OPERATIONS

A significant majority of funds available for investment are deployed in a widely diversified portfolio of high quality, liquid intermediate-term taxable U.S. government, corporate and mortgage backed bonds and tax-exempt U.S. municipal bonds. 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 Company's management of the duration of the fixed income investment portfolio generally produces a duration that modestly exceeds the estimated duration of the Company's net insurance liabilities.

The primary goals of the Company's asset liability management process are to satisfy the insurance liabilities, manage the interest rate risk embedded in those 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 income 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 degree by which the market value of the fixed income portfolio exceeds the present value of the net insurance liabilities, plus the positive cash flow from newly sold policies and the large amount of high quality liquid bonds provides assurance of the Company's ability to fund the payment of claims without having to sell illiquid assets or access credit facilities.

The Company also invests much smaller amounts in equity securities, venture capital investments (through direct ownership and limited partnerships), private equity limited partnerships, joint ventures, other limited partnerships, mortgage loans 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.

DERIVATIVES

See notes 1 and 14 of notes to the Company's consolidated financial statements for a discussion of the policies and transactions related to the Company's derivative financial instruments.

REGULATION

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. TRV's insurance subsidiaries are collectively licensed to transact insurance business in all U.S. states, the District of Columbia, Guam, Puerto Rico, Bermuda and the U.S. Virgin Islands.

Agent and Broker Compensation. As part of ongoing, industry-wide investigations, the Company has received subpoenas and written requests for information from U.S. government agencies and authorities, including 21 states and the SEC. The areas of inquiry addressed to the Company include the method by which brokers and agents are compensated. The Company is cooperating with these subpoenas and requests for information. The Company has entered into agreements with several of these states to resolve issues related to broker and agent compensation. The Company discontinued paying contingent commissions in the United States on excess casualty and umbrella business effective September 30, 2006. In addition, the Company discontinued paying contingent commissions in the United States for all of its personal insurance business (including homeowners multi-peril, private passenger automobile physical damage, private passenger automobile no-fault, other private passenger automobile liability, personal articles floaters, personal insurance boats and yachts, dwelling fire and personal umbrellas) and for its boiler and machinery and financial guaranty insurance lines effective January 1, 2007, and for its fidelity insurance line effective January 1, 2008. The Company has developed alternative compensation arrangements for these lines of business that compensate brokers and agents in a manner that differentiates for business performance and is consistent with all applicable laws. Beginning January 1, 2007, the Company offered an optional fixed commission program in the U.S. for most commercial insurance lines.

Insurance Regulation Concerning Dividends. TRV's principal insurance subsidiaries are domiciled in the states of Connecticut and Minnesota. The insurance holding company laws of both states applicable to TRV's subsidiaries require notice to, and approval by, the state insurance commissioner for the declaration or payment of any 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.

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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 Arrangements. Virtually all states require insurers licensed to do business in their state to bear a portion of the loss suffered by some claimants because of the insolvency of other insurers. Many states also have laws that established 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.

Insurance Regulatory Information System. The National Association of Insurance Commissioners (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 2007 IRIS ratios calculated by the Company, St. Paul Mercury Insurance Company had results outside the normal range on four of the IRIS ratios, and St. Paul Guardian Insurance Company had results outside the normal range on three of the IRIS ratios. These results were due to these companies becoming Travelers Reinsurance Pool participants in 2007. Previously, these companies had been 100% reinsured by The Travelers Indemnity Company, one of the Travelers Reinsurance Pool participants. In conjunction with their new participation, St. Paul Mercury Insurance Company and St. Paul Guardian Insurance Company received capital contributions of \$30 million and \$10 million, respectively, from their parent company, St. Paul Fire and Marine Insurance Company, in 2007. In 2006, Discover Reinsurance Company had results outside the normal range for two of the IRIS ratios, due to reserve strengthening actions taken in 2005.

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Management does not anticipate regulatory action as a result of the 2007 IRIS ratio results. In all instances in prior years, regulators have been satisfied upon follow-up that no regulatory action was required. It is possible that similar results could occur in the future.

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 higher levels of capital. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank these companies. At December 31, 2007, 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.

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 to fight financial crime. TRV's managing agent (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. Through Lloyd's, TRV is licensed to write business in over 70 countries throughout the world by virtue of Lloyd's international licenses. In each such country TRV is subject to the laws and insurance regulation of that country. TRV's Irish insurance operations are regulated by the Irish Financial Services Regulatory Authority. In 2007, a TRV subsidiary, Travelers Casualty and Surety Company, established a representative office in China. The representative office's operations are regulated by the China Insurance Regulatory Commission. In addition, in 2007, TRV's Lloyd's managing agency established a service company in Singapore, the underwriting operations of which are regulated by the Monetary Authority of Singapore.

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, which requires insurance companies to maintain certain levels of capital depending on the type and amount of insurance policies in force.

TRV's branch in runoff in Australia is regulated by the Australian Prudential Regulation Authority.

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 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.

One 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 Financial Services Authority. 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 casualty insurance enterprise, the Company is exposed to many risks from many different events. Some of these risk events can impact multiple areas of the Company simultaneously, requiring an entity-wide view of risk events and their potential impact on all the various areas of the Company. 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 development of plans to mitigate the effects of such risks.

ERM at the Company has been operational for many years and incorporates risk-based reporting and feedback among the various disciplines throughout the Company, including the underwriting, claim, reinsurance, investment, legal, regulatory, actuarial and finance functions. Board oversight of the Company's ERM initiative is provided by the Risk Committee. Key internal risk management functions include the Management Committee (comprised of the Company's Chief Executive Officer and the other most senior members of management), the Risk Committee of management, the Credit Committee, the Chief Compliance Officer, the Business Conduct Officer, the Corporate Actuarial group, the Internal Audit group, the Accounting Policy 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 risk management strategies. Another strategic objective includes working across the Company to enhance risk modeling capabilities.

The Company's ERM efforts build upon its foundation of internal control. It expands the internal control objectives of effective and efficient operations, reliable financial reporting and compliance with applicable laws and regulations, to develop an integrated, risk-based culture that focuses on value creation and preservation. However, internal control systems and ERM can provide only reasonable,

not absolute, assurance that the control system's objectives will be met. Further, the design of any control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result, the possibility of material financial loss remains in spite of the Company's best risk management 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, 2007, the Company had approximately 33,300 employees. The Company believes that its employee relations are satisfactory. None of the Company's employees are subject to collective bargaining agreements.

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 7 of notes to the Company's consolidated financial statements.

Taxation

For a discussion of tax matters affecting the Company and its operations, see note 10 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 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 "Investors" heading.

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.
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>An 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>Ultimate losses under the method equal the known or estimated ultimate claim counts times the estimated average value. Estimated ultimate claim counts are frequently based on a claim count development method, essentially the same as the paid and case incurred development methods mentioned elsewhere in this glossary but using claim count rather than claim dollar data. The average values can be based on historical trends from past closed claims, or backed into from estimated ultimate losses divided by estimated ultimate claim counts, or some other approach. When the average values are calculated from ultimate loss estimates, the resulting estimated averages may be supplemented with other data/analyses.</p>
Bornheutter-Ferguson method	An 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.

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.

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

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 natural and man-made events, including risks such as fire, earthquake, windstorm, explosion, terrorism and other similar events. Each catastrophe has unique characteristics. Catastrophes are not predictable as to timing or amount in advance, and therefore their effects are not included in earnings or claims and claim adjustment expense reserves prior to occurrence. A catastrophe may also result in the payment of reinstatement premiums and assessments from various pools.
Catastrophe loss	Loss and directly identified loss adjustment expenses from catastrophes.
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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Combined ratio	The sum of the loss and LAE ratio, the underwriting expense ratio and, where applicable, the ratio of dividends to policyholders to net premiums earned. A combined ratio under 100% generally indicates an underwriting profit. A combined ratio over 100% generally indicates an underwriting loss.
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.
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.
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."
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."

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 second party or make complete an obligation in response to the default, acts or omissions of an insured.
Ground-up analysis	<p>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 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.</p> <p>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).</p>
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.
Incurred 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.

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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.
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.
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>An 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> <p>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.</p> <p>Advanced applications of the method include adjustments for changing conditions during the historical period and anticipated changes in the future.</p>
Pool	<p>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.</p>
Premiums	<p>The amount charged during the year on policies and contracts issued, renewed or reinsured by an insurance company.</p>
Producer	<p>Contractual entity which directs insureds to the insurer for coverage. This term includes agents and brokers.</p>
Property insurance	<p>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.</p>
Quota share reinsurance	<p>Reinsurance wherein the insurer cedes an agreed-upon fixed percentage of liabilities, premiums and losses for each policy covered on a pro rata basis.</p>

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.
Reported claim development method	<p>An actuarial method to estimate ultimate claim counts for a given cohort of claims such as an accident year/product line component. If the reported-to-date counts are then subtracted from the estimated ultimate counts, the result is an indication of the IBNR counts.</p> <p>The approach is the same as that described in this glossary under the "paid loss development method", but based on the growth in cumulative claim counts rather than paid losses. The basic premise of the method is that cumulative claim counts for a given cohort of claims will grow in a stable, predictable pattern from year-to-year, based on the age of the cohort.</p>
Residual market (involuntary business)	Insurance market which provides coverage for risks for those unable to purchase insurance in the voluntary market. Possible reasons for this inability include the risks being too great or the profit potential too small under the required insurance rate structure. Residual markets are frequently created by state legislation either because of lack of available coverage such as: property coverage in a windstorm prone area or protection of the accident victim as in the case of workers' compensation. The costs of the residual market are usually charged back to the direct insurance carriers in proportion to the carriers' voluntary market shares for the type of coverage involved.
Retention	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.

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Retention rate	Current period renewal premiums, accounts or policies as a percentage of total premiums, accounts or policies available for renewal.
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.
Return on equity	The ratio of net income to average equity.
Risk-based capital (RBC)	A measure adopted by the NAIC and enacted by states for determining the minimum statutory capital and 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.
Run-off business	An operation which has been determined to be nonstrategic; includes non-renewals of inforce 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 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. Statutory surplus is also referred to as "surplus" or "surplus as regards policyholders" for statutory accounting purposes.
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.
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.
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 statutory surplus.
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.
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 hurricanes, windstorms, earthquakes, hail, severe winter weather and fires. Catastrophes can also be man-made, such as a terrorist attack (including those involving nuclear, biological, chemical or radiological events) or a consequence of war or political instability. The geographic distribution of our business subjects us to catastrophe exposures, which include, but are not limited to: hurricanes in the Northeast, Florida, Gulf Coast and Mid-Atlantic regions; tornadoes in the Midwest and Southeast; earthquakes in California, the New Madrid region and the Pacific Northwest region of the United States and Canada; and wildfires in California. The incidence and severity of catastrophes are inherently unpredictable. In recent years, changing climate conditions have added to the unpredictability and frequency of natural disasters (including, but not limited to, hurricanes, tornadoes, other storms and fires) in certain parts of the world and created additional uncertainty as to future trends and exposures. It is possible that both the frequency and severity of natural and man-made catastrophic events will increase. Although the trend of increased severity and frequency of storms was not evident in the United States in 2007 and 2006, we believe that the overall trend of increased severity and frequency of storms experienced in the United States in 2005 and 2004, and experienced in the Caribbean during 2007, may continue in the foreseeable future.

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. States have from time to time passed legislation, and regulators have taken action, that has 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. In addition, following catastrophes, there are sometimes legislative initiatives and court decisions which seek to expand insurance coverage for catastrophe claims beyond the original intent of the policies. Also, our ability 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 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 opportunities.

There are also risks that impact the estimation of ultimate costs for catastrophes. For example, the estimation of 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 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 collectibility. 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 reserves for that reporting period. The estimates related to catastrophes are adjusted as actual claims emerge and additional information becomes available.

Catastrophe losses could materially and adversely affect our results of operations for any fiscal quarter or year and may materially harm our financial position, which in turn 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 following a catastrophe, rating agencies may further increase their capital requirements, which may require us to raise capital to maintain our ratings or adversely affect our ratings. If our ratings were adversely affected, this in turn, 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 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Capital Resources Catastrophe Reinsurance Coverage." Catastrophic events could also adversely impact the credit of the issuers of securities, such as states or municipalities, in whom we have invested, which could materially and adversely affect our results of operations.

In addition to catastrophe losses, the accumulation of losses from smaller weather-related events in any fiscal quarter or year could materially and adversely impact our results of operations in those periods.

Given the unpredictable frequency and severity of terrorism losses, as well as the limited terrorism coverage in our own reinsurance program, future losses from acts of terrorism, particularly those involving nuclear, biological, chemical or radiological events, could materially and adversely affect our results of operations, financial position and/or liquidity. Although the Terrorism Risk Insurance Program Reauthorization Act of 2007 provides benefits in the event of certain acts of terrorism, those benefits are subject to a deductible and other limitations. Under this law, 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.

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 those involving nuclear, biological, chemical or radiological events), could materially and adversely affect our results of operations, financial position and/or liquidity.

If actual claims exceed our loss reserves, or if changes in the estimated level of loss reserves are necessary, our financial results could be materially and adversely affected. Claims and claim adjustment expense reserves (loss 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. Loss 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 loss reserve estimates are expectations of what the ultimate settlement and administration of claims will cost upon final resolution in the future, based on our assessment of facts and circumstances then known, reviews of historical settlement patterns, estimates of trends in claims severity and frequency, expected interpretations of legal theories of liability and other factors. In establishing reserves, we also take into account estimated recoveries from reinsurance, salvage and subrogation.

The process of estimating loss 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, economic 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. Loss 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).

We continually refine our loss reserve estimates in a regular, ongoing process as historical loss experience develops and additional claims are reported and settled. Informed 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. Experts providing input to the various estimates and underlying assumptions include actuaries, underwriters, claim personnel and lawyers, as well as other Company management. Therefore, management may have to consider varying individual viewpoints as part of its estimation of loss reserves.

We attempt to consider all significant facts and circumstances known at the time loss reserves are established. Due to the inherent uncertainty underlying loss reserve estimates, the final resolution of the estimated liability for claims and claim adjustment expenses will likely be higher or lower than the related loss 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.

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

Asbestos Claims. We believe that the property and casualty insurance industry has suffered from court decisions and other trends that have attempted to expand insurance coverage for asbestos claims far beyond the intent of insurers and policyholders. While we have experienced a decrease in asbestos claims over the past several years, we continue to receive a significant number of asbestos claims from our policyholders (which includes others seeking coverage under a policy), including claims against our policyholders by individuals who do not appear to be impaired by asbestos exposure. Factors underlying these claim filings include intensive advertising by lawyers seeking asbestos claimants and the 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 us. Bankruptcy proceedings have also 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 defendants previously considered peripheral, contributes to the claims and claim adjustment expense payments we have experienced. In addition, our asbestos-related claims

and claim adjustment expense experience is impacted by the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or insolvency.

We 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 policyholder. Accordingly, it remains difficult to predict the ultimate cost of these claims.

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 us 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 us. As in the past, we will continue to pursue settlement opportunities.

In addition to 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. We anticipate the filing of other direct actions against insurers, including us, 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.

Environmental Claims. We 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 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.

We have been, and continue to be, involved in litigation involving insurance coverage issues pertaining to environmental claims. We believe 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 us 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 we do not track the monetary amounts being sought in those few claims which indicate a monetary amount.

Asbestos and Environmental Claims. Uncertainties surrounding the final resolution of asbestos and environmental claims continue, and it is difficult to determine the ultimate exposure for these 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 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 some 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 and future developments pertaining to our ability to recover reinsurance for asbestos and environmental claims. It is also not possible to predict changes in the legal and legislative environment and their impact on the future development of asbestos and environmental claims. This development will be affected by future court decisions and interpretations, as well as changes in applicable legislation, including legislation related to asbestos reform. It is also difficult to predict the ultimate outcome of large 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 study 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 our 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 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."

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, impede our ability 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. 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:

adverse changes in loss cost trends, including inflationary pressures in medical costs and auto and home repair costs;

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;

increases in the number and size of claims relating to construction defects, which often present complex coverage and damage valuation questions;

claims from directors' and officers' insurance relating to policyholders' losses from involvement in financial market activities, such as mortgage or financial product origination, distribution or structuring, possible accounting irregularities, and corporate governance issues;

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

medical developments that link health issues to particular causes, resulting in liability claims.

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.

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.

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. We use reinsurance to help manage our exposure to property and casualty risks. The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity, which can affect our business volume and profitability. 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. The ability of reinsurers to transfer their risks to other, less creditworthy reinsurers impacts our risk of collecting amounts due to us. Accordingly, 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 thus our results of operations could be materially and adversely affected.

The intense competition that we face could harm our ability to maintain or increase our profitability and premium volume. The property and casualty insurance industry is highly competitive, and we believe that it will remain highly competitive in the foreseeable future. We compete with both domestic and foreign insurers, some of which have greater financial resources than we do. In addition, several property and casualty insurers writing commercial lines of business now offer products for alternative forms of risk protection, including large deductible programs and various forms of self-insurance that utilize captive insurance companies and risk retention groups. Continued growth in alternative forms of risk protection could reduce our premium volume. Following the terrorist attack on September 11, 2001 and again following the hurricane activity in 2005 and 2004, a number of new insurers and reinsurers were formed to compete in the industry, and a number of existing market participants raised new capital to enhance their ability to compete. The Company expects property casualty market conditions to continue to become more competitive in 2008, particularly for new business. See "Item 7- Management's Discussion and Analysis of Financial Condition and Results of Operation-Outlook".

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Our competitive position is based on many factors, including but not limited to:

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

agent, broker and client relationships;

speed of claims payment;

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

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

reputation, experience and qualifications of employees;

geographic scope of business;

local presence; and

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

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 "Item 1 Business Competition."

We are exposed to credit risk in certain of our business operations and in our investment portfolio. We are exposed to credit risk in several areas of our business operations, including credit risk relating to reinsurance, as discussed above, as well as credit risk related to policyholders in certain lines of insurance and credit risk associated with independent agents and brokers.

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. In addition to workers' compensation insurance, other lines of insurance also expose us to credit risk, such as surety insurance where we guarantee to a third party that our policyholder will satisfy certain performance obligations (e.g., a construction contract).

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.

The value of our investment portfolio is also subject to the risk that certain investments may become impaired due to a deterioration in the financial position of one or more issuers of the securities held in our portfolio, or due to a downgrade of the credit ratings of an insurer that guarantees an issuer's payments of such investments in our portfolio. In addition, defaults by the issuer and, where applicable, its guarantor, of certain investments that result in the failure of such parties to fulfill their obligations with regard to any of these investments could reduce our net investment income and net realized investment gains or result in investment losses.

While we attempt to manage these risks through underwriting and investment guidelines, collateral requirements and other oversight mechanisms, our efforts may not be successful. 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 or recession. As a result, our exposure to any of the above credit risks could materially and adversely affect our results of operations.

The insurance industry and we are the subject of a number of investigations by state and federal authorities in the United States. We cannot predict the outcome of these investigations or the impact on our business practices or financial results. As part of ongoing, industry-wide investigations, we have received subpoenas and written requests for information from government agencies and authorities, including from the Attorneys General of numerous states, various states' insurance and business regulators and the Securities and Exchange Commission. The areas of pending inquiry addressed to us include our relationship with brokers and agents and our involvement with "non-traditional" insurance and reinsurance products. We may receive additional subpoenas and requests for information with respect to these or other areas from government agencies or authorities. We are cooperating with these subpoenas and requests for information. For further information, see "Item 3 Legal Proceedings".

It would be premature to reach any conclusions as to the likely outcome of these matters or the impact on our business or financial results. Potential outcomes could include enforcement proceedings or settlements resulting in fines, penalties and/or changes in business practices that could materially and adversely affect our results of operations. In addition, these investigations may result in changes in laws and regulations affecting the industry in general which could, in turn, also materially and adversely affect our results of operations.

Our businesses are heavily regulated and changes in regulation may reduce our profitability and limit our growth. We are extensively regulated and supervised in the jurisdictions in which we conduct business, including licensing and supervision by government regulatory agencies in such jurisdictions. This regulatory system is generally designed to protect the interests of policyholders, and not necessarily the interests of insurers, their shareholders and other investors. This regulatory system also addresses authorization for lines of business, capital and 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 federal 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 National Association of Insurance Commissioners (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 addition, Congress and some federal agencies from time to time investigate the current condition of insurance regulation in the United States to determine whether to impose federal or national regulation or to allow an optional federal charter, similar to the option available to most banks. We cannot predict the effect any proposed or future legislation or NAIC initiatives may have on the conduct of our business.

Although the United States federal government does not directly regulate the insurance business, changes in federal legislation, regulation and/or administrative policies in several areas, including changes in financial services regulation (e.g., the repeal of the McCarran-Ferguson Act) and federal taxation, can significantly harm the insurance industry, including us.

Insurance 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 and thus could materially and adversely affect our results of operations.

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 have become increasingly important to an insurer's competitive position. Rating agencies review their ratings periodically, and 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 in certain markets may be reduced or our ratings could fall below minimum levels required to maintain existing business. Additionally, we may find it more difficult to access the capital markets and we may incur higher borrowing costs. If significant losses, such as those resulting from one or more major catastrophes, or significant reserve additions 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 in order to maintain our ratings or limit the extent of a downgrade. For example, a continued trend of more frequent and severe weather-related catastrophes may lead rating agencies to substantially increase their capital requirements. The ratings are not in any way a measure of protection offered to investors in our securities and should not be relied upon with respect to making an investment in our securities. For further discussion about our ratings, see, "Item 1 Business Ratings".

Our investment portfolio may suffer reduced returns or losses. Investment returns are an important part of our overall profitability. Accordingly, fluctuations in interest rates or in the fixed income, real estate, equity or alternative investment markets could materially and adversely affect our results of operations.

Changes in the general interest rate environment affect our returns on, and the market value of, our fixed income and short-term investments, which comprised approximately 94% of the market value of our investment portfolio as of December 31, 2007. A decline in interest rates reduces the returns available on new investments, thereby negatively impacting our net investment income. Conversely, rising interest rates reduces the market value of existing fixed income investments. In addition, defaults under, or impairments of, any of these investments as a result of financial problems with the issuer and, where applicable, its guarantor of the investment could reduce our net investment income and net realized investment gains or result in investment losses.

We invest a portion of our assets in equity securities, venture capital investments, private equity limited partnerships, joint ventures, other limited partnerships, and trading securities, which are subject to greater volatility than fixed income investments. General economic conditions, stock market conditions and many other factors beyond our control can adversely affect the value of our non-fixed income investments and the realization of net investment income. As a result of these factors, we may not realize an adequate return on our investments, we may incur losses on sales of our investments and we may be required to write down the value of our investments, which could reduce our net investment income and net realized investment gains or result in investment losses.

The value of our investment portfolio can be subject to valuation uncertainties when the investment markets are dislocated. The valuation of investments is more subjective when the markets are illiquid and may increase the risk that the estimated fair value (i.e., the carrying amount) of the investment portfolio is not reflective of prices at which actual transactions would occur.

Our investment portfolio is invested, in significant part, in tax-exempt obligations. Our portfolio has also benefited from 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 that would lessen or eliminate some or all of the tax advantages currently benefiting us and could adversely affect the value of our investment portfolio. This result could occur in the context of deficit reduction or various types of fundamental tax reform.

The inability of our insurance subsidiaries to pay dividends to our holding company in sufficient amounts would harm our ability to meet our obligations and to pay future shareholder dividends. Our holding company relies in part on dividends from our insurance subsidiaries to meet our obligations for payment of interest and principal on outstanding debt obligations and to pay dividends to shareholders and corporate expenses. The ability of our insurance subsidiaries to pay dividends to us 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. 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 nature of and limitation on investments, the nature of and limitations on dividends to policyholders and shareholders, the nature and extent of required participation in insurance guaranty funds and the involuntary assumption of hard-to-place or high-risk insurance business, primarily in workers' compensation insurance lines. 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 and to pay future shareholder dividends.

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. 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 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, the resulting loss of business could materially and adversely affect our future business volume and results of operations.

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 Ireland. We have also started to explore opportunities in other countries, including in 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, exchange controls and other restrictive governmental actions, which could have an adverse affect on our business. In addition, 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 the local laws. Failure to comply with local laws in a particular market could have a significant and negative effect not only on our business in that market but also on our reputation generally.

We could be adversely affected if our controls 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.

Our business success and profitability depend, in part, on effective information technology systems and on continuing to develop and implement improvements in technology; certain significant multiyear strategic information technology projects are currently in process but may not be successful. We depend in large part on our technology systems for conducting business and processing claims, 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 and may cost more than we expect to complete and may not deliver the benefits we expect once they are complete. 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 certain risks. Our business is highly dependent upon our employees' ability to perform, in an efficient and uninterrupted fashion, necessary business functions, such as Internet support and 24-hour call centers processing new and renewal business, and processing and paying claims. A shut-down of, or inability to, access one or more of our facilities, 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. In addition, because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such service exceeds capacity or a third-party system fails or experiences an interruption. If sustained or repeated, such a business interruption, system failure or service denial 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. Computer viruses, hackers and other external hazards could expose our data systems to security breaches. These increased risks, and expanding regulatory requirements regarding data security, could expose us to data loss, monetary and reputational damages and significant increases in compliance costs. As a result, our ability to conduct our business might be adversely affected.

We outsource certain technology and business process functions to third parties and may do so increasingly in the future. If we do not effectively develop and implement our outsourcing strategy, third party providers do not perform as anticipated or we experience technological or other problems with a transition, we may not realize 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 enhanced risk related to data security, 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.

Item 1B. UNRESOLVED STAFF COMMENTS

On July 23, 2004, the Company announced that it was seeking guidance from the staff of the Division of Corporation Finance of the SEC with respect to the appropriate purchase accounting treatment for certain second quarter 2004 adjustments totaling \$1.63 billion (\$1.07 billion after-tax). The Company recorded these adjustments as charges in its consolidated statement of income in the second quarter of 2004. Through an informal comment process, the staff of the Division of Corporation Finance subsequently asked for further information, which the Company provided. Specifically, the staff asked for information concerning the Company's adjustments to certain of SPC's insurance reserves and reserves for reinsurance recoverables and premiums due from policyholders, and how those adjustments may relate to SPC's reserves for periods prior to the merger of SPC and TPC. After reviewing the staff's questions and comments and discussions with the Company's independent auditors, the Company continues to believe that its accounting treatment for these adjustments is appropriate. If, however, the staff disagrees, some or all of the adjustments being discussed may not be recorded as

charges in the Company's consolidated statement of income, thereby increasing net income for the second quarter and full year 2004 and increasing shareholders' equity at December 31, 2007, 2006, 2005 and 2004, in each case by the approximate after-tax amount of the change. The effect on tangible shareholders' equity (adjusted for the effects of deferred taxes associated with goodwill and other intangible assets) at December 31, 2007, 2006, 2005 and 2004 would not be material.

Increases to goodwill and deferred tax liabilities would be reflected on the Company's balance sheet as of April 1, 2004, either due to purchase accounting or adjustment of SPC's reserves prior to the merger of SPC and TPC. On May 3, 2006, the Company received a letter from the Division of Enforcement of the SEC (the Division) advising the Company that it is conducting an inquiry relating to the second quarter 2004 adjustments and the April 1, 2004 merger between SPC and TPC. The Company is cooperating with the Division's requests for information.

Item 2. PROPERTIES

The Company owns its corporate headquarters buildings located at 385 Washington Street and 130 West Sixth Street, 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 six buildings in Hartford, Connecticut. The Company currently occupies approximately 1.8 million square feet of office space in these buildings. The Company also owns other real property, which includes office buildings in Denver, Colorado; Fall River, Massachusetts; and a data center located in Norcross, Georgia. In January 2007, the Company acquired a building and adjacent land in Windsor, Connecticut and in June 2007 sold an office building which it owned in Irving, Texas. The Company leases 197 field and claim offices totaling approximately 5.2 million square feet throughout the United States under leases or subleases with third parties.

The Company owns a building in London, England, which houses a portion of its 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 10% of the carrying value of the property portfolio at December 31, 2007.

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

This section describes the major pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or to which any of the Company's property is subject.

Asbestos- and Environmental-Related Proceedings

In the ordinary course of its insurance business, the Company receives claims for insurance arising under policies issued by the Company asserting alleged injuries and damages from asbestos- and environmental-related exposures that are the subject of related coverage litigation, including, among others, the litigation described below. The Company continues to be subject to aggressive asbestos-related litigation. The conditions surrounding the final resolution of these claims and the related litigation continue to change. The Company is defending its asbestos- and environmental-related litigation vigorously and believes that it has meritorious defenses; however, the outcomes of these disputes are uncertain. In this regard, the Company employs dedicated specialists and aggressive resolution strategies to manage asbestos and environmental loss exposure, including settling litigation

under appropriate circumstances. For a discussion of other information regarding the Company's asbestos and environmental exposure, see "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Asbestos Claims and Litigation," " Environmental Claims and Litigation" and " Uncertainty Regarding Adequacy of Asbestos and Environmental Reserves."

Travelers Property Casualty Corp. (TPC), a wholly-owned subsidiary of the Company, is involved in three significant proceedings relating to ACandS, Inc. (ACandS), formerly a national distributor and installer of products containing asbestos. The proceedings, which are pending in the U.S. Bankruptcy Court for the District of Delaware (*In re: ACandS, Inc.*) and the U.S. District Court for the District of Pennsylvania (*ACandS, Inc. v. Travelers Casualty and Surety Co.*, No. 03-MC-222 and *ACandS, Inc. v. Travelers Casualty and Surety Co.*, 00-CV-4633), involve disputes as to whether and to what extent any of ACandS' potential liabilities for current or future bodily injury asbestos claims are covered by insurance policies issued by TPC.

On July 6, 2007, the Company announced that it entered into a settlement to resolve fully all current and future asbestos-related coverage claims relating to ACandS, including the three proceedings mentioned above. Under the settlement agreement, the Company will contribute \$449 million to a trust to be established pursuant to ACandS' plan of reorganization. In exchange, the Company will be released from any obligations it has to ACandS for asbestos-related claims and will be protected from any such claims by injunctions to be issued in the Company's favor by the federal court overseeing ACandS' bankruptcy case. The settlement is subject to a number of contingencies. Pursuant to the settlement agreement, ACandS and the Company have agreed to stay the claims against each other in the three proceedings described above. Once all of the contingencies of the settlement are satisfied, these claims will be dismissed with prejudice.

On August 27, 2007, the bankruptcy court overseeing ACandS' bankruptcy approved the settlement and no appeals from that approval were taken. As a result, the Company has placed \$449 million into escrow. Upon fulfillment of all contingencies, including final court approval of a plan of reorganization for ACandS and the issuance of the injunctions described above, those funds will be released from escrow to the trust created under ACandS' plan of reorganization. The release of the funds to the trust will be recorded as a paid claim and reduction in claim reserves, and accordingly, there will be no effect on the Company's results of operations. The Company expects to seek to recover approximately \$84 million of the \$449 million from reinsurers.

In October 2001 and April 2002, two purported class action suits (*Wise v. Travelers* and *Meninger v. Travelers*) were filed against TPC and other insurers (not including SPC) in state court in West Virginia. These cases were subsequently consolidated into a single proceeding in the Circuit Court of Kanawha County, West Virginia. The plaintiffs allege that the insurer defendants engaged in unfair trade practices by inappropriately handling and settling asbestos claims. The plaintiffs seek to reopen large numbers of settled asbestos claims and to impose liability for damages, including punitive damages, directly on insurers. Similar lawsuits were filed in West Virginia, Massachusetts and Hawaii state courts (these suits are collectively referred to as the Statutory and Hawaii Actions).

In March 2002, the plaintiffs in consolidated asbestos actions pending before a mass tort panel of judges in West Virginia state court amended their complaint to include TPC as a defendant, alleging that TPC and other insurers breached alleged duties to certain users of asbestos products. The plaintiffs seek damages, including punitive damages. Lawsuits seeking similar relief and raising similar allegations, primarily violations of purported common law duties to third parties, are also pending in Texas state court against TPC and SPC, and in Louisiana state court against TPC (the claims asserted in these suits, together with the West Virginia suit, are collectively referred to as the Common Law Claims).

The federal bankruptcy court that had presided over the bankruptcy of TPC's former policyholder Johns-Manville Corporation issued a temporary injunction prohibiting the prosecution of the Statutory

Actions (but not the Hawaii Actions), the Common Law Claims and an additional set of cases filed in various state courts in Texas and Ohio, and enjoining certain attorneys from filing any further lawsuits against TPC based on similar allegations. Notwithstanding the injunction, additional common law claims were filed against TPC.

In November 2003, the parties reached a settlement of the Statutory and Hawaii Actions. This settlement includes a lump-sum payment of up to \$412 million by TPC, subject to a number of significant contingencies. In May 2004, the parties reached a settlement resolving substantially all pending and similar future Common Law Claims against TPC. This settlement requires a payment of up to \$90 million by TPC, subject to a number of significant contingencies. Each of these settlements is contingent upon, among other things, an order of the bankruptcy court clarifying that all of these claims, and similar future asbestos-related claims against TPC, are barred by prior orders entered by the bankruptcy court.

On August 17, 2004, the bankruptcy court entered an order approving the settlements and clarifying its prior orders that all of the pending Statutory and Hawaii Actions and substantially all Common Law Claims pending against TPC are barred. The order also applies to similar direct action claims that may be filed in the future.

On March 29, 2006, the U.S. District Court for the Southern District of New York substantially affirmed the bankruptcy court's orders while vacating that portion of the bankruptcy court's orders that required all future direct actions against TPC to first be approved by the bankruptcy court before proceeding in state or federal court.

Various parties appealed the district court's March 29, 2006 ruling to the U.S. Court of Appeals for the Second Circuit. On February 15, 2008, the Second Circuit issued an opinion vacating on jurisdictional grounds the District Court's approval of an order issued by the bankruptcy court prohibiting the prosecution of the Statutory and Hawaii Actions and the Common Law Claims, as well as future similar direct action litigation, against TPC. Final approval of the order was a predicate to TPC's financial obligations under the settlement agreements. One or more of the parties may seek further appellate review of the Second Circuit's opinion, and the Company is evaluating its appellate options. Unless the Second Circuit's decision is reversed on further appeal and the bankruptcy court's order is reinstated and becomes final, the settlements will be voided, TPC will have no obligation to pay the amounts due under the settlement agreements (other than certain administrative expenses) and the Company intends to litigate the direct action cases vigorously.

SPC, which is not covered by the bankruptcy court rulings or the settlements described above, has numerous defenses in the direct action cases asserting common law claims that are pending against it. There have been favorable rulings during 2003 and 2004 in Texas and during 2004 and 2005 in Ohio on motions to dismiss filed by SPC and other insurers that dealt with statute of limitations and the validity of the alleged causes of actions. On May 26, 2005, the Court of Appeals of Ohio, Eighth District, affirmed the earliest of these favorable rulings. In Texas, only one court, in June of 2005, has denied the insurers' initial challenges to the pleadings. That ruling was contrary to the rulings by other courts in similar cases, and SPC and the other insurer defendants have filed a petition with the Texas Court of Appeals seeking relief from that ruling.

Currently, it is not possible to predict legal outcomes and their impact on the future development of claims and litigation relating to asbestos and environmental claims. Any such development will be affected by future court decisions and interpretations, as well as changes in applicable legislation. Because of these uncertainties, additional liabilities may arise for amounts in excess of the current related reserves. In addition, the Company's estimate of ultimate 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 results of operations in future periods.

Shareholder Litigation and Related Proceedings

In November 2004, two purported class actions were brought in the U.S. District Court for the District of Minnesota by certain shareholders of the Company against the Company and certain of its current and former officers and directors. These two actions were consolidated as *In re St. Paul Travelers Securities Litigation II*. An amended consolidated complaint was filed alleging violations of federal securities laws in connection with (i) the Company's alleged failure to make disclosure relating to the practice of paying brokers commissions on a contingent basis, (ii) the Company's alleged involvement in a conspiracy to rig bids and (iii) the Company's allegedly improper use of finite reinsurance products. On January 17, 2008, the parties in *In re St. Paul Travelers Securities Litigation II* entered into a stipulation of settlement resolving the case. The settlement is subject to court approval. The settlement will not have a material impact on the Company's results of operations.

Other Proceedings

From time to time, the Company is involved in proceedings addressing disputes with its reinsurers regarding the collection of amounts due under the Company's reinsurance agreements. These proceedings may be initiated by the Company or the reinsurers and may involve the terms of the reinsurance agreements, the coverage of particular claims, exclusions under the agreements, as well as counterclaims for rescission of the agreements. One of these disputes is the action described in the following paragraphs.

The Company's Gulf operation brought an action on May 22, 2003 in the Supreme Court of New York, County of New York (*Gulf Insurance Company v. Transatlantic Reinsurance Company, et al.*), against Transatlantic Reinsurance Company (Transatlantic), XL Reinsurance America, Inc. (XL), Odyssey America Reinsurance Corporation (Odyssey), Employers Reinsurance Company (Employers) and Gerling Global Reinsurance Corporation of America (Gerling), to recover amounts due under reinsurance contracts issued to Gulf and related to Gulf's February 2003 settlement of a coverage dispute under a vehicle residual value protection insurance policy. The reinsurers asserted counterclaims seeking rescission of the vehicle residual value reinsurance contracts issued to Gulf and unspecified damages for breach of contract. Gerling commenced a separate action asserting the same claims, which has been consolidated with the original Gulf action for pre-trial purposes.

Gulf has entered into final settlement agreements with Employers, XL, Transatlantic and Odyssey which resolve all claims between Gulf and these defendants under the reinsurance agreements at issue in the litigation.

In November 2007, the court issued rulings denying Gulf's motion for partial summary judgment against Gerling, the sole remaining defendant, but granting Gerling's motion for partial summary judgment on certain claims and counterclaims asserted by Gulf and Gerling. Gulf has appealed the court's decision to the Supreme Court of New York Appellate Division, First Department, and has been granted a stay of trial on the remaining claims pending that appeal. Gulf denies Gerling's allegations, believes that it has a strong legal basis to collect the amounts due under the reinsurance contracts and intends to vigorously pursue the action.

Based on the Company's beliefs about its legal positions in its various reinsurance recovery proceedings, the Company does not expect any of these matters will have a material adverse effect on its results of operations in a future period.

The Company is a defendant in three consolidated lawsuits in the U.S. District Court for the Eastern District of Louisiana arising out of disputes with certain policyholders over whether insurance coverage is available for flood losses arising from Hurricane Katrina: *Chehardy, et al. v. State Farm, et al.*, *Vanderbrook, et al. v. State Farm Fire & Cas. Co., et al.*, and *Xavier University of Louisiana v. Travelers Property Ca. Co. of America*. *Chehardy* and *Vanderbrook* are purported class actions in which the

Company is one of several insurer defendants. *Xavier* is an individual suit involving a property insurance policy brought by one of the Company's insureds. All of these actions allege that the losses were caused by the failure of the New Orleans levees. On November 27, 2006, the district court issued a ruling in the three consolidated cases denying the motions of the Company and certain other insurers for a summary disposition of the cases.

On August 2, 2007, the U.S. Court of Appeals for the Fifth Circuit reversed the district court's ruling, holding that there is no coverage for the plaintiffs' flood losses under the policies at issue (including policies issued by the Company) because the policies' flood exclusions unambiguously exclude coverage. On August 27, 2007, the Fifth Circuit denied the plaintiffs' petition for rehearing. The plaintiffs filed a Petition for Writ of Certiorari with the U.S. Supreme Court, which was denied on February 19, 2008.

The district court to which these cases were remanded following the Fifth Circuit decision discussed above has issued an order staying all proceedings concerning the interpretation of the flood exclusion until a decision is rendered in an appeal pending in the Louisiana Supreme Court entitled *Joseph Sher v. Lafayette Insurance Co., et al.* *Sher* is an appeal from a decision of a Louisiana state appellate court in which, contrary to the Fifth Circuit's ruling discussed above, certain judges on the panel ruled that the flood exclusion at issue in the case is ambiguous. Although the Company is not a party to *Sher*, the district court issued the stay on the basis that the Louisiana Supreme Court's decision in *Sher* may be relevant to the outcome of the district court cases. Oral argument in *Sher* is scheduled for February 26, 2008.

As previously disclosed, as part of ongoing, industry-wide investigations, the Company and its affiliates have received subpoenas and written requests for information from a number of government agencies and authorities, including, among others, state attorneys general, state insurance departments, the U.S. Attorney for the Southern District of New York and the U.S. Securities and Exchange Commission. The areas of pending inquiry addressed to the Company include its relationship with brokers and agents and the Company's involvement with "non-traditional insurance and reinsurance products." The Company and its affiliates may receive additional subpoenas and requests for information with respect to these matters.

The Company is cooperating with these subpoenas and requests for information. In addition, outside counsel, with the oversight of the Company's board of directors, conducted an internal review of certain of the Company's business practices. This review initially focused on the Company's relationship with brokers and was commenced after the announcement of litigation brought by the New York Attorney General's office against a major broker.

The internal review was expanded to address the various requests for information described above and to verify whether the Company's business practices in these areas have been appropriate. The Company's review has been extensive, involving the examination of e-mails and underwriting files, as well as interviews of current and former employees.

In its review, the Company found only a few instances of conduct that were inconsistent with the Company's employee code of conduct and has responded appropriately. The Company's internal review with respect to finite reinsurance considered finite products the Company both purchased and sold. The Company has completed its review with respect to the identified finite products purchased and sold, and has concluded that no adjustment to previously issued financial statements is required.

Any authority with open inquiries or investigations could ask that additional work be performed or reach conclusions different from the Company's. Accordingly, it would be premature to reach any conclusions as to the likely outcome of the regulatory inquiries described above.

In 2005, four putative class action lawsuits were brought against a number of insurance brokers and insurers, including the Company and/or certain of its affiliates, by plaintiffs who allegedly

purchased insurance products through one or more of the defendant brokers. The plaintiffs alleged that various insurance brokers conspired with each other and with various insurers, including the Company and/or certain of its affiliates, to artificially inflate premiums, allocate brokerage customers and rig bids for insurance products offered to those customers. To the extent they were not originally filed there, the federal class actions were transferred to the U.S. District Court for the District of New Jersey and were consolidated for pre-trial proceedings with other class actions under the caption *In re Insurance Brokerage Antitrust Litigation*. On August 1, 2005, various plaintiffs, including the four named plaintiffs in the above-referenced class actions, filed an amended consolidated class action complaint naming various brokers and insurers, including the Company and certain of its affiliates, on behalf of a putative nationwide class of policyholders. The complaint included causes of action under the Sherman Act, the Racketeer Influenced and Corrupt Organizations Act (RICO), state common law and the laws of the various states prohibiting antitrust violations. The complaint sought monetary damages, including punitive damages and trebled damages, permanent injunctive relief, restitution, including disgorgement of profits, interest and costs, including attorneys' fees. All defendants moved to dismiss the complaint for failure to state a claim. After giving plaintiffs multiple opportunities to replead, the court dismissed the Sherman Act claims on August 31, 2007 and the RICO claims on September 28, 2007, both with prejudice, and declined to exercise supplemental jurisdiction over the state law claims. The plaintiffs are appealing the district court's decisions to the U.S. Court of Appeals for the Third Circuit. Additional individual actions have been brought in state and federal courts against the Company involving allegations similar to those in *In re Insurance Brokerage Antitrust Litigation*, and further actions may be brought. The Company believes that all of these lawsuits have no merit and intends to defend vigorously.

In addition to those described above, the Company is involved in numerous lawsuits, not involving asbestos and environmental claims, arising mostly in the ordinary course of business operations either as a liability insurer defending third-party claims brought against policyholders, or as an insurer defending claims brought against it relating to coverage or the Company's business practices. While the ultimate resolution of these legal proceedings could be material to the Company's results of operations in a future period, in the opinion of the Company's management, none would likely have a material adverse effect on the Company's financial position or liquidity.

The Company previously reported that it sought guidance from the Division of Corporation Finance of the SEC with respect to the appropriate purchase accounting treatment for certain second quarter 2004 adjustments totaling \$1.63 billion. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Other Uncertainties." After discussion with the staff of the Division of Corporate Finance and the Company's independent auditors, the Company continues to believe that its accounting treatment for these adjustments is appropriate. On May 3, 2006, the Company received a letter from the Division of Enforcement of the SEC advising the Company that it is conducting an inquiry relating to the second quarter 2004 adjustments and the April 1, 2004 merger of SPC and TPC. The Company is cooperating with the requests for information.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

NONE.

EXECUTIVE OFFICERS OF THE REGISTRANT

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

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 83,966 as of February 15, 2008. 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 amount of cash dividends declared per share and the high and low closing sales prices of the Company's common stock for each quarter during the last two fiscal years.

	<u>High</u>	<u>Low</u>	<u>Cash Dividend Declared</u>
2007			
First Quarter	\$ 53.74	\$ 49.59	\$ 0.26
Second Quarter	56.76	51.85	0.29
Third Quarter	55.01	48.38	0.29
Fourth Quarter	55.18	50.05	0.29
2006			
First Quarter	\$ 47.65	\$ 40.75	\$ 0.23
Second Quarter	45.86	41.02	0.26
Third Quarter	47.39	42.62	0.26
Fourth Quarter	54.23	46.43	0.26

The Company paid cash dividends per share of \$1.13 in 2007 and \$1.01 in 2006. 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.

SHAREHOLDER RETURN PERFORMANCE GRAPH

The following graph shows a five-year comparison of the cumulative total return 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 Index, which the Company believes is the most appropriate comparative index.

(1) Assumes \$100 invested in common shares of The St. Paul Companies, Inc. on December 31, 2002. The performance reflected is that of The St. Paul Companies, Inc. only until the date of the merger (April 1, 2004), and is that of The Travelers Companies, Inc. thereafter.

(2) Companies in the S&P Property-Casualty Index as of December 31, 2007 were the following: The Travelers Companies, Inc., ACE Ltd., AMBAC Financial Group, Inc., Safeco Corporation, The Chubb Corporation, Cincinnati Financial Corporation, Progressive Corporation, Allstate Corporation, MBIA, Inc. and XL Capital, Ltd.

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

ISSUER PURCHASES OF EQUITY SECURITIES

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

Period Beginning	Period Ending	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum dollar value of shares that may yet be purchased under the plans or programs
Oct. 1, 2007	Oct. 31, 2007	3,401,195	\$ 52.92	3,283,940	\$ 1,758,356,131
Nov. 1, 2007	Nov. 30, 2007	9,790,857	51.79	9,709,073	1,255,522,761
Dec. 1, 2007	Dec. 31, 2007	6,043,294	53.76	6,015,200	932,186,671
Total		19,235,346	\$ 52.61	19,008,213	\$ 932,186,671

The Company repurchased 227,133 shares during this three-month period that were not part of the publicly announced share repurchase authorization, representing shares repurchased to cover payroll withholding taxes in connection with the vesting of restricted stock awards and exercises of stock options, and shares used to cover the exercise price of certain stock options that were exercised. The Company's share repurchase authorization, which has no expiration date, was first approved and announced by the Company's board of directors in May 2006. The original authorized repurchase capacity was \$2 billion; in January 2007, the board of directors authorized an additional \$3 billion of repurchase capacity. Through December 31, 2007, the Company had repurchased a cumulative total of 78.8 million shares for a total cost of \$4.07 billion, and had \$932 million of remaining capacity at December 31, 2007 under the authorization. In January 2008, the board of directors authorized an additional \$5 billion for share repurchases.

Item 6. SELECTED FINANCIAL DATA

All data in the following table for 2003 represent historical data for TPC. For accounting purposes, the merger of SPC and TPC was accounted for as a reverse acquisition with TPC treated as the accounting acquirer. Accordingly, this transaction was accounted for as a purchase business combination, using TPC's historical financial information and applying fair value estimates to the acquired assets, liabilities and commitments of SPC as of April 1, 2004. Historical results are not necessarily indicative of results to be expected in the future.

	At and for the year ended December 31,(1)				
	2007	2006	2005	2004	2003
	(in millions, except per share amounts)				
Total revenues	\$ 26,017	\$ 25,090	\$ 24,365	\$ 22,544	\$ 15,139
Income from continuing operations	\$ 4,601	\$ 4,208	\$ 2,061	\$ 867	\$ 1,696
Income (loss) from discontinued operations			(439)	88	
Net income	\$ 4,601	\$ 4,208	\$ 1,622	\$ 955	\$ 1,696
Total investments	\$ 74,818	\$ 72,268	\$ 68,287	\$ 64,368	\$ 38,653
Total assets	115,224	115,292	113,736	111,246	64,872
Claims and claim adjustment expense reserves	57,700	59,288	61,090	59,070	34,573
Total debt	6,242	5,760	5,850	6,313	2,675
Total liabilities	88,608	90,157	91,433	90,045	52,885
Total shareholders' equity	26,616	25,135	22,303	21,201	11,987
Basic earnings per share:(2)					
Income from continuing operations	\$ 7.04	\$ 6.12	\$ 3.04	\$ 1.42	\$ 3.91
Income (loss) from discontinued operations(3)			(0.65)	0.14	
Net income	\$ 7.04	\$ 6.12	\$ 2.39	\$ 1.56	\$ 3.91
Diluted earnings per share:(2)					
Income from continuing operations	\$ 6.86	\$ 5.91	\$ 2.95	\$ 1.40	\$ 3.80
Income (loss) from discontinued operations(3)			(0.62)	0.13	
Net income	\$ 6.86	\$ 5.91	\$ 2.33	\$ 1.53	\$ 3.80
Year-end common shares outstanding(2)	627.8	678.3	693.4	670.3	435.8
Per common share data:					
Cash dividends(2)	\$ 1.13	\$ 1.01	\$ 0.91	\$ 1.16	\$ 0.65
Book value(2)	\$ 42.22	\$ 36.86	\$ 31.94	\$ 31.35	\$ 27.51

(1) On April 1, 2004, TPC merged with SPC, as a result of which TPC became a wholly-owned subsidiary of SPC, and SPC changed its name to The St. Paul Travelers Companies, Inc. On February 26, 2007, the name of the Company was changed to The Travelers Companies, Inc. All financial information presented herein for the year ended December 31, 2004 reflects the accounts of TPC for the three months ended March 31, 2004 and the consolidated accounts of SPC and TPC for the nine months ended December 31, 2004.

(2) Earnings per share, year-end common shares outstanding, cash dividends per share and book value per share were restated for 2003 to reflect the impact of the merger with SPC.

(3)

In August 2005, the Company completed its divestiture of Nuveen Investments, Inc., its asset management subsidiary acquired in the merger. Accordingly, the Company's share of Nuveen Investments' results prior to the divestiture was classified as discontinued operations, along with the net after-tax loss on disposal. Prior period results were reclassified to be consistent with the 2005 presentation.

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

The following is a discussion and analysis of the financial condition and results of operations of The Travelers Companies, Inc. (together with its subsidiaries, the Company).

2007 FINANCIAL HIGHLIGHTS

2007 Consolidated Results of Operations

Income from continuing operations and net income of \$4.60 billion, or \$7.04 per share basic and \$6.86 diluted

Net favorable prior year reserve development of \$546 million pretax (\$351 million after-tax)

Net earned premiums of \$21.47 billion

GAAP combined ratio of 87.4%

Pretax net investment income of \$3.76 billion (\$2.92 billion after-tax)

Pretax net realized investment gains of \$154 million (\$101 million after-tax)

2007 Consolidated Financial Condition

Total assets of \$115.22 billion

Total investments of \$74.82 billion, up \$2.55 billion from December 31, 2006; fixed maturities and short-term securities comprise 94% of total investments

Total debt of \$6.24 billion, resulting in a debt to total capital ratio of 19.4%

Repurchased 56.0 million common shares for total cost of \$2.95 billion under share repurchase authorization

Shareholders' equity of \$26.62 billion, up \$1.48 billion from December 31, 2006; book value per common share of \$42.22, up 15% from December 31, 2006

Holding company liquidity of \$1.62 billion

CONSOLIDATED OVERVIEW

The Company provides a wide range of property and casualty insurance products and services to businesses, government units, associations and individuals, primarily in the United States and in selected international markets.

Consolidated Results of Operations

For the year ended December 31,	2007	2006	2005
Revenues			
Premiums	\$ 21,470	\$ 20,760	\$ 20,341
Net investment income	3,761	3,517	3,165
Fee income	508	591	664
Net realized investment gains	154	11	17
Other revenues	124	211	178
Total revenues	26,017	25,090	24,365
Claims and expenses			
Claims and claim adjustment expenses	12,397	12,244	14,927
Amortization of deferred acquisition costs	3,706	3,339	3,252
General and administrative expenses	3,352	3,458	3,229
Interest expense	346	324	286
Total claims and expenses	19,801	19,365	21,694
Income from continuing operations before income taxes	6,216	5,725	2,671
Income tax expense	1,615	1,517	610
Income from continuing operations	4,601	4,208	2,061
Discontinued operations:			
Operating loss, net of taxes			(663)
Gain on disposal, net of taxes			224
Loss from discontinued operations			(439)
Net income	\$ 4,601	\$ 4,208	\$ 1,622
Income from continuing operations per share			
Basic	\$ 7.04	\$ 6.12	\$ 3.04
Diluted	\$ 6.86	\$ 5.91	\$ 2.95
GAAP combined ratio			
Loss and loss adjustment expense ratio	56.6%	57.5%	71.9%
Underwriting expense ratio	30.8	30.6	29.4
GAAP combined ratio	87.4%	88.1%	101.3%

The Company's discussions of income from continuing operations, loss from discontinued operations, net income and segment operating income included in the following discussion 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

Income from continuing operations of \$6.86 per common share in 2007 was 16% higher than the \$5.91 per common share in 2006. Income from continuing operations in 2007 totaled \$4.60 billion, 9% higher than \$4.21 billion in 2006. The higher rate of growth in per share income compared with the rate of growth in actual income in 2007 over 2006 reflected the impact of the Company's significant common share repurchases since its repurchase program began in the second quarter of 2006. The increase in income from continuing operations in 2007 reflected growth in net investment income, a higher level of net favorable prior year reserve development, an increase in net realized investment

gains, favorable current accident year results and increased business volume, partially offset by an increase in expenses and a decline in fee income. Net favorable prior year reserve development totaled \$546 million in 2007, compared with net favorable prior year reserve development of \$394 million in 2006. Expenses in 2007 included a net benefit of \$163 million due to the implementation of a new fixed, value-based compensation program for the majority of the Company's agents, which resulted in a reduction in commission expense compared to what would have otherwise been reported, due to a change in the timing of expense recognition compared with 2006. Catastrophe losses in 2007 totaled \$167 million, compared with \$103 million in 2006. Income from continuing operations in both 2007 and 2006 included after-tax benefits of \$86 million due to the favorable resolution of various prior year tax matters. The 2007 total also included net realized investment gains of \$154 million, compared with net realized investment gains of \$11 million in 2006.

Income from continuing operations in 2006 totaled \$4.21 billion, or \$5.91 per share, compared with 2005 income from continuing operations of \$2.06 billion, or \$2.95 per share. The \$2.15 billion increase in 2006 operating results reflected a significant decline in catastrophe losses, net favorable prior year reserve development, strong growth in net investment income and higher business volume. These factors were partially offset by an increase in general and administrative expenses and a decline in fee income. Catastrophe losses in 2006 totaled \$103 million, whereas results in 2005 included \$2.19 billion of catastrophe costs, primarily resulting from Hurricanes Katrina, Rita and Wilma. Net favorable prior year reserve development totaled \$394 million in 2006, compared with net unfavorable prior year reserve development of \$325 million in 2005.

In 2005, the Company sold its equity interest in Nuveen Investments, which constituted its Asset Management segment. The Company recorded a net loss from discontinued operations of \$439 million, consisting primarily of \$710 million of tax expense which resulted from the difference between the tax basis and the GAAP carrying value of the Company's investment in Nuveen Investments, partially offset by the \$224 million after-tax gain on the divestiture and the Company's share of Nuveen Investments' net income for 2005.

Revenues

Earned Premiums

Earned premiums in 2007 totaled \$21.47 billion, an increase of \$710 million, or 3%, over 2006. In the Business Insurance segment, earned premium growth of 4% in 2007 over 2006 primarily reflected the impact of the growth in business volume over the preceding twelve months. In the Financial, Professional & International Insurance segment, earned premium growth of 2% in 2007 over 2006 was driven by the favorable impact of foreign currency rates of exchange, growth in business volume and a benefit from adjustments to prior year premium estimates for the Company's operations at Lloyd's, partially offset by the impact of the sale of the Company's Mexican surety subsidiary, Afianzadora Insurgentes, S.A. de C.V. (Afianzadora Insurgentes), in late March 2007. In the Personal Insurance segment, earned premium growth of 4% in 2007 over 2006 reflected continued strong business retention rates, continued renewal price increases and growth from new business volumes over the preceding twelve months, partially offset by the impact of the sale of Mendota Insurance Company and its subsidiaries (collectively, Mendota) in early April 2007.

Earned premiums in 2006 totaled \$20.76 billion, an increase of \$419 million, or 2%, over the 2005 total of \$20.34 billion. Earned premiums in 2006 were negatively impacted by an increase in property catastrophe reinsurance costs. Earned premiums in 2005 were reduced by \$121 million of reinstatement premiums, which represent additional premiums payable to reinsurers to restore coverage limits that had been exhausted as a result of reinsured losses under certain excess-of-loss reinsurance treaties related to Hurricanes Katrina, Rita and Wilma. In the Business Insurance segment, earned premiums in 2006 declined 2% from the comparable 2005 total, primarily reflecting the impact of business in

runoff and the sale of the Personal Catastrophe Risk operation in November 2005. Earned premiums in the Financial, Professional & International Insurance segment in 2006 increased 4% over 2005, primarily reflecting growth in Bond & Financial Products and the absence of catastrophe-related reinstatement premiums. In the Personal Insurance segment, earned premium growth of 9% in 2006 reflected strong new business volume and continued renewal price increases.

Net Investment Income

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

(for the year ended December 31, in millions)	2007	2006	2005
Average investments(a)	\$ 73,872	\$ 71,252	\$ 66,695
Pretax net investment income	3,761	3,517	3,165
After-tax net investment income	2,915	2,712	2,438
Average pretax yield(b)	5.1%	4.9%	4.7%
Average after-tax yield(b)	3.9%	3.8%	3.7%

(a) Excludes net unrealized investment gains and losses, net of tax, and is adjusted for cash, receivables for investment sales, payables on investment purchases and accrued investment income.

(b) Excludes net realized gains and losses and unrealized investment gains and losses.

Net investment income totaled \$3.76 billion in 2007, an increase of \$244 million, or 7%, over 2006 net investment income of \$3.52 billion. The increase in 2007 was primarily the result of continued growth in the Company's fixed maturity portfolio resulting from strong cash flows from operating activities and higher yields on long-term taxable fixed maturity securities. Also contributing to investment income growth in 2007 were strong levels of net investment income from the Company's real estate joint venture investments. The amortized cost of the fixed maturity portfolio at December 31, 2007 totaled \$64.15 billion, \$1.91 billion higher than year-end 2006. The average pretax investment yield was 5.1% in 2007, compared with 4.9% in 2006. The increase primarily reflected strong returns generated by the real estate joint venture investments and higher yields on taxable investments purchased in 2007.

Net investment income totaled \$3.52 billion in 2006, an increase of \$352 million, or 11%, over 2005 net investment income of \$3.17 billion. The increase in 2006 was primarily the result of higher yields on short-term and long-term taxable securities, continued growth in the Company's fixed maturity portfolio resulting from strong cash flows from operating activities and a decline in investment expenses. Also contributing to investment income growth in 2006 was the full-year impact of investment returns from the investment of \$2.40 billion in proceeds from the divestiture of the Company's equity interest in Nuveen Investments during 2005. The Company's real estate joint venture investments also produced strong levels of net investment income in 2006. The amortized cost of the fixed maturity portfolio at December 31, 2006 totaled \$62.24 billion, \$3.63 billion higher than year-end 2005. The average pretax investment yield was 4.9% in 2006 compared with 4.7% in 2005. The increase in yield primarily reflected higher yields on taxable investments purchased in 2006 and the strong returns generated by the real estate joint venture investments.

The Company allocates invested assets and the related net investment income to its reportable business segments. Pretax net investment income is allocated based upon an investable funds concept, which takes into account liabilities (net of non-invested assets) and appropriate capital considerations for each segment. For investable funds, a benchmark investment yield is developed that reflects the estimated duration of the loss reserves' future cash flows, the interest rate environment at the time the losses were incurred and A+ rated corporate debt instrument yields. For capital, a benchmark investment yield is developed that reflects the average yield on the total investment portfolio. The

benchmark investment yields are applied to each segment's investable funds and capital, respectively, to produce a total notional investment income by segment. The Company's actual net investment income is allocated to each segment in proportion to the respective segment's notional investment income to total notional investment income.

Fee Income

The National Accounts market in the Business Insurance segment is the primary source of the Company's fee-based business. The declines in fee income in 2007 and 2006 compared with the respective prior years is described in the Business Insurance segment discussion that follows.

Net Realized Investment Gains

Net realized investment gains in 2007 totaled \$154 million, compared with net realized investment gains of \$11 million in 2006. The 2007 total included \$91 million of net realized investment gains (net of impairment losses of \$16 million) generated by the venture capital portfolio (including an \$81 million net realized investment gain from the bundled sale of a substantial portion of the Company's venture capital investment holdings), \$63 million of net realized investment gains from the sale of a privately held security, \$21 million of net realized investment gains related to the Company's holdings of stock purchase warrants of Platinum Underwriters Holdings, Ltd., a publicly-held company, and \$5 million of net realized investment gains (net of impairment losses of \$37 million) from the Company's fixed maturity portfolio. These gains were partially offset by a net realized loss of \$24 million related to the divestiture of a subsidiary.

Net realized investment gains in 2006 totaled \$11 million, compared with net realized investment gains of \$17 million in 2005. The 2006 total included \$49 million of net realized investment gains (net of impairment losses of \$33 million) generated by the venture capital portfolio and \$30 million of net realized investment gains related to U.S. Treasury futures contracts (which require a daily mark-to-market settlement and are used to shorten the duration of the Company's fixed maturity investment portfolio). These gains were substantially offset by \$33 million of net realized investment losses from the fixed maturity portfolio (including \$7 million of impairment losses) and \$22 million of net realized investment losses related to the Company's holdings of stock purchase warrants of Platinum Underwriters Holdings, Ltd. In addition, the Company incurred net realized losses of \$11 million related to the divestiture of two small subsidiaries.

Net realized investment gains in 2005 were primarily generated from sales of venture capital investments and equity securities. In addition, the Company realized a gain of \$21 million from the sale of its Personal Catastrophe Risk operation and \$13 million of net gains related to U.S. Treasury futures contracts. Net realized investment gains in 2005 were reduced by \$109 million of impairment losses, which were concentrated in the venture capital portfolio as described in more detail later in this discussion.

Further information regarding the nature of impairment charges in each year is included in the "Investment Portfolio" section later in this discussion.

Other Revenues

Other revenues in all periods presented primarily consist of premium installment charges. In 2007, other revenues also reflected a \$39 million loss related to the Company's redemption of its 4.50% convertible junior subordinated notes in April 2007, consisting of the redemption premium paid and the write-off of remaining debt issuance costs. Other revenues in 2006 included a \$42 million gain on the redemption of the Company's \$593 million, 7.60% subordinated debentures.

Written Premiums

Consolidated gross and net written premiums were as follows:

(for the year ended December 31, in millions)	Gross Written Premiums		
	2007	2006	2005
Business Insurance	\$ 13,017	\$ 13,047	\$ 13,453
Financial, Professional & International Insurance	4,037	3,981	3,809
Personal Insurance	7,144	7,011	6,474
Total	\$ 24,198	\$ 24,039	\$ 23,736

(for the year ended December 31, in millions)	Net Written Premiums		
	2007	2006	2005
Business Insurance	\$ 11,318	\$ 11,046	\$ 10,999
Financial, Professional & International Insurance	3,465	3,393	3,159
Personal Insurance	6,835	6,711	6,228
Total	\$ 21,618	\$ 21,150	\$ 20,386

Gross and net written premiums in 2007 increased 1% and 2%, respectively, over 2006. In early 2007, the Company completed the sales of Afianzadora Insurgentes and Mendota. These operations generated combined net written premiums of \$74 million in 2007 prior to their sale, compared with combined net written premiums of \$265 million in 2006. Adjusting for the impact of that premium volume in both years, the Company's consolidated net written premiums in 2007 increased 3% over 2006.

Net written premiums in 2007 in each of the Company's business segments increased 2% over the respective 2006 total. In Business Insurance, growth was concentrated in the Commercial Accounts, Select Accounts and Industry-Focused Underwriting markets, primarily driven by strong business retention rates coupled with higher new business volume. In addition, a decline in premiums ceded for catastrophe reinsurance contributed to net written premium growth over 2006 in Business Insurance. In Financial, Professional & International Insurance, the increase reflected the favorable impact of foreign currency rates of exchange, strong business volume in construction surety, in Canada and at Lloyd's, partially offset by the impact of the sale of Afianzadora Insurgentes. Adjustments to prior year premium estimates for the Company's operations at Lloyd's also contributed to the growth in net premium volume in 2007. Net written premium growth in the Personal Insurance segment in 2007 was driven by continued strong retention rates and renewal price increases, partially offset by the impact of the sale of Mendota and a decline in new business volume, particularly for coastal coverages.

Gross and net written premiums in 2006 increased 1% and 4%, respectively, over 2005. The disparity between gross and net written premium growth rates in 2006 was concentrated in the Business Insurance segment and was primarily due to a change in the structure of reinsurance coverage in the Company's Discover Re subsidiary that resulted in a decline in ceded premiums. Net written premium volume in 2006 was negatively impacted by a higher level of premiums ceded for the cost of property catastrophe reinsurance, whereas net written premiums in 2005 were reduced by \$121 million of catastrophe-related reinstatement premiums.

In Business Insurance, net written premium growth in 2006 was driven by strong increases in Target Risk Underwriting, due to significant renewal price increases for Southeastern U.S. catastrophe-prone exposures, and in Industry-Focused Underwriting, due to growth in several industry sectors served by this market. That growth was largely offset by a reduction in premium volume for operations in runoff primarily due to the sale of the Personal Catastrophe Risk operation in the fourth quarter of 2005. Business retention rates remained strong throughout the Business Insurance segment in 2006, and

new business volume increased. In Financial, Professional & International Insurance, written premium growth in 2006 reflected strong business volume throughout the segment, and the absence of catastrophe-related reinstatement premiums. Net written premium growth in the Personal Insurance segment in 2006 reflected growth in new business volume, renewal price increases and continued strong business retention rates, partially offset by the estimated impact of transitioning to six-month policy terms in the second half of the year for a large portion of the Company's multivariate pricing Automobile product, and an increase in ceded premiums for catastrophe reinsurance.

Claims and Expenses

Claims and Claim Adjustment Expenses

Claims and claim adjustment expenses totaled \$12.40 billion in 2007, \$153 million, or 1%, higher than the 2006 total of \$12.24 billion. The 2007 total included \$546 million of net favorable prior year reserve development and \$167 million of catastrophe losses, whereas the 2006 total included \$394 million of net favorable prior year reserve development and \$103 million of catastrophe losses.

The Company's three business segments each experienced net favorable prior year reserve development in 2007. In Business Insurance, net favorable prior year reserve development was primarily driven by better than expected loss development for recent accident years in the commercial multi-peril, general liability, commercial automobile and property product lines. Net total prior year reserve development in 2007 in the Business Insurance segment included a \$185 million increase to environmental reserves. In the Financial, Professional & International Insurance segment, net favorable prior year reserve development in 2007 primarily reflected better than expected loss development in international property, employers' liability, professional indemnity and motor lines of business for recent accident years. In the Personal Insurance segment, net favorable prior year reserve development in 2007 occurred in both the Automobile and Homeowners and Other lines of business. Factors contributing to net favorable prior year reserve development in each segment are discussed in more detail in the segment discussions that follow.

Net favorable prior year reserve development in 2006 was concentrated in the Personal Insurance segment, primarily reflecting better than expected loss experience in the auto bodily injury and non-catastrophe related Homeowners and Other lines of business, and a reduction in loss estimates for the 2005 hurricanes. The Business Insurance segment also experienced net favorable prior year loss experience in its ongoing operations in 2006, primarily in the commercial multi-peril, general liability, property and commercial automobile lines of business. The favorable development in 2006 was partially offset by increases to asbestos and environmental reserves, which are discussed in more detail in the "Asbestos Claims and Litigation" and "Environmental Claims and Litigation" sections herein. There was also unfavorable prior year reserve development in runoff assumed reinsurance business in 2006.

Catastrophe losses of \$167 million in 2007 primarily resulted from wildfires in California and several wind, rain and hail storms throughout the United States. In 2006, catastrophe losses totaled \$103 million, all of which was incurred in the Personal Insurance segment and resulted from several wind, rain, hail and snow storms in the United States throughout the year.

Claims and claim adjustment expenses totaled \$12.24 billion in 2006, \$2.68 billion less than the 2005 total of \$14.93 billion. The 2006 total included \$103 million of catastrophe losses and \$394 million of net favorable prior year reserve development, whereas the 2005 total included \$2.03 billion of catastrophe losses included in claims and claim adjustment expenses and \$325 million of net unfavorable prior year reserve development. Net favorable prior year reserve development in 2006 was driven by the factors described above. In 2005, the net unfavorable prior year reserve development was concentrated in the Business Insurance segment and was primarily driven by an increase to asbestos reserves, which was partially offset by other, non-asbestos related net favorable prior year reserve development in all three business segments.

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In 2005, the Company's cost of catastrophes, net of reinsurance and including reinstatement premiums of \$121 million and state assessments of \$43 million, totaled \$2.19 billion, primarily resulting from Hurricanes Katrina, Rita and Wilma. Reinstatement premiums represent 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 and are recorded as a reduction of net written and earned premiums. The majority of catastrophe costs in 2005 were incurred in the Business Insurance segment (\$1.41 billion) and in the Personal Insurance segment (\$593 million).

Amortization of Deferred Acquisition Costs

The amortization of deferred acquisition costs totaled \$3.71 billion in 2007, \$367 million, or 11%, higher than the comparable total of \$3.34 billion in 2006, primarily reflecting a \$213 million increase from the implementation of a new fixed agent compensation program for the majority of the Company's agents as described in more detail below. The remaining increase was primarily due to growth in business volume in 2007. In 2006, the total of \$3.34 billion was \$87 million, or 3%, higher than the 2005 total of \$3.25 billion, primarily reflecting growth in business volume.

General and Administrative Expenses

General and administrative expenses totaled \$3.35 billion in 2007, a decrease of \$106 million, or 3%, from the comparable 2006 total of \$3.46 billion. The decline primarily reflected the impact of the Company's implementation of the new fixed agent compensation program described in the following paragraph, which was largely offset by expenses related to increased business volume and continued expenditures to support business growth and product development.

In the first quarter of 2007, the Company discontinued the use of contingent commissions and implemented a new fixed agent compensation program for all of its personal insurance business. The Company also offered the majority of its agents conducting commercial insurance business the option to switch to this new program. The Company's total payout rate for all agent compensation for 2007 was substantially the same as for 2006; however, the change to the new program created a difference in the timing of commission expense recognition. The cost of the new program is required to be deferred and amortized over the related policy period (generally six to twelve months), whereas the cost of the contingent commission program was not subject to deferred acquisition cost accounting treatment and, therefore, was expensed as incurred. That timing difference resulted in a benefit to income during the 2007 transition year. The impact of this change in 2007 was to lower reported expenses by \$376 million in the "General and Administrative Expenses" income statement line, and increase reported expenses by \$213 million in the "Amortization of Deferred Acquisition Costs" income statement line, compared to what would have been reported under the prior contingent commission program.

General and administrative expenses totaled \$3.46 billion in 2006, an increase of \$229 million, or 7%, over the comparable 2005 total of \$3.23 billion. The increase in 2006 was driven by investments made throughout the Company to support business growth and product development, costs related to the Company's national advertising campaign and legal expenses related to investigations of various business practices by certain governmental agencies (see "Item 3 Legal Proceedings"). These factors were partially offset by the impact of the favorable resolution of certain prior-year state tax matters, certain tax benefits, the absence of catastrophe-related state assessments and lower premium tax-related expenses.

Interest Expense

Interest expense of \$346 million in 2007 was \$22 million higher than the comparable 2006 total of \$324 million. Interest expense in 2006 was \$38 million higher than in 2005. The increases in both years primarily reflected the impact of the Company's issuance of debt, which is described in more detail in

the "Liquidity and Capital Resources" section herein. Proceeds from a substantial portion of debt issuances in both 2007 and 2006 were used to fund the redemption and maturity of certain of the Company's indebtedness.

Effective Tax Rate

The Company's effective tax rate on income from continuing operations was 26.0%, 26.5% and 22.8% in 2007, 2006 and 2005, respectively. The decline in 2007 compared with 2006 reflected an increase in non-taxable investment income. The increase in 2006 over 2005 primarily reflected a higher level of pretax income in 2006 due to improved underwriting performance.

GAAP Combined Ratios

The consolidated loss and loss adjustment expense ratio of 56.6% in 2007 was 0.9 points lower than the comparable 2006 loss and loss adjustment expense ratio of 57.5%. The 2007 and 2006 loss and loss adjustment expense ratios included benefits of 2.5 points and 1.9 points, respectively, from net favorable prior year reserve development. Catastrophe losses accounted for 0.7 points and 0.5 points of the 2007 and 2006 loss and loss adjustment expense ratios. Excluding catastrophe losses and prior year reserve development, the 2007 loss and loss adjustment expense ratio improved by 0.5 points compared with the comparable 2006 ratio, reflecting continuing improvement in current accident year results in several lines of business. The underwriting expense ratio of 30.8% in 2007 was 0.2 points higher than the comparable 2006 underwriting expense ratio of 30.6%. The implementation of the new fixed agent compensation program described above provided a benefit of 0.8 points to the expense ratios in 2007, which was more than offset by the increases in expenses discussed above.

The consolidated loss and loss adjustment expense ratio of 57.5% in 2006 improved by 14.4 points compared with 2005, primarily reflecting the decline in catastrophe losses. Catastrophe losses accounted for 0.5 points of the 2006 loss and loss adjustment expense ratio, compared with a 10.3 point impact in 2005. The 2006 loss and loss adjustment expense ratio included a 1.9 point impact from net favorable prior year reserve development, whereas the 2005 loss and loss adjustment expense ratio included a 1.6 point impact from net unfavorable prior year reserve development. The 2006 loss and loss adjustment expense ratio excluding catastrophe losses and prior year reserve development improved over the 2005 ratio on the same basis, reflecting improvement in frequency and severity trends in several lines of business. The underwriting expense ratio for 2006 was 1.2 points higher than the underwriting expense ratio in 2005. The changes primarily reflect the impact of the increase in general and administrative expenses described previously. In addition, the 2006 ratio was negatively impacted by a decline in National Accounts' fee income, a portion of which is accounted for as a reduction of expenses for purposes of calculating the expense ratio. The underwriting expense ratio in 2005 also included a 0.4 point impact from reinstatement premiums and state assessments.

Discontinued Operations

In March 2005, the Company and Nuveen Investments jointly announced that the Company would implement a program to divest its 78% equity interest in Nuveen Investments, which constituted the Company's Asset Management segment and was acquired as part of the merger on April 1, 2004. The divestiture was completed through a series of transactions in the second and third quarters of 2005, resulting in net pretax cash proceeds of \$2.40 billion.

The Company recorded a net operating loss from discontinued operations of \$663 million in 2005, consisting primarily of \$710 million of tax expense due to the difference between the tax basis and the GAAP carrying value of the Company's investment in Nuveen Investments, partially offset by the Company's share of Nuveen Investments' net income prior to divestiture. The Company recorded a pretax gain on disposal of \$345 million (\$224 million after-tax) in 2005.

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)	2007	2006	2005
Revenues:			
Earned premiums	\$ 11,283	\$ 10,876	\$ 11,116
Net investment income	2,708	2,538	2,341
Fee income	508	591	663
Other revenues	24	44	64
Total revenues	\$ 14,523	\$ 14,049	\$ 14,184
Total claims and expenses	\$ 10,444	\$ 10,509	\$ 12,968
Operating income	\$ 3,015	\$ 2,622	\$ 1,044
Loss and loss adjustment expense ratio	57.1%	60.3%	81.5%
Underwriting expense ratio	30.7	30.6	28.9
GAAP combined ratio	87.8%	90.9%	110.4%

Overview

Operating income of \$3.02 billion in 2007 was \$393 million, or 15%, higher than operating income of \$2.62 billion in 2006, primarily reflecting increases in net favorable prior year reserve development and net investment income, the continuation of favorable current accident year results and the resolution of certain tax matters. In addition, results in 2007 benefited from the change to the new fixed agent compensation program that is described in more detail in the "Consolidated Overview" section herein. These factors were partially offset by an increase in general and administrative expenses and a decline in fee income in 2007. Net favorable prior year reserve development in 2007 and 2006 totaled \$301 million and \$21 million, respectively. Catastrophe losses in 2007 totaled \$4 million, compared with no catastrophe losses in 2006.

Operating income of \$2.62 billion in 2006 was \$1.58 billion higher than operating income of \$1.04 billion in 2005, primarily reflecting a decline in catastrophe losses, net favorable prior year reserve development, favorable current accident year results and an increase in net investment income. In 2005, the cost of catastrophes totaled \$1.41 billion (including reinstatement premiums of \$67 million), resulting from Hurricanes Katrina, Rita and Wilma. Net favorable prior year reserve development totaled \$21 million in 2006, compared with net unfavorable prior year reserve development of \$757 million in 2005 that was primarily driven by an increase in asbestos reserves. These factors were partially offset by an increase in general and administrative expenses and a decline in fee income in 2006.

Earned Premiums

Earned premiums of \$11.28 billion in 2007 increased 4% over 2006 earned premiums of \$10.88 billion, reflecting the growth in net written premium volume over the prior twelve months in the majority of the markets comprising this segment, driven by strong business retention rates and increases in new business volume, partially offset by minor decreases in renewal price changes. In 2006, earned premiums of \$10.88 billion decreased by \$240 million, or 2%, compared with 2005, as premium increases in the majority of the segment's ongoing operations were more than offset by the continuing decline in other runoff operations' earned premiums, including the impact of the sale of the Personal Catastrophe Risk operation in November 2005. The Personal Catastrophe Risk operation accounted for

\$111 million of earned premiums in 2005. Earned premiums in 2005 were reduced by \$67 million of reinstatement premiums related to catastrophe losses.

Net Investment Income

Refer to the "Net Investment Income" section of the "Consolidated Results of Operations" discussion herein for a description of the factors contributing to the increase in the Company's net investment income in 2007 and 2006.

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, and claims and policy management services to workers' compensation residual market pools. The \$83 million and \$72 million declines in fee income in 2007 and 2006, respectively, primarily resulted from lower serviced premium volume due to the depopulation of workers' compensation residual market pools, the impact of lower loss costs on fee income due to workers' compensation reforms, primarily in California, and lower new business volume due to increased competition.

Claims and Expenses

Claims and claim adjustment expenses in 2007 of \$6.67 billion declined by \$180 million, or 3%, from the 2006 total of \$6.85 billion, primarily reflecting an increase in net favorable prior year reserve development and continued favorable current accident year results, partially offset by an increase in business volume.

Net favorable prior year reserve development totaled \$301 million in 2007, compared with \$21 million in 2006. The 2007 total was primarily driven by better than expected loss development for recent accident years in the commercial multi-peril, general liability, commercial automobile and property product lines. The commercial multi-peril and general liability product lines experienced better than anticipated loss development that was attributable to several factors, including improved legal and judicial environments, as well as enhanced risk control, underwriting and claim process initiatives. The commercial automobile product line experienced better than expected loss development due to more favorable legal and judicial environments, claim handling initiatives focused on the automobile line of insurance and improvements in auto safety technology. The property product line experienced fewer than expected late reported claims related to non-catastrophe weather events that occurred late in 2006, as well as better than expected frequency and severity due in part to changes in the marketplace, such as higher deductibles and lower policy limits. In addition, the property product line experienced better than expected large loss outcomes which were partially attributable to favorable litigation resolutions. Net total prior year reserve development in 2007 included a \$185 million increase to environmental reserves. The Company's completion of its annual in-depth asbestos claim review in the third quarter of 2007 and its quarterly asbestos reserve reviews throughout the year resulted in no change to the Company's asbestos reserves in 2007. (Refer to the "Asbestos Claims and Litigation" and "Environmental Claims and Litigation" sections herein for additional discussion.)

In 2006, net favorable prior year reserve development in the commercial multi-peril, general liability, property and commercial automobile lines of business was largely offset by increases totaling \$275 million to asbestos and environmental reserves and reserve strengthening for assumed reinsurance business in runoff. The commercial multi-peril and liability lines of business experienced better than anticipated loss development in 2006 that was attributable to several factors, including improving legal and judicial environments, as well as enhanced risk control, underwriting and claim process initiatives. The favorable prior year reserve development in 2006 in the property line of business primarily reflected less "demand surge" inflation than originally estimated for 2005 accident year non-catastrophe

and catastrophe losses. "Demand surge" refers to significant short-term increases in building material and labor costs due to a sharp increase in demand for those materials and services. The commercial automobile line of business experienced better than expected loss development which was attributable to more favorable legal and judicial environments, claim handling initiatives focused on the automobile line of insurance and improvements in auto safety technology. The reserve strengthening in assumed reinsurance was primarily due to changes in projected loss development driven by an unanticipated change in the claim settlement patterns of the underlying casualty exposures.

Claims and claim adjustment expenses of \$6.85 billion in 2006 were \$2.51 billion lower than the 2005 total of \$9.36 billion, primarily due to a significant decline in catastrophe losses and net favorable prior year reserve development in 2006 compared with net unfavorable prior year reserve development in 2005. No catastrophe losses were incurred in 2006, whereas 2005 included catastrophe losses of \$1.32 billion, nearly all of which resulted from Hurricanes Katrina, Rita and Wilma.

Net favorable prior year reserve development totaled \$21 million in 2006, the components of which are described above. In 2005, net unfavorable prior year reserve development of \$757 million was driven by an increase to asbestos reserves of \$830 million and reserve strengthening for environmental claims and runoff assumed reinsurance business. Those increases were partially offset by favorable prior year reserve development from lower frequency and severity for both casualty and property-related lines of business, which were driven by increasingly favorable legal and judicial environments, coupled with better than expected results from changes in policy provisions as well as underwriting and pricing criteria. Company initiatives relating to claims handling, which affected claims staffing and workflows, also are believed to have contributed to the emergence of favorable severity experience in 2005.

The amortization of deferred acquisition costs totaled \$1.74 billion in 2007, 13% higher than the comparable 2006 total of \$1.55 billion. The increase reflected the growth in business volume, as well as a \$108 million increase from the implementation of the new fixed agent compensation program described in more detail in the "Consolidated Overview" section herein. In 2006, the amortization of deferred amortization costs of \$1.55 billion was slightly lower than the 2005 total of \$1.57 billion.

General and administrative expenses in 2007 totaled \$2.03 billion, 4% lower than the comparable total of \$2.10 billion in 2006. The implementation of the new fixed agent compensation program in the first quarter of 2007 resulted in a reduction of \$189 million in reported general and administrative expenses in 2007 compared to what would have been reported under the prior contingent commission program during those periods. That reduction was partially offset by an increase in expenses related to growth in business volume and continuing expenditures to support business growth and product development. The 2006 total included a provision for legal expenses related to investigations of various business practices by certain governmental agencies.

General and administrative expenses in 2006 totaled \$2.10 billion, 3% higher than the comparable total of \$2.04 billion in 2005. The increase in 2006 primarily reflected the segment's expenditures to support business growth and product development, the segment's share of costs associated with the Company's national advertising campaign and the legal expenses described above.

GAAP Combined Ratio

The loss and loss adjustment expense ratio of 57.1% in 2007 was 3.2 points lower than the comparable 2006 ratio of 60.3%. In 2007, net favorable prior year reserve development provided a 2.6 point benefit to the loss and loss adjustment expense ratio, whereas the 2006 loss and loss adjustment expense ratio included a 0.2 point benefit from net favorable prior year reserve development. Adjusting for the impact of prior year reserve development in both years, the loss and loss adjustment expense ratio in 2007 was 0.8 points better than the comparable 2006 ratio, reflecting continued favorable current accident year results. The loss and loss adjustment expense ratio in 2006 improved by 21.2 points compared with the 2005 ratio of 81.5%, primarily due to the absence of catastrophe losses and

net favorable prior year reserve development in 2006, compared with net unfavorable prior year reserve development in 2005. Catastrophe losses accounted for 12.3 points of the 2005 loss and loss adjustment expense ratio. Net favorable prior year reserve development in 2006 provided a 0.2 point benefit to the loss and loss adjustment expense ratio, whereas net unfavorable prior year reserve development in 2005 accounted for 6.8 points of the loss and loss adjustment expense ratio. Excluding catastrophe losses and prior year reserve development, the 2006 loss and loss adjustment expense ratio improved 1.9 points over the comparable 2005 ratio, reflecting improvement in frequency and severity trends in several lines of business in 2006.

The underwriting expense ratio of 30.7% in 2007, which included a 0.7 point benefit resulting from the implementation of the new fixed agent compensation program, was 0.1 points higher than the 2006 ratio, reflecting the increases in general and administrative expenses described above, and the impact of a decline in fee income. A portion of fee income is accounted for as a reduction of expenses for purposes of calculating the expense ratio. The underwriting expense ratio for 2006 was 1.7 points higher than the 2005 ratio, primarily reflecting the increases in general and administrative expenses described above, and the impact of declines in fee income. Catastrophe-related reinstatement premiums of \$67 million and catastrophe-related state assessments of \$18 million added 0.3 points to the 2005 expense ratio.

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		
	2007	2006	2005
Select Accounts	\$ 2,774	\$ 2,733	\$ 2,799
Commercial Accounts	2,740	2,613	2,535
National Accounts	1,859	2,169	2,627
Industry-Focused Underwriting	2,380	2,279	2,154
Target Risk Underwriting	2,182	2,187	2,040
Specialized Distribution	1,033	1,036	920
Total Business Insurance Core	12,968	13,017	13,075
Business Insurance Other	49	30	378
Total Business Insurance	\$ 13,017	\$ 13,047	\$ 13,453

(for the year ended December 31, in millions)	Net Written Premiums		
	2007	2006	2005
Select Accounts	\$ 2,711	\$ 2,663	\$ 2,722
Commercial Accounts	2,518	2,376	2,330
National Accounts	1,056	1,135	1,230
Industry-Focused Underwriting	2,301	2,196	2,080
Target Risk Underwriting	1,665	1,629	1,482
Specialized Distribution	1,015	1,022	908
Total Business Insurance Core	11,266	11,021	10,752
Business Insurance Other	52	25	247
Total Business Insurance	\$ 11,318	\$ 11,046	\$ 10,999

In Business Insurance Core, gross written premiums in 2007 declined \$49 million, or less than 1%, from the comparable 2006 total, whereas net written premiums increased \$245 million, or 2%, compared with 2006. The difference in growth rates between gross and net written premiums in 2007

was concentrated in National Accounts and was due to the nature of certain products offered in this market. A significant portion of gross written premiums for products offered by National Accounts is ceded to other insurers; as a result, a decline in gross written premiums does not necessarily have a proportional impact on net written premiums. All markets in Business Insurance Core operations, except National Accounts and Specialized Distribution, recorded net written premium growth in 2007, driven by higher new business volume throughout the majority of markets coupled with continued strong business retention rates, offset in some markets by minor decreases in renewal price changes. Net written premium growth in 2007 also benefited from a reduction in ceded premiums related to catastrophe reinsurance coverage.

In Business Insurance Core operations, gross written premiums in 2006 were down slightly from 2005. Net written premiums in 2006, however, increased slightly over 2005. The disparity between gross and net written premium growth rates in 2006 was primarily due to a change in the structure of reinsurance coverage in the Company's Discover Re subsidiary in National Accounts that resulted in a decline in ceded premiums. For purposes of comparison between 2006 and 2005 net written premium volume, the impact of a higher level of ceded premiums for property catastrophe reinsurance in 2006 was virtually equivalent to the impact of the \$67 million of catastrophe-related reinstatement premiums in 2005. Net written premium growth in Business Insurance Core operations in 2006 was primarily concentrated in Target Risk Underwriting and Industry-Focused Underwriting, driven by continued strong business retention rates, renewal price increases and higher new business volume throughout the majority of businesses comprising these markets. The decline in National Accounts' net written premiums primarily reflected a reduction in premiums related to favorable loss experience on business priced on a loss-sensitive basis and lower new business volume, partially offset by the decline in ceded premiums at Discover Re due to a change in the structure of reinsurance coverage. In Business Insurance Other operations, gross and net written premiums were down significantly from the comparable 2005 totals, reflecting the sale of the Personal Catastrophe Risk operation in November 2005 and the intentional non-renewal of business in the runoff operations comprising this category.

Select Accounts. Net written premiums of \$2.71 billion in 2007 grew 2% over 2006. New business volume increased over 2006, due in part to the introduction of the Company's enhanced quote-to-issue agency platform and multivariate pricing program in 37 states. That platform is expected to be introduced in the remainder of the United States over the next six months. Enhanced marketing efforts and additional products sold to existing customers also contributed to new business growth in 2007. Business retention rates remained strong in 2007. Renewal price changes in this market remained positive in 2007 but were lower than in 2006, as price increases for coastal coverages were partially offset by declines in renewal price changes for non-coastal coverages, which continue to be impacted by competitive market conditions. Net written premiums of \$2.66 billion in 2006 declined 2% from 2005, primarily reflecting the impact of a reduction in premium volume from certain national small business insurance programs, the majority of which was transferred to the Specialized Distribution market. Excluding the impact of the business transferred, net written premiums increased by approximately 2% in 2006. Business retention rates remained strong and increased over 2005, and focused investments in technology and personnel led to improvement in new business volume over 2005. Renewal price changes for the Select Accounts market in 2006 were consistent with 2005, as modest pricing pressures in non-coastal coverages were largely offset by price increases for coastal coverages.

Commercial Accounts. Net written premiums of \$2.52 billion in 2007 grew 6% over 2006, primarily driven by an increase in new business volume, coupled with continued strong business retention rates. The growth in new business volume reflected the impact of recent product introductions, additional products sold to existing customers and increased marketing efforts. Renewal price changes in this market declined from 2006 and were negative in 2007, primarily reflecting competitive market conditions. Net written premiums of \$2.38 billion in 2006 increased 2% over 2005, driven by a strong increase in business retention rates and an improvement in renewal pricing.

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National Accounts. Net written premiums of \$1.06 billion in 2007 declined 7% from 2006, primarily reflecting competitive market conditions that resulted in lower business volume. Net written premiums in 2006 declined by \$95 million, or 8%, from 2005, primarily reflecting a reduction in premiums related to favorable loss experience on business priced on a loss-sensitive basis and lower new business volume, partially offset by the decline in ceded premiums at Discover Re due to a change in the structure of reinsurance coverage.

Industry-Focused Underwriting. Net written premiums of \$2.30 billion in 2007 increased 5% over 2006. The increase was driven by the Construction business unit, where favorable economic conditions contributed to higher new business volume; the Oil & Gas business unit, due to increased business retention rates and continued strong renewal price changes; and the Public Sector unit, due to an increase in retention rates. In addition, continued strong new business volume and business retention rates in the Agribusiness business unit contributed to premium growth in 2007. Net written premiums in the Technology business unit in 2007 were level with 2006. Net written premiums of \$2.20 billion in 2006 increased by 6% over 2005, driven by growth in the Construction and Oil & Gas business units. Favorable economic conditions in these industry sectors, significant increases in business retention rates and continued strong new business volume contributed to the increase in premium volume in 2006 in these two business units. The remaining three business units in this market Technology, Agribusiness and Public Sector all achieved lesser degrees of net written premium growth over 2005.

Target Risk Underwriting. Net written premiums of \$1.67 billion in 2007 grew 2% over 2006, driven by increases in the Inland Marine and National Property business units. Strong growth in new business volume accounted for the increase in Inland Marine net written premium volume, whereas National Property's premium volume growth was driven by continued strong business retention rates and a decline in premiums ceded for catastrophe reinsurance coverage, partially offset by a decrease in renewal price changes, which were negative. Growth in these two business units was partially offset by a decline in Excess Casualty net written premiums. Net written premiums of \$1.63 billion in 2006 increased by 10% over 2005, driven by strong growth in the National Property and Inland Marine business units. Significant renewal price increases, particularly for Southeastern U.S. catastrophe-prone exposures, and strong business retention rates were the primary factors accounting for net written premium growth in these two business units in 2006. The Ocean Marine business unit also contributed to net written premium growth in 2006, primarily due to a decrease in the amount of business ceded.

Specialized Distribution. Net written premiums of \$1.02 billion in 2007 declined less than 1% from 2006. The decline was primarily due to premium reductions in the National Programs business unit, driven by reductions in new business volume and business retention rates due to competitive market conditions. These reductions were largely offset by premium growth in the Northland business unit due to strong business retention rates and new business volume. Net written premium volume in 2006 of \$1.02 billion increased 13% over 2005, primarily driven by the transfer of certain national small business insurance programs from Select Accounts to the National Programs business unit. In addition, Northland also experienced premium growth in 2006, primarily resulting from higher business retention rates and new business volume in commercial trucking, its primary line of business.

In Business Insurance Other, the decline in 2007 and 2006 net premium volume compared with 2005 reflected the impact of business in runoff and the sale of the Company's Personal Catastrophe Risk operation in November 2005. The runoff healthcare, reinsurance and international business acquired in the merger produced minimal written premium volume in 2007, 2006 and 2005.

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)	2007	2006	2005
Revenues:			
Earned premiums	\$ 3,384	\$ 3,321	\$ 3,197
Net investment income	494	429	360
Fee income			1
Other revenues	29	26	20
Total revenues	\$ 3,907	\$ 3,776	\$ 3,578
Total claims and expenses	\$ 2,981	\$ 2,968	\$ 2,961
Operating income	\$ 675	\$ 609	\$ 391
Loss and loss adjustment expense ratio	50.8%	53.7%	56.8%
Underwriting expense ratio	36.8	35.3	35.7
GAAP combined ratio	87.6%	89.0%	92.5%

Overview

In March 2007, the Company completed the sale of Afianzadora Insurgentes, which accounted for \$25 million, \$78 million and \$78 million of net written premiums for the years ended December 31, 2007, 2006 and 2005, respectively. The impact of this transaction was not material to the Company's results of operations or financial position.

Operating income of \$675 million in 2007 was \$66 million, or 11%, higher than operating income of \$609 million in 2006, primarily driven by an increase in net favorable prior year reserve development, higher net investment income and favorable current accident year results. These factors were partially offset by an increase in general and administrative expenses and non-catastrophe losses incurred in the United Kingdom related to flooding. Net favorable prior year reserve development totaled \$93 million in 2007, compared with \$14 million in 2006.

Operating income of \$609 million in 2006 increased by \$218 million, or 56%, over 2005. The improvement was driven by the absence of catastrophe losses in 2006, an increase in net investment income and growth in business volume, partially offset by a decline in net favorable prior year reserve development and an increase in general and administrative expenses. Operating income in 2006 also benefited from favorable tax impacts from businesses outside of the United States, including an \$18 million benefit associated with the then pending sale of Afianzadora Insurgentes. No catastrophe losses were incurred in 2006, whereas results in 2005 included \$191 million in catastrophe costs. Net favorable prior year reserve development totaled \$14 million in 2006, compared with \$72 million in 2005.

Earned Premiums

Earned premiums in 2007 were slightly higher than in 2006. Adjusting for the sale of Afianzadora Insurgentes in both years, earned premiums in 2007 grew 3% over 2006. Earned premium growth was concentrated in the International group, driven by the favorable impact of foreign currency rates of exchange and growth in business volume over the preceding twelve months. Earned premium growth in 2007 also benefited from adjustments to prior year premium estimates for the Company's operations at Lloyd's.

Earned premiums in 2006 increased \$124 million, or 4%, over 2005, primarily driven by growth in Bond & Financial Products. In addition, earned premiums in 2005 were reduced by \$33 million of

reinstatement premiums related to catastrophe losses, primarily in the Company's operations at Lloyd's. Earned premium volume in International in 2006 declined slightly from 2005, primarily reflecting the elimination of a one-month reporting lag at Lloyd's in 2005 that resulted in \$48 million of additional earned premiums being included in 2005 results. Also contributing to the decline in earned premiums in International in 2006 was the sale of certain classes of personal lines business at Lloyd's in the first quarter of 2005, which had accounted for \$43 million of earned premiums in 2005.

Net Investment Income

Refer to the "Net Investment Income" section of the "Consolidated Results of Operations" discussion herein for a description of the factors contributing to the increase in the Company's net investment income in 2007 and 2006.

Claims and Expenses

Claims and claim adjustment expenses totaled \$1.74 billion in 2007, a decrease of 3% from 2006, primarily reflecting an increase in net favorable prior year reserve development and the impact of the sale of Afianzadora Insurgentes, partially offset by the increase in business volume, \$37 million of non-catastrophe losses incurred in the United Kingdom in 2007 related to flooding and the impact of foreign currency rates of exchange. Net favorable prior year reserve development in 2007 totaled \$93 million, compared to \$14 million in 2006. The net favorable development in 2007 primarily reflected better than expected loss development in international property, employers' liability, professional indemnity and motor lines of business for recent accident years, which was attributable to several factors, including enhanced pricing and underwriting strategies throughout the International operations, and the favorable impact of legal and judicial reforms in Ireland.

Claims and claim adjustment expenses in 2006 totaled \$1.79 billion, a decrease of 1% from 2005. The 2006 total included no catastrophe losses and \$14 million of net favorable prior year reserve development, whereas the 2005 total included \$158 million of catastrophe losses and \$72 million of net favorable prior year reserve development. Net favorable prior year reserve development in 2005 was attributable to the better than anticipated favorable impact from changes in underwriting and pricing strategies for International property-related exposures.

General and administrative expenses totaled \$590 million in 2007, an increase of 10% over the 2006 of \$536 million. The increase primarily reflected the segment's continued expenditures to support business growth and the impact of foreign currency exchange rates. The Company's implementation of a new fixed agent compensation program in the first quarter of 2007 did not have a material impact on this segment. General and administrative expenses in 2006 increased by 5% over the 2005 total of \$509 million. The increase primarily reflected the segment's expenditures to support business growth and the segment's share of costs associated with the Company's national advertising campaign and legal expenses related to investigations of various business practices by certain governmental agencies.

GAAP Combined Ratio

The loss and loss adjustment expense ratio of 50.8% in 2007 was 2.9 points lower than the 2006 ratio of 53.7%. The 2007 ratio included a 2.7 point benefit from net favorable prior year reserve development, compared with a 0.4 point benefit in 2006. Excluding this factor in each year, the 2007 ratio was slightly lower than the 2006 ratio. The loss and loss adjustment expense ratio in 2006 was 3.1 points lower than the ratio of 56.8% in 2005. The 2006 ratio included no impact of catastrophe losses and a 0.4 point benefit from net favorable prior year reserve development, whereas the 2005 ratio included a 5.5 point impact from catastrophes and a 2.3 point benefit from net favorable prior year reserve development. Excluding those factors in each year, the 2006 ratio was slightly higher than the 2005 ratio.

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The underwriting expense ratio of 36.8% in 2007 was 1.5 points higher than the comparable 2006 expense ratio, driven by the increase in expenses supporting business growth. The underwriting expense ratio in 2006 improved by 0.4 points compared with 2005, benefiting from the absence of catastrophe-related reinstatement premiums and increased business volume. Reinstatement premiums of \$33 million increased the 2005 underwriting expense ratio by 0.4 points.

Written Premiums

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

Gross Written Premiums			
(for the year ended December 31, in millions)	2007	2006	2005
Bond & Financial Products	\$ 2,614	\$ 2,657	\$ 2,531
International	1,423	1,324	1,278
Total Financial, Professional & International Insurance	\$ 4,037	\$ 3,981	\$ 3,809

Net Written Premiums			
(for the year ended December 31, in millions)	2007	2006	2005
Bond & Financial Products	\$ 2,228	\$ 2,255	\$ 2,117
International	1,237	1,138	1,042
Total Financial, Professional & International Insurance	\$ 3,465	\$ 3,393	\$ 3,159

Gross and net written premiums in 2007 increased 1% and 2%, respectively, over 2006. Adjusting for the sale of Afianzadora Insurgentes, gross and net written premiums increased 3% and 4%, respectively, over 2006. Net written premiums in the Bond & Financial Products group in 2007 increased 1% over 2006 (adjusted for the sale of Afianzadora Insurgentes), primarily due to increased construction surety business volume resulting from strong economic conditions in the public works sector of the construction industry. For Bond and Financial Products (excluding the surety line of business, for which these are not relevant measures), business retention rates in 2007 increased over 2006. Renewal price changes in 2007 were slightly positive but down from 2006, and new business levels declined due in part to competitive market conditions. In the International group, net written premiums in 2007 increased \$99 million, or 9%, over 2006, primarily reflecting the favorable impact of foreign currency exchange rates and strong business volume at Lloyd's and in Canada. Net written premium volume in the International group in 2007 also benefited from adjustments to prior year premium estimates in the Lloyd's operation. In 2007, business retention rates remained strong, new business volume increased over 2006, and renewal price changes, which were negative, in the International group declined slightly from 2006.

The Financial, Professional & International Insurance segment's gross and net written premiums in 2006 increased 5% and 7%, respectively, over 2005. Growth in net written premium volume in 2006 resulted from strong construction surety volume in Bond & Financial Products, strong price increases for Southeastern U.S. catastrophe-prone exposures in the Company's operations at Lloyd's, strong business retention rates and new business volume in International, and the absence of catastrophe-related reinstatement premiums. The elimination of a reporting lag at the Company's operations at Lloyd's resulted in \$39 million and \$31 million of additional gross and net written premium volume in 2005, respectively. In Bond & Financial Products (excluding the surety line of business, for which these are not relevant measures), business retention rates in 2006 remained strong and increased over 2005. Renewal price increases in 2006 also increased over 2005, but new business volume was down slightly from 2005. For International in 2006, business retention rates increased over 2005, renewal price changes increased slightly and new business volume was significantly higher than in 2005. Net written premiums in the Financial, Professional & International Insurance segment for 2005 were reduced by

\$33 million of catastrophe-related reinstatement premiums, primarily related to the Company's operations at Lloyd's.

Personal Insurance

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

(for the year ended December 31, in millions)	2007	2006	2005
Revenues:			
Earned premiums	\$ 6,803	\$ 6,563	\$ 6,028
Net investment income	559	548	457
Other revenues	90	94	96
Total revenues	\$ 7,452	\$ 7,205	\$ 6,581
Total claims and expenses	\$ 5,996	\$ 5,555	\$ 5,464
Operating income	\$ 1,019	\$ 1,132	\$ 775
Loss and loss adjustment expense ratio	58.6%	54.8%	62.2%
Underwriting expense ratio	28.2	28.3	26.9
GAAP combined ratio	86.8%	83.1%	89.1%

Overview

In April 2007, the Company completed the sale of its subsidiary, Mendota Insurance Company, and its wholly-owned subsidiaries, Mendakota Insurance Company and Mendota Insurance Agency, Inc. (collectively, Mendota). These subsidiaries primarily offered nonstandard automobile coverage and accounted for \$49 million, \$187 million and \$137 million of net written premiums in the years ended December 31, 2007, 2006 and 2005, respectively. The impact of this transaction was not material to the Company's results of operations or financial position.

Operating income of \$1.02 billion in 2007 was \$113 million, or 10%, lower than operating income of \$1.13 billion in 2006, primarily reflecting a decline in net favorable prior year reserve development and an increase in catastrophe losses, partially offset by growth in business volume and net investment income. In addition, results in 2007 benefited from the Company's implementation of a new fixed agent compensation program, which is described in more detail in the "Consolidated Overview" section herein. Net favorable prior year reserve development in 2007 and 2006 totaled \$152 million and \$359 million, respectively. Catastrophe losses in 2007 totaled \$163 million, compared with catastrophe losses of \$103 million in 2006.

Operating income of \$1.13 billion in 2006 was \$357 million, or 46%, higher than operating income of \$775 million in 2005. Results in 2006 reflected a significant decline in catastrophe losses, strong growth in business volume, continued favorable current accident year loss trends and an increase in net investment income, partially offset by an increase in general and administrative expenses. Catastrophe losses in 2006 totaled \$103 million, compared with a cost of catastrophes of \$593 million in 2005. Results in both 2006 and 2005 benefited from significant net favorable prior year reserve development, which totaled \$359 million and \$360 million, respectively.

Earned Premiums

Earned premiums of \$6.80 billion in 2007 grew 4% over 2006, primarily reflecting continued strong business retention rates, increases in renewal price changes, and growth from new business volume over the preceding twelve months, partially offset by the impact of the sale of Mendota in early April 2007. Excluding the impact of Mendota in both years, earned premiums in 2007 increased 6% over 2006. In 2006, earned premiums of \$6.56 billion increased 9% over the 2005 total of \$6.03 billion, primarily due

to significant new business volume, renewal price increases and continued strong business retention rates over the prior twelve months. Earned premiums in 2005 were reduced by \$21 million of catastrophe-related reinstatement premiums.

Net Investment Income

Refer to the "Net Investment Income" section of the "Consolidated Results of Operations" discussion herein for a description of the factors contributing to the increase in the Company's net investment income in 2007 and 2006.

Claims and Expenses

Claims and claim adjustment expenses in 2007 totaled \$3.99 billion, an increase of \$390 million, or 11%, over 2006, primarily reflecting a decline in net favorable prior year reserve development, an increase in catastrophe losses and higher business volume, partially offset by the impact of the sale of Mendota.

Net favorable prior year reserve development in 2007 totaled \$152 million, compared with \$359 million in 2006. The 2007 total was driven by better than expected automobile loss experience due in part to claim initiatives and fewer than expected late reported homeowners' claims related to non-catastrophe weather events that occurred in the fourth quarter of 2006. In addition, a portion of net favorable prior year reserve development in the Homeowners and Other line of business in 2007 was attributable to a decrease in the number of claims due to changes in the marketplace, including higher deductibles and fewer small-dollar claims. The net favorable prior year reserve development in 2006 was driven by better than expected loss experience in the auto bodily injury and non-catastrophe related Homeowners and Other lines of business, and a reduction in loss estimates for the 2005 hurricanes. In the Automobile line of business, the improvement in 2006 was partially driven by better than expected results from changes in claim handling practices. These changes included practices which have allowed case reserves to be established more accurately earlier in the claim settlement process, thereby changing historical loss development patterns. In addition, industry and Company initiatives to fight fraud in several states led to a decrease in the total number of claims and a change in historical loss development patterns. In the Homeowners and Other line of business, favorable prior year reserve development in 2006 was partially driven by a significant decrease in the number of claims, attributable to changes in the marketplace, including higher deductibles and fewer small-dollar claims. These changes also resulted in a change in historical loss development patterns. In addition, for 2006, non-catastrophe related Homeowners and Other loss experience was favorable due to continued evidence of a less than expected impact from "demand surge," 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. Approximately \$100 million of net favorable prior year reserve development in 2006 resulted from a reduction in loss estimates for catastrophes incurred in 2005, primarily due to lower than expected additional living expense losses related to Hurricane Katrina.

Catastrophe losses in 2007 totaled \$163 million, \$60 million higher than the 2006 total of \$103 million. Catastrophe losses in 2007 were primarily the result of wildfires in California and several storms throughout the United States, whereas the 2006 total was driven by several wind, rain, hail and snow storms throughout the year in the United States.

Claims and claim adjustment expenses in 2006 totaled \$3.60 billion, a decline of \$154 million from the 2005 total of \$3.75 billion, primarily reflecting a reduction in catastrophe losses, which was partially offset by the impact of higher business volume in 2006. Catastrophe losses of \$103 million in 2006 declined significantly from the 2005 total of \$547 million. The 2005 catastrophe losses were primarily the result of Hurricanes Katrina, Rita and Wilma.

Net favorable prior year reserve development in 2006 and 2005 was \$359 million and \$360 million, respectively. The 2006 total was driven by the factors described above. In 2005, in the Automobile line of business, the improvement was partially driven by better than expected results from changes in claim handling practices. These changes included practices which have allowed case reserves to be established more accurately earlier in the claim settlement process, thereby changing historical loss development patterns. In addition, industry and Company initiatives to fight fraud in several states led to a decrease in the total number of claims in 2005 and a change in historical loss development patterns. In the Homeowners and Other line of business, favorable prior year reserve development in 2005 was partially driven by a significant decrease in the number of claims, attributable to changes in the marketplace, including higher deductibles and fewer small-dollar claims. These changes also resulted in a change in historical loss development patterns.

The amortization of deferred acquisition costs totaled \$1.31 billion in 2007, \$156 million, or 14%, higher than the comparable 2006 total of \$1.15 billion. The increase included \$94 million from the implementation of the new fixed agent compensation program in 2007 described in more detail in the "Consolidated Overview" section herein, as well as growth in business volume, partially offset by the impact of the sale of Mendota. In 2006, the amortization of deferred acquisition costs totaled \$1.15 billion, \$106 million, or 10%, higher than the comparable 2005 total of \$1.05 billion, primarily reflecting growth in business volume.

General and administrative expenses totaled \$699 million in 2007, a decrease of \$105 million, or 13%, from the 2006 total of \$804 million. The decrease in expenses in 2007 primarily reflected a decline in commission expenses resulting from the implementation of the new fixed agent compensation program, as well as the impact of the sale of Mendota, which were partially offset by expenses related to increased business volume, and continued investments to support business growth and product development. The implementation of the new fixed agent compensation program in 2007 resulted in a \$165 million reduction in reported general and administrative expenses, compared to what would have been reported under the prior contingent commission program.

General and administrative expenses of \$804 million in 2006 were \$139 million, or 21%, higher than the 2005 total of \$665 million. The increase reflected increased business volume, the segment's continued investments to support business growth and product development, legal expenses related to investigations of various business practices by certain governmental agencies, and the segment's share of costs associated with the Company's national advertising campaign. The 2005 total included \$25 million of catastrophe-related assessments.

GAAP Combined Ratio

The loss and loss adjustment expense ratio of 58.6% in 2007 was 3.8 points higher than the comparable 2006 ratio of 54.8%, primarily reflecting the decline in net favorable prior year reserve development. The ratio in 2007 included a 2.2 point benefit from net favorable prior year reserve development, compared with a 5.5 point benefit in 2006. Catastrophe losses accounted for 2.4 points and 1.6 points, respectively, of the loss and loss adjustment expense ratios in 2007 and 2006. Excluding the impact of prior year development and catastrophes in both years, the adjusted 2007 loss and loss adjustment expense ratio was 0.3 points lower than the adjusted 2006 ratio. The 2006 loss and loss adjustment expense ratio of 54.8% was 7.4 points lower than the comparable 2005 ratio of 62.2%. The 2005 ratio included a 9.3 point impact of catastrophe losses and a 6.0 point benefit from net favorable prior year reserve development. Excluding those factors from both years, the loss and loss adjustment expense ratio in 2006 was slightly lower than the comparable 2005 ratio, reflecting continued favorable trends in current accident year loss experience in 2006.

The underwriting expense ratio of 28.2% in 2007, which included a 1.0 point benefit from the implementation of the new fixed agent compensation program, was 0.1 points lower than the 2006

expense ratio of 28.3%, reflecting the impact of continued investments to support business growth and product development. The underwriting expense ratio of 28.3% in 2006 was 1.4 points higher than the 2005 expense ratio of 26.9%, primarily reflecting the impact of the increase in general and administrative expenses in 2006 described above, and a slight increase in commission expenses. In 2005, reinstatement premiums related to catastrophe losses reduced earned premium volume by \$21 million, and catastrophe-related assessments from various insurance pools increased taxes, licenses and fees by \$25 million. These factors combined to result in a 0.5 point unfavorable impact on the Personal Insurance segment's 2005 underwriting expense ratio.

Written Premiums

The Personal Insurance segment's gross and net written premiums by product line were as follows:

				Gross Written Premiums		
(for the year ended December 31, in millions)	2007	2006	2005			
Automobile	\$ 3,673	\$ 3,731	\$ 3,526			
Homeowners and Other	3,471	3,280	2,948			
Total Personal Insurance	\$ 7,144	\$ 7,011	\$ 6,474			
				Net Written Premiums		
(for the year ended December 31, in millions)	2007	2006	2005			
Automobile	\$ 3,628	\$ 3,692	\$ 3,477			
Homeowners and Other	3,207	3,019	2,751			
Total Personal Insurance	\$ 6,835	\$ 6,711	\$ 6,228			

Gross and net written premiums in 2007 both increased 2% over the respective totals in 2006. Adjusting for the sale of Mendota in both years, net written premiums in the Personal Insurance segment in 2007 increased 4% over 2006, driven by continued strong retention rates and increases in renewal price changes, partially offset by a decline in new business volume. Gross and net written premiums in 2006 increased 8% over 2005. Net written premium volume in 2006 reflected increased costs for property catastrophe coverage (which reduces net written premiums), while net written premiums in 2005 were reduced by \$21 million of catastrophe-related reinstatement premiums.

In the Automobile line of business, net written premiums in 2007 declined 2%, from 2006. Adjusting for the impact of the sale of Mendota, net written premiums in the Automobile line of business in 2007 increased 2% over 2006. That growth primarily reflected renewal price change increases coupled with continued strong retention rates, partially offset by a decline in new business volume due to competitive market conditions. The Company's multivariate pricing product in the Automobile line of business had been introduced in 39 states and the District of Columbia by the end of 2007. In 2006, net written premium growth of 6% over 2005 in the Automobile line of business primarily reflected a strong increase in new business, partially offset by the impact of transitioning to six-month policy terms in the second half of the year for the Company's multivariate pricing product that resulted in a lower amount of reported net written premiums in 2006. Business retention rates in 2006 remained strong and consistent with prior year rates. Renewal price changes in 2006 remained positive but were slightly below those in 2005. New business volume in 2006 was significantly higher than in 2005.

In the Homeowners and Other line of business, net written premiums in 2007 grew 6% over 2006, primarily reflecting renewal price change increases, particularly for coastal coverages, coupled with continued strong retention rates. New business volume in this line of business in 2007 declined from 2006, primarily driven by strategies to reduce exposure to losses on the Atlantic and Gulf coasts of the

United States. Adjusting for the sale of Mendota for both years, net written premiums in the Homeowners and Other line of business in 2007 increased 7% over 2006. Net written premiums in 2006 in this line of business grew 10% over 2005. Business retention rates and new business volume remained strong and increased over 2005. Renewal price changes in 2006 remained positive but declined from 2005. Net written premium volume in this line of business in 2006 also benefited from cross-selling initiatives involving the Company's automobile multivariate pricing product.

The Personal Insurance segment had approximately 7.2 million and 7.0 million policies in force at December 31, 2007 and 2006, respectively, excluding Mendota in both years. In the Automobile line of business, policies in force at December 31, 2007 increased 1% over the same date in 2006. Policies in force in the Homeowners and Other line of business at December 31, 2007 grew by 3% over the same date in 2006.

Interest Expense and Other

(for the year ended December 31, in millions)	2007	2006	2005
Net loss	\$ (209)	\$ (163)	\$ (184)

The \$46 million increase in net loss for Interest Expense and Other in 2007 compared with 2006 was driven by the impact of debt redemptions in each year. The net loss in 2007 included an after-tax loss of \$25 million related to the Company's redemption of its 4.50% convertible junior subordinated notes in April 2007, consisting of the redemption premium paid and the write-off of remaining debt issuance costs. Conversely, the net loss in 2006 was reduced by a \$27 million after-tax gain realized on the redemption of the Company's \$593 million, 7.6% subordinated debentures. After-tax interest expense in 2007 totaled \$224 million, compared with \$207 million in 2006. The net losses in this category for 2007 and 2006 were reduced by the favorable resolution of various prior year tax matters.

The \$21 million decline in net loss for Interest Expense and Other in 2006 compared with 2005 was primarily due to the \$27 million after-tax gain referred to above. Results in 2006 also reflected the favorable resolution of various prior year federal and state tax matters and the absence of expenses associated with the amortization of discount on forward contracts related to the Company's divestiture of Nuveen Investments that impacted the 2005 loss. These factors were partially offset by incremental interest expense in 2006 due to debt issuances during the year.

ASBESTOS CLAIMS AND LITIGATION

The Company believes that the property and casualty insurance industry has suffered from court decisions and other trends that have attempted to expand insurance coverage for asbestos claims far beyond the intent of insurers and policyholders. While the Company has experienced a decrease in asbestos claims over the past several years, the Company continues to receive a significant number of asbestos claims from the Company's policyholders (which includes others seeking coverage under a policy), including claims against the Company's policyholders by individuals who do not appear to be impaired by asbestos exposure. Factors underlying these claim filings include intensive advertising by lawyers seeking asbestos claimants and the 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. Bankruptcy proceedings have 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 loss and loss expense payments experienced by the Company. The Company's asbestos-related claims and claim adjustment expense experience has been impacted by the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or insolvency.

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 policyholders' 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.

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.

On July 6, 2007, the Company announced that it had entered into a settlement to resolve fully all current and future asbestos-related coverage claims relating to ACandS. Under the settlement agreement, the Company will contribute \$449 million to a trust to be established pursuant to ACandS' plan of reorganization. In exchange, the Company will be released from any obligations it has to ACandS for asbestos-related claims and will be protected from any such claims by injunctions to be issued in the Company's favor by the federal court overseeing ACandS' bankruptcy case. The settlement is subject to a number of contingencies. On August 27, 2007 the bankruptcy court overseeing ACandS' bankruptcy approved the settlement and no appeals from that approval were taken. As a result, the Company has placed \$449 million into escrow. Upon fulfillment of all contingencies, including final court approval of a plan of reorganization for ACandS and the issuance of the injunctions described above, those funds will be released from escrow to the trust created under ACandS' plan of reorganization. The release of the funds to the trust will be recorded as a paid claim and a reduction in claim reserves and, accordingly, there will be no effect on the Company's results of operations. The Company expects to seek to recover approximately \$84 million of the \$449 million from reinsurers. (Also, see "Part I Item 3, Legal Proceedings").

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. The Company anticipates the filing of other direct actions against insurers, including the Company, 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. Additionally, Travelers Property Casualty Corp. (TPC), a wholly-owned subsidiary of the Company, had entered into settlement agreements, which had been approved by the court in connection with the proceedings initiated by TPC in the Johns Manville

bankruptcy court. On March 29, 2006, the U.S. District Court for the Southern District of New York substantially affirmed the bankruptcy court's orders, while vacating that portion of the bankruptcy court's orders which required all future direct actions against TPC to first be approved by the bankruptcy court before proceeding in state or federal court. Various parties appealed the district court's March 29, 2006 ruling to the U.S. Court of Appeals for the Second Circuit. On February 15, 2008, the Second Circuit issued an opinion vacating the District Court's order on jurisdictional grounds. The parties' obligations under the settlement agreements are contingent upon approval of the bankruptcy court's order. Unless the Second Circuit's decision is reversed on further appeal and the bankruptcy court's order is reinstated and becomes final, the settlements will be voided, TPC will have no obligation to pay the amounts due under the settlement agreements (other than certain administrative expenses) and the Company intends to litigate the direct action cases vigorously. (For a description of these matters, see "Item 3 Legal Proceedings").

Because each policyholder presents different liability and coverage issues, the Company generally reviews the exposure presented by each policyholder at least annually. In the course of this review, the Company considers, among other factors: 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 each 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 2007, the Company completed its annual in-depth asbestos claim review. As in prior years, the 2007 annual review considered active policyholders and litigation cases, including cases challenging the applicability of aggregate limits on asbestos claims. The trends noted at the completion of the 2006 review continued into 2007. The trends include:

the emergence of more stable payment trends for a large proportion of policyholders;

a decrease in the number of new claims received;

a decrease in the number of large asbestos exposures confronting the Company due to additional settlement activity;

a decrease in the number and volatility of asbestos-related bankruptcies; and

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

The Company believes that these trends indicate a reduction in the volatility associated with the Company's overall asbestos exposure. Nonetheless, there remains a high degree of uncertainty with respect to future exposure from asbestos claims.

Beginning in 2007 the Company supplemented the existing annual in-depth asbestos claim review and the existing quarterly asbestos review process with additional aggregate quarterly reserve analyses. These additional analyses provide the Company with an increased ability to detect and respond to emerging trends in its quarterly reserve estimates.

The Company's asbestos reserve review includes an analysis of exposure and claim payment patterns by policyholder category, as well as recent settlements, policyholder bankruptcies, judicial rulings and legislative actions. Developing payment trends among policyholders in the Home Office, Field Office and Assumed and International categories are also analyzed. The Company also 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. For those policyholders for

which an estimate of the gross ultimate exposure for indemnity and related claim adjustment expense is determined, the Company calculates, by each policy year, a ceded reinsurance projection based on any applicable facultative and treaty reinsurance, past ceded experience and reinsurance collections. Conventional actuarial methods are not utilized to establish asbestos reserves.

In 2007, the Home Office and Field Office categories, which account for the vast majority of policyholders with active asbestos-related claims, continued to experience an overall reduction in new claim filings. In addition, the number of policyholders tendering asbestos claims for the first time also declined. However, due to the level of trial activity involving impaired individuals, defense and indemnity costs in these categories remain at levels similar to those previously experienced by the Company. The Company's evaluations have not resulted in any data from which a meaningful average asbestos defense or indemnity payment may be determined. Payments in the Assumed and International category increased in 2007 mainly as a result of increased commutation activity.

Net asbestos losses and expenses paid in 2007 were \$317 million, compared with \$469 million in 2006. Gross paid losses in 2007 were lower than in 2006 primarily due to installment payments made during 2006 on settlements reached in prior years. Additionally, net paid losses were lower due to increased reinsurance billings in 2007. Approximately 20% in 2007 and 50% in 2006 of total net paid losses related to policyholders with whom the Company previously 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	
	2007	2006	2007	2006	2007	2006
Policyholders with settlement agreements	22	27	\$ 62	\$ 235	\$ 1,152	\$ 879
Home office, field office and other	1,659	1,762	211	197	2,116	2,678
Assumed reinsurance and International			44	37	466	494
Total	1,681	1,789	\$ 317	\$ 469	\$ 3,734	\$ 4,051

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. Included in this category are TPC's settlements of the Statutory and Hawaii Actions and the Common Law Claims (collectively, the Direct Action Settlement). One of the contingencies of the Direct Action Settlement is affirmation by all appellate courts of the order entered by the U.S. Bankruptcy Court with respect to the Direct Action Settlement. On February 15, 2008 the Second Circuit issued an opinion vacating the District Court's order, which had substantially affirmed the bankruptcy court's order. Unless the Second Circuit's decision is reversed on further appeal and the bankruptcy court's order is reinstated and becomes final, the Direct Action Settlement will be voided, TPC will have no obligation to pay the amounts due under the Direct Action Settlement (other than certain administrative expenses) and the Company intends to litigate the direct action cases vigorously. In that event, the settlement funds will be returned to TPC's unallocated asbestos reserve. The Company will not make an adjustment to the level of its asbestos reserves as a result of the Second Circuit's decision. (For a description of these matters, see "Item 3 Legal Proceedings"). Also included in this category is the Company's announced settlement to resolve fully all current and future asbestos-related coverage claims relating to ACandS. The settlement was approved by the bankruptcy court and no appeals from that approval were taken. As a result, pursuant to the settlement, a \$449 million payment by the Company has been placed into escrow. Upon fulfillment of all remaining settlement contingencies, which includes final approval of a plan of reorganization for ACandS, those funds will be

released from escrow to the asbestos trust to be created under ACandS' plan of reorganization. The funds will be released back to the Company if the remaining settlement contingencies are not met. The ACandS matter was included in the home office, field office and other category in 2006. (For a description of this matter, see "Item 3 Legal Proceedings"). Coverage in place arrangements represent agreements with major policyholders on specified amounts of coverage to be provided. Payment obligations may be subject to annual maximums and are 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.

Home office, field office and other relates to policyholders for which settlement agreements have not been reached, and also includes unallocated IBNR. Policyholders are identified for 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, 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.

Assumed reinsurance exposure primarily consists of reinsurance of excess coverage, including various pool participations. International is exposed to U.S. asbestos liabilities through participations in excess insurance policies, quota share and excess of loss reinsurance policies, and retrocession policies, underwritten in the London insurance market. Details of exposures under the reinsurance and retrocession policies are identified only when the Company is advised by the cedant.

The Company recorded no asbestos reserve additions in 2007 and recorded pretax asbestos reserve additions of \$155 million and \$830 million in 2006 and 2005, respectively. Approximately half of the \$155 million 2006 pretax reserve adjustment was due to an increase in the projected defense costs for ten policyholders. The majority of the remainder of the reserve adjustment was primarily due to continued litigation activity against smaller, peripheral defendants. The asbestos reserve addition in 2005 resulted, in part, from higher than expected defense costs due to increased trial activity for seriously impaired plaintiffs and prolonged litigation before cases are settled or dismissed. The 2005 reserve addition also considered the January 2006 court decision voiding, on procedural grounds, the previously rendered favorable arbitration decision in the ongoing ACandS litigation (described in more detail in note 15). At December 31, 2007, net asbestos reserves totaled \$3.73 billion, compared with \$4.05 billion at December 31, 2006.

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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)	2007	2006	2005
Beginning reserves:			
Direct	\$ 4,777	\$ 5,103	\$ 4,775
Ceded	(726)	(739)	(843)
Net	4,051	4,364	3,932
Incurred losses and loss expenses:			
Direct	(1)	196	833
Ceded	1	(41)	(3)
Net		155	830
Accretion of discount:			
Direct		1	1
Ceded			
Net		1	1
Losses paid:			
Direct	423	523	506
Ceded	(106)	(54)	(107)
Net	317	469	399
Ending reserves:			
Direct	4,353	4,777	5,103
Ceded	(619)	(726)	(739)
Net	\$ 3,734	\$ 4,051	\$ 4,364

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

ENVIRONMENTAL CLAIMS AND LITIGATION

The Company 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 by settlement on a policyholder-by-policyholder basis as opposed to a claim-by-claim basis. 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 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 future liability arising from known specified sites or claims. These agreements also include appropriate 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 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 allegations of environmental harm at each site; the number of sites; the total number of potentially responsible parties at each site; the nature of 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. 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. These policyholders generally 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. However, the Company has experienced higher than expected defense and settlement costs driven in part by coverage disputes with its policyholders and adverse judicial developments in certain states regarding the availability of coverage for environmental claims. In addition, while the Company continues to experience a decline in both the number of new policyholders tendering claims for the first time and the number of pending lawsuits between the Company and its policyholders pertaining to coverage for environmental claims, the Company has seen a moderation in the rate of this decline. As a result of these factors, the Company increased its environmental reserve by \$185 million in 2007 and \$120 million in 2006. In

2005, the Company increased its environmental reserves by \$30 million, primarily for declaratory judgment litigation costs.

Net paid losses in 2007 and 2006 were \$113 million and \$127 million, respectively. TPC entered into a significant settlement with one policyholder in 2005. TPC executed an agreement with this policyholder which resolved all past, present and future hazardous waste and pollution property damage claims, and all related past and pending bodily injury claims. In 2006, the Company made the final payment related to this settlement and billed a substantial portion of the total settlement to its reinsurers. In addition, TPC and this policyholder entered into a coverage-in-place agreement which addressed the handling and resolution of all future hazardous waste and pollution bodily injury claims. Under the coverage-in-place agreement, TPC has no defense obligation, and there is an overall cap with respect to any indemnity obligation that might be owed.

At December 31, 2007, approximately 87% of the net environmental reserve (approximately \$428 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 13% of the net environmental reserve (approximately \$62 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)	2007	2006	2005
Beginning reserves:			
Direct	\$ 413	\$ 494	\$ 725
Ceded	5	(69)	(84)
Net	<u>418</u>	<u>425</u>	<u>641</u>
Incurred losses and loss expenses:			
Direct	182	108	17
Ceded	3	12	13
Net	<u>185</u>	<u>120</u>	<u>30</u>
Losses paid:			
Direct	117	189	248
Ceded	(4)	(62)	(2)
Net	<u>113</u>	<u>127</u>	<u>246</u>
Ending reserves:			
Direct	478	413	494
Ceded	12	5	(69)
Net	<u>\$ 490</u>	<u>\$ 418</u>	<u>\$ 425</u>

UNCERTAINTY REGARDING ADEQUACY OF ASBESTOS AND ENVIRONMENTAL RESERVES

As a result of the processes and procedures described above, management believes that the reserves carried for asbestos and environmental claims at December 31, 2007 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 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 some 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 and future developments pertaining to the Company's ability to recover reinsurance for asbestos and environmental claims. The Company's asbestos-related claims and claim adjustment expense experience has been impacted by the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or insolvency. In addition, uncertainties arise from the insolvency or bankruptcy of other defendants, although the Company has noted a decrease in the number and volatility of asbestos-related bankruptcies. 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 development will be affected by future court and regulatory decisions and interpretations, as well as changes in applicable legislation. 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 "Part I Item 3, Legal Proceedings").

Because of the uncertainties set forth above, additional liabilities may arise for amounts in excess of the current related 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, 2007 totaled \$74.82 billion, of which 94% was invested in fixed maturity and short-term investments, 1% in equity securities, 1% in real estate and 4% in other investments. Because the primary purpose of the investment portfolio is to fund future claims payments, the Company employs a conservative investment philosophy. The Company's fixed maturity portfolio at December 31, 2007 totaled \$64.92 billion, comprising \$64.50 billion of publicly traded fixed maturities and \$420 million of private fixed maturities. The weighted average quality ratings of the Company's publicly traded fixed maturity portfolio and private fixed maturity portfolio at December 31, 2007 were Aa1 and A3, respectively. Included in the fixed maturity portfolio at that date was approximately \$1.64 billion of below investment grade securities. During 2007, holdings of tax-exempt securities were increased to \$38.55 billion to take advantage of their relatively high credit quality and attractive after-tax yields. The average effective duration of the fixed maturity portfolio, including short-term investments, was 4.0 (4.3 excluding short-term investments), at both December 31, 2007 and 2006.

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

(at December 31, 2007, in millions)	Carrying Value	Percent of Total Carrying Value
Quality Rating:		
Aaa	\$ 43,946	67.7%
Aa	11,827	18.2
A	4,343	6.7
Baa	3,163	4.9
<hr/>		
Total investment grade	63,279	97.5
Non-investment grade	1,641	2.5
<hr/>		
Total fixed maturity investments	\$ 64,920	100.0%

The Company makes investments in residential collateralized mortgage obligations (CMOs) that typically have high credit quality, offer good liquidity and are expected to provide an advantage in yield compared to U.S. Treasury securities. The Company's investment strategy is to purchase CMO tranches which offer the most favorable return given the risks involved. One significant risk evaluated is prepayment sensitivity. While prepayment risk (either shortening or lengthening of duration) and its effect on total return cannot be fully controlled, particularly when interest rates move dramatically, the investment process generally favors securities that control this risk within expected interest rate ranges. The Company does not purchase residual interests in CMOs.

At December 31, 2007 and 2006, the Company held CMOs classified as available for sale with a fair value of \$3.59 billion and \$3.56 billion, respectively. Approximately 31% and 36% of the Company's CMO holdings are guaranteed by or fully collateralized by securities issued by GNMA, FNMA or FHLMC at December 31, 2007 and 2006, respectively. In addition, the Company held \$3.79 billion and \$4.36 billion of GNMA, FNMA, FHLMC or FHA mortgage-backed pass-through securities classified as available for sale at December 31, 2007 and 2006, respectively. Virtually all of these securities are rated Aaa.

At December 31, 2007 and 2006, the Company held commercial mortgage-backed securities (CMBS) of \$935 million and \$1.07 billion, respectively. At December 31, 2007, approximately \$302 million of these securities, or the loans backing such securities, contain guarantees by the United States Government or a government-sponsored enterprise and \$26 million were comprised of Canadian non-guaranteed securities. The remaining \$607 million at December 31, 2007, were comprised of U.S. non-guaranteed securities, issued in 2004 and prior years. The average credit rating of these securities was "Aaa." The CMBS portfolio is supported by loans that are diversified across economic sectors and geographical areas. 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 underlying credit strength of these securities.

The Company's fixed maturity investment portfolio at December 31, 2007 included asset-backed securities collateralized by sub-prime mortgages and collateralized mortgage obligations backed by alternative documentation mortgages with a collective market value of \$286 million (comprising approximately 0.4% of the Company's total fixed maturity investments). The Company defines sub-prime mortgage-backed securities as investments which contain loans to borrowers that exhibit one or more of the following characteristics: low FICO scores, above-prime interest rates, high loan-to-value ratios, high debt-to-income ratios, low loan documentation (e.g., limited or no verification of income and assets), or other characteristics that are inconsistent with conventional underwriting standards employed by government-sponsored mortgage entities. Alternative documentation mortgages are mortgage loans with low loan documentation as described above. The average credit rating on all of these securities and obligations held by the Company was "Aaa" at December 31, 2007. No securities in the residential mortgage portfolio were downgraded in 2007.

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The Company's fixed maturity investment portfolio at December 31, 2007 included securities issued by numerous municipalities with a total carrying value of \$38.82 billion. Approximately \$14.10 billion, or 36%, of the securities were enhanced by third-party insurance for the payment of principal and interest in the event of an issuer default. Such insurance generally results in a rating of "Aaa" being assigned by independent ratings agencies to those securities. The downgrade of credit ratings of insurers of these securities could result in a corresponding downgrade in the ratings of the securities from "Aaa" to the underlying rating of the respective security without giving effect to the benefit of insurance. Of the total \$14.10 billion of insured municipal securities in the Company's investment portfolio, approximately 96% were rated at A3 or above, and approximately 76% 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 Company's real estate investments include warehouses and office buildings and other commercial land and properties that are directly owned. The Company's other investments primarily comprise venture capital, through direct ownership and limited partnerships, private equity limited partnerships, joint ventures, other limited partnerships and trading securities, which are subject to more volatility than the Company's fixed income investments, but historically have provided a higher return. At December 31, 2007 and 2006, the carrying value of the Company's other investments was \$3.37 billion and \$3.40 billion, respectively. The Company does not believe it has a material exposure to sub-prime mortgages within its other investments portfolio based on recent information provided by the limited partnerships.

The net unrealized investment gains (losses) that were included as a separate component of accumulated other changes in equity from nonowner sources were as follows:

(for the year ended December 31, in millions)	2007	2006	2005
Fixed maturities	\$ 768	\$ 422	\$ 367
Equity securities	15	37	41
Venture capital	17	108	89
Other investments (excluding venture capital)	138	113	(12)
	<u>938</u>	<u>680</u>	<u>485</u>
Unrealized investment gains before tax	938	680	485
Provision for taxes	318	227	158
	<u>620</u>	<u>453</u>	<u>327</u>
Net unrealized investment gains at end of year	\$ 620	\$ 453	\$ 327

Net pretax unrealized investment gains at December 31, 2007 increased by \$258 million over year-end 2006, primarily driven by the fixed maturity portfolio. The increase in net unrealized investment gains on fixed maturities was primarily driven by the impact of declining market interest rates on both taxable and tax-exempt securities, which were partially offset by an increase in credit spreads and a decrease in unrealized investment gains in the venture capital portfolio, primarily due to sale activities. In May 2007, the Company completed a bundled sale of a substantial portion of its venture capital portfolio, which resulted in the realization of \$81 million of previously unrealized net investment gains.

Net pretax unrealized investment gains at December 31, 2006 increased by \$195 million over year-end 2005, primarily concentrated in the fixed maturity portfolio and in other investments carried at fair value. The increase in net unrealized investment gains on fixed maturities was primarily driven by the impact of declining market interest rates on tax-exempt securities, which was partially offset by a slight increase in market interest rates on taxable securities.

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Impairment charges included in net realized investment gains were as follows:

(for the year ended December 31, in millions)	2007	2006	2005
Fixed maturities	\$ 37	\$ 7	\$ 11
Equity securities	7	4	
Real estate	10		
Venture capital	16	33	80
Other investments (excluding venture capital)		4	18
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 70	\$ 48	\$ 109
	<u> </u>	<u> </u>	<u> </u>

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For the year ended December 31, 2007, the Company recognized the following other-than-temporary impairments:

\$37 million in the fixed maturities portfolio, consisting of \$23 million resulting from the potential to sell various holdings prior to a recovery in market value and \$14 million related to credit risk associated with various issuers' deteriorated financial position;

\$7 million in the equity portfolio when it was determined that the cost basis of those securities would not be recovered over the expected holding period;

\$10 million in the real estate portfolio, related to the fundamental decline in the financial condition of one real estate development property; and

\$16 million in the venture capital portfolio on 14 holdings. Three of the holdings were public securities whose cost basis was not anticipated to be recovered over the expected holding period. Nine holdings experienced fundamental economic deterioration (characterized by less than expected revenues or a fundamental change in product). The remaining two holdings were impaired due to the impending sale, liquidation or shutdown of the entity.

For the year ended December 31, 2006, the Company recognized the following other-than-temporary impairments:

\$7 million in the fixed maturities portfolio, consisting of \$6 million resulting from the potential to sell various holdings prior to a recovery in market value and \$1 million related to credit risk associated with various issuers' deteriorated financial position;

\$4 million in the equity portfolio when it was determined that the cost basis of those securities would not be recovered over the expected holding period;

\$33 million in the venture capital portfolio on 16 holdings. Four of the holdings were impaired due to new financings on unfavorable terms. Six holdings experienced fundamental economic deterioration (characterized by less than expected revenues or a fundamental change in product). Four of the holdings were impaired due to the impending sale, liquidation or shutdown of the entity. Two of the holdings were public securities whose cost basis was not anticipated to be recovered over the expected holding period; and

\$4 million in other investments (excluding venture capital). The loss recorded was the result of one mortgage loan refinancing at less favorable terms.

For the year ended December 31, 2005, the Company recognized the following other-than-temporary impairments:

\$11 million in the fixed maturities portfolio related to various issuers due to credit risk associated with the issuer's deteriorated financial position;

\$80 million in the venture capital portfolio on 22 holdings. Two of the holdings were impaired due to new financings on unfavorable terms. Fifteen holdings experienced fundamental economic deterioration (characterized by less than expected revenues or a fundamental change in product). Three of the holdings were impaired due to the impending sale, liquidation or shutdown of the entity. Two of the holdings were public securities whose cost basis was not anticipated to be recovered over the expected holding period; and

\$18 million in other investments (excluding venture capital). The losses recorded were the result of an equity partnership and a private stock holding which both experienced fundamental deterioration in their financial position.

The specific circumstances that led to the impairments described above did not materially impact other individual investments held during 2007, 2006 or 2005. The Company continually evaluates current developments in the market that have the potential to affect the valuation of the Company's investments.

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The following table summarizes for all fixed maturities and equity securities available for sale for which fair value is less than 80% of amortized cost or cost at December 31, 2007, the gross unrealized investment loss by length of time those securities have continuously been in an unrealized loss position:

(in millions)	Period For Which Fair Value Is Less Than 80% of Amortized Cost				Total
	Less Than 3 Months	Greater Than 3 Months, Less Than 6 Months	Greater Than 6 Months, Less Than 12 Months	Greater Than 12 Months	
Fixed maturities	\$ 7	\$	\$	\$	\$ 7
Equity securities	2				2
Total	\$ 9	\$	\$	\$	\$ 9

Unrealized investment losses as of December 31, 2007 represent less than 1% of the portfolio, and, therefore, any impact on the Company's financial position would not be significant.

At December 31, 2007, non-investment grade securities comprised 3% of the Company's fixed income investment portfolio. Included in those categories at December 31, 2007 were securities in an unrealized loss position that, in the aggregate, had an amortized cost of \$799 million and a fair value of \$762 million, resulting in a net pretax unrealized investment loss of \$37 million. These securities in an unrealized loss position represented approximately 1% of the total amortized cost and approximately 1% of the fair value of the fixed income portfolio at December 31, 2007, and accounted for 12% of the total pretax unrealized investment loss in the fixed income portfolio.

Following are the pretax realized losses on investments sold during the year ended December 31, 2007:

(in millions)	Loss	Fair Value
Fixed maturities	\$ 34	\$ 1,621
Equity securities	1	31
Other		4
Total	\$ 35	\$ 1,656

Resulting 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.

REINSURANCE RECOVERABLES

Ceded reinsurance involves credit risk, except with regard to mandatory pools, 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 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.

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The Company's reinsurance recoverables totaled \$15.64 billion at December 31, 2007, a decline of \$2.18 billion from year-end 2006, primarily reflecting significant collections on reinsurance recoverables, including those related to prior year hurricane losses, operations in runoff (primarily Gulf) and various commutation agreements.

The following presents the Company's top five reinsurer groups, by reinsurance recoverables at December 31, 2007 (in millions). Also included is the A.M. Best rating of each reinsurer group at February 21, 2007:

Reinsurer Group	Reinsurance Recoverables	A.M. Best Rating of Group's Predominant Reinsurer	
Swiss Re Group	\$ 1,266	A+	second highest of 16 ratings
Munich Re Group(1)	994	A+	second highest of 16 ratings
Berkshire Hathaway Group	591	A++	highest of 16 ratings
American International Group(2)	553	A+	second highest of 16 ratings
XL Capital Group(3)	511	A	third highest of 16 ratings

- (1) On January 30, 2008, A.M. Best upgraded the financial strength rating of Munich Reinsurance America, Inc. from "A" to "A+."
- (2) On February 14, 2008, A.M. Best placed the financial strength ratings of "A+" of most of American International Group's domestic property casualty subsidiaries and its 60% majority-owned company, Transatlantic Holdings, Inc., under review with negative implications.
- (3) On January 25, 2008, A.M. Best downgraded the financial strength rating of XL Capital Group to "A" from "A+."

At December 31, 2007, \$3.0 billion of reinsurance recoverables were collateralized by letters of credit, trust agreements and funds held.

OUTLOOK

The Company's strategic objective is to enhance its position as a consistently profitable market leader and a cost-effective provider of property and casualty insurance in the United States and in selected international markets. A variety of factors continue to affect the property and casualty insurance market and the Company's core business outlook for 2008, including competitive conditions in the markets served by the Company's business segments, loss cost trends, interest rate trends and the investment environment.

Competition. The Company expects property casualty market conditions to continue to become modestly more competitive in 2008, particularly for new business. The pricing environment for new business generally has less of an impact on underwriting profitability than renewal price changes, particularly in an environment of high retention rates, which the Company has experienced over the past several years. In the Business Insurance and the Financial, Professional & International Insurance segments, the Company expects renewal price changes in 2008 will modestly decline from their 2007 levels. In the Personal Insurance segment, the Company expects automobile and homeowners renewal price changes will increase slightly compared to their 2007 levels. These expectations for the pricing environment, when combined with expected modestly increased loss costs, will likely result in somewhat reduced underwriting profitability in 2008 as compared to 2007.

Loss Cost Trends. Loss cost trends are primarily driven by changes in claim frequency and claim severity. The industry has generally experienced unprecedented low levels of non-catastrophe related claim frequency over the last several years. The Company expects this trend in claim frequency to continue in 2008 in certain lines of business, while claim frequency is expected to increase modestly in other lines of business. The Company also expects severity to increase modestly for non-catastrophe related claims.

The Company believes that the overall trend of increased frequency and severity of catastrophic Gulf and Atlantic Coast storms experienced in recent years may continue for the foreseeable future, although the trend was not evident in the United States in 2007 and 2006. Given the potential increase in frequency and severity of storms, the Company will continue to reassess its definition of, and exposure to, coastal risks. These risks will be reflected in the pricing and terms and conditions it will offer in coastal areas. Due in part to the increased frequency and severity of the Gulf and Atlantic Coast storms, there has been some disruption in the market for coastal wind insurance, most significantly in personal lines, as insurers, including the Company, have reduced capacity and increased prices. The continued disruption in market conditions, along with the potential for increased frequency and severity of coastal storms, could result in a decrease in the amount of coastal wind coverage that the Company is able or willing to write.

In recent periods, the Company has recorded net favorable prior year reserve development, primarily driven by better than expected loss experience in all of the Company's segments for prior loss years. If better than expected loss experience continues, the Company may record additional net favorable prior year reserve development in 2008. In that case, the Company may also concurrently revise favorably its current year loss estimates. However, better than expected loss experience may not continue or may reverse, in which case the Company may record no favorable prior year reserve development or net unfavorable prior year reserve development in future periods. In that case, the Company may revise current year loss estimates upward in future periods.

Investment Returns. Changes in the general interest rate environment affect the returns available on new investments. While a rising interest rate environment enhances the returns available on new fixed income investments, thereby favorably impacting net investment income, it reduces the market value of existing fixed maturity investments, and therefore, shareholders' equity. A decline in interest rates reduces the returns available on new investments, thereby negatively impacting net investment income, but increases the market value of existing investments and therefore, shareholders' equity. In 2007, short-term and long-term interest rates declined. A downward trend in interest rates may continue into 2008.

At December 31, 2007, approximately 6% of the Company's invested assets were comprised of equity securities, venture capital investments, private equity limited partnerships, joint ventures, other limited partnerships and trading securities, which are subject to greater volatility than fixed income investments. General economic conditions, stock market conditions and many other factors beyond the Company's control may affect the value of these non-fixed income investments and the realization of net investment income. The Company is not able to predict future market conditions or their impact on net investment income.

Net investment income is an important contributor to the Company's results of operations, and the Company expects the investment environment to become more challenging in 2008, particularly with respect to its non-fixed income investment portfolio.

For a discussion of potential risks that could impact the Company's financial condition or results of operations, see Item 1A "Risk Factors" in this report.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet the short- and long-term cash requirements of its business operations. The liquidity requirements of the Company's business have been met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims and claim adjustment expense payments and operating expenses. 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 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. The Company also maintains liquidity at the holding company level. At December 31, 2007, total cash, short-term invested assets and other readily marketable securities aggregating \$1.62 billion were held at the holding company. The assets held at the holding company, combined with other sources of funds available, primarily additional dividends from operating subsidiaries, are sufficient to meet the Company's current liquidity requirements. These liquidity requirements primarily include shareholder dividends and debt service. The Company also has the ability to issue securities under its shelf registration statement with the Securities and Exchange Commission and has access to liquidity through its \$1 billion line of credit.

Operating Activities

Net cash flows provided by operating activities of continuing operations totaled \$5.29 billion, \$4.77 billion and \$3.59 billion in 2007, 2006 and 2005, respectively. Cash flows in each of 2007 and 2006, as compared to the preceding year, reflected higher levels of collected premiums and net investment income, lower claim payments on catastrophe losses, as well as lower runoff claim payments. Cash flows from operations in 2007 and 2006 benefited from significant collections on reinsurance recoverables in both years, including those related to 2005 hurricane losses, operations in runoff (primarily Gulf) and various commutation agreements. These factors were partially offset by an increase in tax payments resulting from higher profitability, expenses related to increased business volume and continued expenditures to support business growth and product development, and higher interest payments. Cash flows in 2005 reflected an increase in loss and loss adjustment expense payments primarily related to the catastrophe losses incurred during 2005 and 2004, and an increase in tax payments resulting from higher profitability. The Company utilized \$11 million, \$11 million and \$2.00 billion of net operating loss (NOL) carryforwards during 2007, 2006 and 2005, respectively, thereby reducing current regular tax payments by \$4 million, \$4 million and \$698 million, respectively.

Net cash flows provided by operating activities for all three years were negatively impacted by payments for asbestos and environmental liabilities, as well as by payments for claims related to the Company's runoff operations.

Investing Activities

Net cash flows used in investing activities of continuing operations totaled \$2.53 billion, \$3.06 billion and \$5.44 billion in 2007, 2006 and 2005, respectively. Fixed maturity securities accounted for the majority of investment purchases in all three years. As discussed in more detail in "Part I Item 3, Legal Proceedings," in 2007, the Company announced that it had entered into a settlement agreement, subject to contingencies, to resolve fully all current and future asbestos-related coverage claims relating to ACandS, Inc. As a result, the Company has placed \$449 million into escrow. Upon fulfillment of all settlement contingencies, including final court approval of a plan of reorganization for ACandS and the issuance of the injunctions described in "Part I Item 3, Legal Proceedings," those funds will be released from escrow to the trust created under ACandS' plan of reorganization. The Company funded the escrow through the purchase of short-term securities.

The majority of funds available for investment are deployed in a widely diversified portfolio of high quality, liquid intermediate-term taxable U.S. government, corporate and mortgage backed bonds and tax-exempt U.S. municipal bonds. 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 Company's management of the duration of the fixed income investment portfolio generally produces a duration that exceeds the estimated duration of the Company's net insurance liabilities. The average duration of fixed maturities and short-term securities was 4.0 at December 31, 2007 and 2006.

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The Company also invests much smaller amounts in equity securities, venture capital and real estate. 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. During 2007, the Company sold a substantial portion of its venture capital investment portfolio.

The primary goals of the Company's asset liability management process are to satisfy the insurance liabilities, manage the interest rate risk embedded in those 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 income 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 degree by which the market value of the fixed income portfolio exceeds the expected present 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, provide assurance of the Company's ability to fund the payment of claims without having to sell illiquid assets or access credit facilities.

Sale of Subsidiary. The Company's cash flows in 2005 included \$2.40 billion of pretax proceeds (after underwriting fees and transaction costs) from the divestiture of its equity interest in Nuveen Investments. Of this amount, \$405 million was received directly by the Company's insurance subsidiaries, and the remainder was received directly by the holding company. Of the proceeds received directly by the holding company, \$1.225 billion was contributed to the capital of the Company's insurance subsidiaries, with the remainder available for general corporate purposes.

Financing Activities

Net cash flows used in financing activities of continuing operations totaled \$2.95 billion, \$1.59 billion and \$473 million in 2007, 2006 and 2005, respectively. The 2007 total primarily reflected common share repurchases, the early redemption of debt, the repayment of maturing debt and dividends to shareholders, partially offset by the issuance of debt and proceeds from employee stock option exercises. The 2006 total primarily reflected common share repurchases, the early redemption of debt and the repayment of maturing debt, and dividends to shareholders, partially offset by proceeds from the issuance of debt and employee stock option exercises. In 2005, the total primarily reflected the repayment of debt and dividends to shareholders, which were partially offset by the issuance of common stock pursuant to the maturity of equity unit forward contracts and the issuance of debt.

Debt Transactions.

2007. In January 2007, the Company redeemed \$81 million of 8.47% subordinated debentures originally issued in 1997 and due January 10, 2027. The debentures were redeemable by the Company on or after January 10, 2007. In January 1997, USF&G Capital II, a business trust, issued \$100 million of capital securities, the proceeds of which, along with \$3 million in capital provided by the Company, were used to purchase the subordinated debentures issued by USF&G Corporation and subsequently assumed by the Company after the merger of The St. Paul Companies Inc. (SPC) and Travelers Property Casualty Corp. (TPC). During the period prior to redemption, the Company had repurchased and retired \$22 million of the debentures in open market transactions. Upon the Company's redemption of the remaining \$81 million of subordinated debentures in January 2007, USF&G Capital II in turn used the proceeds to redeem its remaining capital securities outstanding. USF&G Capital II was then liquidated, and the Company received a \$3 million distribution of capital. The Company recorded a \$3 million pretax gain on the redemption of the subordinated debentures, due to the remaining unamortized fair value adjustment recorded at the merger date, less the redemption premium paid.

In March 2007, the Company issued \$1 billion aggregate principal amount of 6.25% fixed-to-floating rate junior subordinated debentures due March 15, 2067 for net proceeds of \$986 million (after original issue discount and the deduction of underwriting expenses and commissions

and other expenses). The debentures were issued at a discount, resulting in an effective interest rate of 6.447%. The debentures bear interest at an annual rate of 6.25% from the date of issuance to, but excluding, March 15, 2017, payable semi-annually in arrears on March 15 and September 15. From and including March 15, 2017, the debentures will bear inte