TRAVELERS COMPANIES, INC.
Form 10-Q
July 26, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2007**

**or**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file number 001-10898**

## The Travelers Companies, Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Minnesota** | **41-0518860** |
| (State or other jurisdiction of incorporation or organization) | (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)

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 x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares of the Registrant s Common Stock, without par value, outstanding at July 19, 2007 was 656,515,649.

**The Travelers Companies, Inc.**

**Quarterly Report on Form 10-Q**

**For Quarterly Period Ended June 30, 2007**

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**Item 1. FINANCIAL STATEMENTS**

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF INCOME (Unaudited)**

(in millions, except per share data)

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Six Months Ended June 30, 2007 | Six Months Ended June 30, 2006 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Premiums | **$ 5,327** | $ 5,181 | **$ 10,622** | $ 10,172 |
| Net investment income | **990** | 874 | **1,950** | 1,749 |
| Fee income | **127** | 153 | **247** | 303 |
| Net realized investment gains | **128** | 10 | **142** | 4 |
| Other revenues | **1** | 37 | **39** | 77 |
| **Total revenues** | **6,573** | 6,255 | **13,000** | 12,305 |
| | | | | |
| **Claims and expenses** | | | | |
| Claims and claim adjustment expenses | **3,096** | 3,153 | **6,285** | 6,195 |
| Amortization of deferred acquisition costs | **915** | 814 | **1,784** | 1,614 |
| General and administrative expenses | **836** | 866 | **1,669** | 1,660 |
| Interest expense | **85** | 78 | **161** | 154 |
| **Total claims and expenses** | **4,932** | 4,911 | **9,899** | 9,623 |
| | | | | |
| **Income before income taxes** | **1,641** | 1,344 | **3,101** | 2,682 |
| Income tax expense | **387** | 374 | **761** | 706 |
| **Net income** | **$ 1,254** | $ 970 | **$ 2,340** | $ 1,976 |
| | | | | |
| **Net income per share** | | | | |
| Basic | **$ 1.90** | $ 1.40 | **$ 3.52** | $ 2.85 |
| Diluted | **$ 1.86** | $ 1.36 | **$ 3.41** | $ 2.76 |
| | | | | |
| **Weighted average number of common shares outstanding** | | | | |
| Basic | **658.6** | 691.8 | **664.2** | 692.0 |
| Diluted | **676.0** | 720.4 | **688.6** | 720.6 |

See notes to consolidated financial statements (unaudited).

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEET**

(in millions)

| | June 30, 2007 | December 31, 2006 |
|---|---|---|
| | (Unaudited) | |
| **Assets** | | |
| Fixed maturities, available for sale at fair value (including $1,666 and $1,674 subject to securities lending) (amortized cost $63,912 and $62,244) | $ 63,321 | $ 62,666 |
| Equity securities, at fair value (cost $432 and $436) | 464 | 473 |
| Real estate | 867 | 793 |
| Short-term securities | 4,480 | 4,938 |
| Other investments | 3,225 | 3,398 |
| **Total investments** | 72,357 | 72,268 |
| | | |
| Cash | 562 | 459 |
| Investment income accrued | 862 | 827 |
| Premiums receivable | 6,489 | 6,181 |
| Reinsurance recoverables | 16,734 | 17,820 |
| Ceded unearned premiums | 1,341 | 1,243 |
| Deferred acquisition costs | 1,797 | 1,615 |
| Deferred tax asset | 1,700 | 1,536 |
| Contractholder receivables | 6,737 | 6,554 |
| Goodwill | 3,366 | 3,438 |
| Other intangible assets | 884 | 764 |
| Other assets | 2,532 | 2,587 |
| **Total assets** | $ 115,361 | $ 115,292 |
| | | |
| **Liabilities** | | |
| Claims and claim adjustment expense reserves | $ 58,504 | $ 59,288 |
| Unearned premium reserves | 11,459 | 11,228 |
| Contractholder payables | 6,737 | 6,554 |
| Payables for reinsurance premiums | 784 | 685 |
| Debt | 6,733 | 5,760 |
| Other liabilities | 5,822 | 6,642 |
| **Total liabilities** | 90,039 | 90,157 |
| | | |
| **Shareholders equity** | | |
| Preferred Stock Savings Plan convertible preferred stock (0.4 shares issued and outstanding at both dates) | 119 | 129 |
| Common stock (1,750.0 shares authorized; 657.0 and 678.3 shares issued and outstanding) | 18,839 | 18,530 |
| Retained earnings | 9,228 | 7,253 |
| Accumulated other changes in equity from nonowner sources | (220) | 452 |
| Treasury stock, at cost (51.8 and 25.2 shares) | (2,644) | (1,229) |
| **Total shareholders equity** | 25,322 | 25,135 |
| **Total liabilities and shareholders equity** | $ 115,361 | $ 115,292 |

See notes to consolidated financial statements (unaudited).

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**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (Unaudited)**

(in millions)

| For the six months ended June 30, | 2007 | 2006 |
|---|---|---|
| **Convertible preferred stock savings plan** | | |
| Balance, beginning of year | **$ 129** | $ 153 |
| Redemptions during period | **(10)** | (13) |
| Total preferred shareholders equity | **119** | 140 |
| | | |
| **Common stock** | | |
| Balance, beginning of year | **18,530** | 18,096 |
| Employee share-based compensation | **178** | 75 |
| Conversion of convertible notes | **36** | |
| Compensation amortization under share-based plans and other | **95** | 88 |
| Balance, end of period | **18,839** | 18,259 |
| | | |
| **Retained earnings** | | |
| Balance, beginning of year | **7,253** | 3,750 |
| Net income | **2,340** | 1,976 |
| Dividends | **(368)** | (343) |
| Minority interest and other | **3** | (1) |
| Balance, end of period | **9,228** | 5,382 |
| | | |
| **Accumulated other changes in equity from nonowner sources, net of tax** | | |
| Balance, beginning of year | **452** | 351 |
| Change in net unrealized gain on investment securities | **(716)** | (804) |
| Net change in unrealized foreign currency translation and other changes | **44** | 47 |
| Balance, end of period | **(220)** | (406) |
| | | |
| **Treasury stock (at cost)** | | |
| Balance, beginning of year | **(1,229)** | (47) |
| Reacquired under share repurchase program | **(1,347)** | (250) |
| Reacquired related to employee share-based compensation plans | **(68)** | (26) |
| Balance, end of period | **(2,644)** | (323) |
| Total common shareholders equity | **25,203** | 22,912 |
| Total shareholders equity | **$ 25,322** | $ 23,052 |
| | | |
| **Common shares outstanding** | | |
| Balance, beginning of year | **678.3** | 693.4 |
| Shares acquired share repurchase program | **(25.3)** | (5.6) |
| Net shares issued under employee share-based compensation plans | **3.3** | 3.6 |
| Shares issued pursuant to conversion of convertible notes | **0.7** | |
| Balance, end of period | **657.0** | 691.4 |
| | | |
| **Summary of changes in equity from nonowner sources** | | |
| Net income | **$ 2,340** | $ 1,976 |
| Other changes in equity from nonowner sources, net of tax | **(672)** | (757) |
| Total changes in equity from nonowner sources | **$ 1,668** | $ 1,219 |

See notes to consolidated financial statements (unaudited).

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)**

(in millions)

| For the six months ended June 30, | 2007 | 2006 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | **$ 2,340** | $ 1,976 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net realized investment gains | **(142)** | (4) |
| Depreciation and amortization | **408** | 394 |
| Deferred federal income tax expense | **181** | 203 |
| Amortization of deferred policy acquisition costs | **1,784** | 1,614 |
| Equity income from other investments | **(372)** | (274) |
| Premiums receivable | **(351)** | (248) |
| Reinsurance recoverables | **1,079** | 1,006 |
| Deferred acquisition costs | **(1,991)** | (1,710) |
| Claims and claim adjustment expense reserves | **(605)** | (1,646) |
| Unearned premium reserves | **335** | 375 |
| Trading account activities | **(4)** | 6 |
| Excess tax benefits from share-based payment arrangements | **(20)** | (6) |
| Other | **(718)** | (275) |
| **Net cash provided by operating activities** | **1,924** | 1,411 |
| | | |
| **Cash flows from investing activities** | | |
| Proceeds from maturities of fixed maturities | **2,564** | 2,650 |
| Proceeds from sales of investments: | | |
| Fixed maturities | **1,538** | 3,174 |
| Equity securities | **56** | 126 |
| Other investments | **931** | 512 |
| Purchases of investments: | | |
| Fixed maturities | **(6,013)** | (8,049) |
| Equity securities | **(55)** | (64) |
| Real estate | **(53)** | (14) |
| Other investments | **(371)** | (363) |
| Net sales (purchases) of short-term securities | **304** | (93) |
| Securities transactions in course of settlement | **54** | 509 |
| Other | **(210)** | (122) |
| **Net cash used in investing activities** | **(1,255)** | (1,734) |
| | | |
| **Cash flows from financing activities** | | |
| Payment of debt | **(1,468)** | (4) |
| Issuance of debt | **2,461** | 786 |
| Dividends to shareholders | **(368)** | (343) |
| Issuance of common stock employee share options | **160** | 58 |
| Treasury shares acquired share repurchase program | **(1,335)** | (230) |
| Treasury shares acquired net employee share-based compensation | **(38)** | (17) |
| Excess tax benefits from share-based payment arrangements | **20** | 6 |
| Other | | 1 |
| **Net cash provided by (used in) financing activities** | **(568)** | 257 |
| | | |
| Effect of exchange rate changes on cash | **2** | 3 |
| Net increase (decrease) in cash | **103** | (63) |
| Cash at beginning of period | **459** | 337 |
| **Cash at end of period** | **$ 562** | $ 274 |
| | | |
| **Supplemental disclosure of cash flow information** | | |
| Income taxes paid | **$ 786** | $ 253 |

| | | |
|---|---|---|
| Interest paid | **$ 161** | $ 164 |

See notes to consolidated financial statements (unaudited).

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

**Basis of Presentation**

The interim consolidated financial statements include the accounts of The Travelers Companies, Inc. (together with its subsidiaries, the Company). These financial statements are prepared in conformity with U.S. generally accepted accounting principles (GAAP) and are unaudited. In the opinion of the Company s management, all adjustments necessary for a fair presentation have been reflected. Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but that is not required for interim reporting purposes, has been omitted. Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 presentation. This includes a reclassification of certain contractholder receivables and payables in the consolidated balance sheet, which had previously been reported on a net basis, to a gross basis, consistent with the Company s accounting policy. The accompanying interim consolidated financial statements and related notes should be read in conjunction with the Company s consolidated financial statements and related notes included in the Company s 2006 Annual Report on Form 10-K/A.

Effective February 26, 2007, The St. Paul Travelers Companies, Inc. amended its articles of incorporation to change its name to The Travelers Companies, Inc. and, effective the same day, amended its bylaws to reflect the name change.

**Adoption of New Accounting Standards**

**Accounting for Uncertainty in Income Taxes**

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 is intended to clarify the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Under FIN 48, evaluation of a tax position is a two-step process. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of that position. The second step is to measure a tax position that meets the more-likely-than-not threshold to determine the amount of benefit to be recognized in the financial statements. A tax position that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent financial reporting period in which the threshold is no longer met.

The adoption of FIN 48 at January 1, 2007 did not have a material effect on the Company s financial position.

The total amount of unrecognized tax benefits as of January 1, 2007 was $339 million. Included in that balance were $101 million of unrecognized tax benefits that, if recognized, would affect the annual effective tax rate and $175 million of tax positions for which the ultimate deductibility is certain, but for which there is uncertainty about the timing of deductibility. The timing of such deductibility would not affect the annual effective tax rate. The balance of unrecognized tax benefits at January 1, 2007 was comprised of $63 million of unrecognized tax benefits that, if recognized, would reduce goodwill.

The Company recognizes accrued interest and penalties, if any, related to unrecognized tax benefits in income taxes. The Company had approximately $35 million for the payment of interest accrued at January 1, 2007.

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES, Continued

During the six months ended June 30, 2007, the Company effectively settled Internal Revenue Service (IRS) tax examinations for all years through December 31, 2004. As a result, the Company recorded after-tax benefits of $58 million and $86 million in its consolidated statement of income for the three months and six months ended June 30, 2007, respectively. In addition, $63 million of previously unrecognized tax benefits related to the IRS settlement were recognized through a reduction of goodwill during the second quarter of 2007.

The Company does not expect any significant changes to its liability for unrecognized tax benefits during the next twelve months.

In May 2007, the FASB issued FASB Staff Position (FSP) FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* (FSP FIN 48-1). The FSP addresses whether it is appropriate for a company to recognize a previously unrecognized tax benefit when the only factor that has changed, since determining that a benefit should not be recognized, was the completion of an examination or audit by a taxing authority. The FSP is effective January 1, 2007, the date of the Company s initial adoption of FIN 48. The adoption of FSP FIN 48-1 did not have a material effect on the Company s results of operations, financial condition or liquidity.

**Accounting for Certain Hybrid Financial Instruments**

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140* (FAS 155). FAS 155 nullifies the guidance in the FASB s Derivatives Implementation Group Issue D1 Application of Statement 133 to Beneficial Interests in Securitized Assets , which had deferred the bifurcation requirements of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), for certain beneficial interests in securitized financial assets. FAS 155 requires that beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or hybrid instruments that contain an embedded derivative requiring bifurcation.

FAS 155 permits entities to fair value any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This election is on a contract-by-contract basis and is irrevocable. Additionally, FAS 155 narrows the exception afforded to interest-only strips and principal-only strips from derivative accounting. In addition, FAS 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement 125,* to eliminate the restriction on the passive derivative instruments a Qualifying Special Purpose Entity can hold.

FAS 155 is effective for all financial instruments acquired, issued or subject to a remeasurement (new basis) event occurring after the beginning of an entity s fiscal year that begins after September 15, 2006. At adoption, for contracts where the fair value option has been elected, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative-effect adjustment to beginning retained earnings.

In January 2007, the FASB released Statement 133 Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets (B40).* B40 provides a limited scope exception from paragraph 13(b) of FAS 133 for securitized interests that contain only an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets and if both of the following criteria are met: (a) the investor does not control the right to accelerate the settlement, and (b) the securitized interest does not contain an embedded derivative for which bifurcation would be required other than an embedded derivative that results from embedded call options in the underlying financial assets. B40 is effective upon the adoption of FAS 155, except for criterion (b) which is not applicable to securitized interests issued before June 30, 2007, and that only include embedded derivatives that have an extremely remote possibility of having greater than a trivial fair value during the life of the securitized interest.

The Company adopted FAS 155 effective January 1, 2007 and it did not elect the fair value option. There was no cumulative effect upon adoption of FAS 155.

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES, Continued

**Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts**

In September 2005, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts* (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in Statement of Financial Accounting Standards No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. The adoption of SOP 05-1 effective January 1, 2007 did not have a material effect on the Company s results of operations, financial condition or liquidity.

**Endorsement Split-Dollar Life Insurance Arrangements**

In September 2006, FASB issued Emerging Issues Task Force Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4). EITF 06-4 requires a company to recognize a liability and related compensation expense for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. EITF 06-4 is effective January 1, 2008, with earlier adoption permitted. The early adoption of EITF 06-4 on January 1, 2007 did not have a material effect on the Company s results of operations, financial condition or liquidity.

**Accounting for Corporate-Owned Life Insurance**

In September 2006, the FASB issued Emerging Issues Task Force Issue No. 06-5, *Accounting for Purchase of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No 85-4* (EITF 06-5). EITF 06-5 provides additional guidance on determining the amount that can be realized under a corporate-owned life insurance contract (that is, converted to cash) based upon how the contract is assumed to be hypothetically settled. EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The adoption of EITF 06-5 did not have a material effect on the Company s results of operations, financial condition or liquidity.

**Accounting Standards Not Yet Adopted**

**Fair Value Measurements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. It applies to other pronouncements that require or permit fair value but does not require any new fair value measurements. The statement defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

FAS 157 establishes a fair value hierarchy to increase consistency and comparability in fair value measurements and disclosures. The hierarchy is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets. The highest possible level should be used to measure fair value.

FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the provisions of FAS 157 to have a material effect on its results of operations, financial condition or liquidity.

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES, Continued

**Fair Value Option for Financial Assets and Financial Liabilities**

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). FAS 159 permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attribute for many financial assets and liabilities and certain other items including property and casualty insurance contracts. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense up-front costs and fees associated with the item for which the fair value option is elected. Entities electing the fair value option are required to distinguish on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. An entity can accomplish this by either reporting the fair value and non-fair-value carrying amounts as separate line items or aggregating those amounts and disclosing parenthetically the amount of fair value included in the aggregate amount.

FAS 159 is effective for fiscal years beginning after November 15, 2007. Upon adoption, an entity is permitted to elect the fair value option irrevocably for any existing asset or liability within the scope of the standard. The adjustment to reflect the difference between the fair value and the carrying amount would be accounted for as a cumulative-effect adjustment to retained earnings as of the date of initial adoption. Retrospective application would not be permitted. The Company does not intend to elect the fair value option for assets and liabilities currently held, and therefore FAS 159 will not have an impact on the Company s results of operations, financial condition or liquidity.

**Collateral Assignment Split-Dollar Life Insurance Arrangements**

In March 2007, the FASB issued Emerging Issues Task Force Issue No. 06-10, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements* (EITF 06-10). EITF 06-10 provides guidance on the recognition and measurement of assets related to collateral assignment split-dollar life insurance arrangements. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. The Company does not expect the provisions of EITF 06-10 to have a material effect on its results of operations, financial condition or liquidity.

**Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies**

In June 2007, AcSEC issued Statement of Position 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (SOP 07-1). SOP 07-1 provides guidance in determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Investment Companies*. It also addresses whether the specialized industry accounting of the Investment Company Audit Guide should be retained by a parent company in consolidation or by an equity method investor. The Company is a passive equity method investor (i.e. does not have significant influence) in certain entities which are expected to adopt SOP 07-1. Upon the adoption of SOP 07-1, the Company s investment in these entities will be carried at fair value, and the change in fair value will be recorded as net investment income in the consolidated statement of income. The provisions of SOP 07-1 are effective for fiscal years beginning on or after December 15, 2007. The Company is in the process of determining the effect that SOP 07-1 may have on its results of operations, financial condition and liquidity.

**Nature of Operations**

The Company is organized into three reportable business segments: Business Insurance; Financial, Professional & International Insurance; and Personal Insurance. These segments reflect the manner in which the Company s businesses are managed and represent an aggregation of products and services based on type of customer, how the business is marketed, and the manner in which risks are underwritten. The business segments are as follows:

**Business Insurance**

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

Specialized Distribution.

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES, Continued

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; and policies written by the Company s Gulf operation (Gulf), which was placed into runoff during the second quarter of 2004. These are collectively referred to as Business Insurance Other.

**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 Bond & Financial Products group, as well as the International and Lloyd s group.

In March 2007, the Company completed the sale of its Mexican surety subsidiary, Afianzadora Insurgentes, S.A. de C.V., which accounted for $6 million and $25 million of net written premiums in the second quarter and first six months of 2007, respectively, and $15 million and $38 million of net written premiums in the second quarter and first six months of 2006, respectively. Written premiums recorded in the second quarter of 2007 subsequent to the completion of the sale reflected the impact of the one-month reporting lag for this operation. The impact of this transaction was not material to the Company s results of operations or financial condition.

**Personal Insurance**

The Personal Insurance segment writes virtually all types of property and casualty insurance covering personal risks. The primary coverages in Personal Insurance are automobile and homeowners insurance sold to individuals.

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. These subsidiaries primarily offered nonstandard automobile coverage and accounted for $0 and $49 million of net written premiums in the second quarter and first six months of 2007, respectively, and $46 million and $98 million of net written premiums in the second quarter and first six months of 2006, respectively. The sale was not material to the Company s results of operations or financial condition.

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 2. SEGMENT INFORMATION

| (for the three months ended June 30, in millions) | Business Insurance | Financial, Professional & International Insurance | Personal Insurance | Total Reportable Segments |
|---|---|---|---|---|
| **202007 Revenues** | | | | |
| Premiums | **$ 2,802** | **$ 844** | **$ 1,681** | **$ 5,327** |
| Net investment income | **717** | **125** | **148** | **990** |
| Fee income | **127** | | | **127** |
| Other revenues | **10** | **6** | **21** | **37** |
| Total operating revenues (1) | **$ 3,656** | **$ 975** | **$ 1,850** | **$ 6,481** |
| Operating income (1) | **$ 805** | **$ 152** | **$ 276** | **$ 1,233** |
| | | | | |
| **2006 Revenues** | | | | |
| Premiums | $ 2,715 | $ 839 | $ 1,627 | $ 5,181 |
| Net investment income | 635 | 102 | 137 | 874 |
| Fee income | 153 | | | 153 |
| Other revenues | 9 | 6 | 22 | 37 |
| Total operating revenues (1) | $ 3,512 | $ 947 | $ 1,786 | $ 6,245 |
| Operating income (1) | $ 655 | $ 149 | $ 203 | $ 1,007 |

| (for the six months ended June 30, in millions) | Business Insurance | Financial, Professional & International Insurance | Personal Insurance | Total Reportable Segments |
|---|---|---|---|---|
| **2007 Revenues** | | | | |
| Premiums | **$ 5,565** | **$ 1,688** | **$ 3,369** | **$ 10,622** |
| Net investment income | **1,411** | **246** | **293** | **1,950** |
| Fee income | **247** | | | **247** |
| Other revenues | **14** | **11** | **45** | **70** |
| Total operating revenues (1) | **$ 7,237** | **$ 1,945** | **$ 3,707** | **$ 12,889** |
| Operating income (1) | **$ 1,483** | **$ 308** | **$ 542** | **$ 2,333** |
| | | | | |
| **2006 Revenues** | | | | |
| Premiums | $ 5,358 | $ 1,627 | $ 3,187 | $ 10,172 |
| Net investment income | 1,271 | 205 | 271 | 1,747 |
| Fee income | 303 | | | 303 |
| Other revenues | 16 | 11 | 46 | 73 |
| Total operating revenues (1) | $ 6,948 | $ 1,843 | $ 3,504 | $ 12,295 |
| Operating income (1) | $ 1,306 | $ 290 | $ 443 | $ 2,039 |

(1) Operating revenues exclude net realized investment gains (losses). Operating income equals net income excluding the after-tax impact of net realized investment gains (losses).

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 2. SEGMENT INFORMATION, Continued

**Business Segment Reconciliations**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **(in millions)** | **2007** | **2006** | **2007** | **2006** |
| **Revenue reconciliation** | | | | |
| Earned premiums: | | | | |
| Business Insurance: | | | | |
| Commercial multi-peril | **$ 770** | $ 762 | **$ 1,530** | $ 1,504 |
| Workers compensation | **549** | 515 | **1,082** | 1,017 |
| Commercial automobile | **509** | 500 | **1,016** | 978 |
| Property | **499** | 477 | **980** | 928 |
| General liability | **472** | 447 | **927** | 915 |
| Other | **3** | 14 | **30** | 16 |
| Total Business Insurance | **2,802** | 2,715 | **5,565** | 5,358 |
| | | | | |
| | | | | |
| Financial, Professional & International Insurance: | | | | |
| General liability | **242** | 251 | **484** | 498 |
| Fidelity and surety | **268** | 277 | **538** | 537 |
| International | **300** | 283 | **600** | 534 |
| Other | **34** | 28 | **66** | 58 |
| Total Financial, Professional & International Insurance | **844** | 839 | **1,688** | 1,627 |
| | | | | |
| Personal Insurance: | | | | |
| Automobile | **912** | 910 | **1,851** | 1,782 |
| Homeowners and other | **769** | 717 | **1,518** | 1,405 |
| Total Personal Insurance | **1,681** | 1,627 | **3,369** | 3,187 |
| Total earned premiums | **5,327** | 5,181 | **10,622** | 10,172 |
| Net investment income | **990** | 874 | **1,950** | 1,747 |
| Fee income | **127** | 153 | **247** | 303 |
| Other revenues | **37** | 37 | **70** | 73 |
| Total operating revenues for reportable segments | **6,481** | 6,245 | **12,889** | 12,295 |
| Interest Expense and Other | **(36)** | | **(31)** | 6 |
| Net realized investment gains | **128** | 10 | **142** | 4 |
| Total consolidated revenues | **$ 6,573** | $ 6,255 | **$ 13,000** | $ 12,305 |
| | | | | |
| **Income reconciliation, net of tax** | | | | |
| Total operating income for reportable segments | **$ 1,233** | $ 1,007 | **$ 2,333** | $ 2,039 |
| Interest Expense and Other | **(66)** | (48) | **(88)** | (69) |
| Total operating income | **1,167** | 959 | **$ 2,245** | $ 1,970 |
| Net realized investment gains | **87** | 11 | **95** | 6 |
| Total consolidated net income | **$ 1,254** | $ 970 | **$ 2,340** | $ 1,976 |

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 2. SEGMENT INFORMATION, Continued

| (in millions) | June 30, 2007 | December 31, 2006 |
|---|---|---|
| **Asset reconciliation:** | | |
| Business Insurance | **$ 87,594** | $ 88,171 |
| Financial, Professional & International Insurance | **13,710** | 13,265 |
| Personal Insurance | **13,355** | 13,294 |
| Total assets for reportable segments | **114,659** | 114,730 |
| Other assets (1) | **702** | 562 |
| Total consolidated assets | **$ 115,361** | $ 115,292 |

(1) The primary components of other assets in 2007 were intangible assets and accrued over-funded benefit plan assets. The primary components of other assets in 2006 were accrued over-funded benefit plan assets and deferred taxes.

## 3. INVESTMENTS

### Fixed Maturities

The amortized cost and fair value of investments in fixed maturities classified as available-for-sale were as follows:

| | Amortized | Gross Unrealized | | Fair |
|---|---|---|---|---|
| **(at June 30, 2007, in millions)** | **Cost** | **Gains** | **Losses** | **Value** |
| Mortgage-backed securities, collateralized mortgage obligations and pass-through securities | **$ 7,329** | **$ 30** | **$ 200** | **$ 7,159** |
| U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities | **2,280** | **7** | **40** | **2,247** |
| Obligations of states, municipalities and political subdivisions | **37,844** | **275** | **410** | **37,709** |
| Debt securities issued by foreign governments | **1,471** | **2** | **19** | **1,454** |
| All other corporate bonds | **14,892** | **114** | **359** | **14,647** |
| Redeemable preferred stock | **96** | **13** | **4** | **105** |
| Total | **$ 63,912** | **$ 441** | **$ 1,032** | **$ 63,321** |

| | Amortized | Gross Unrealized | | Fair |
|---|---|---|---|---|
| **(at December 31, 2006, in millions)** | **Cost** | **Gains** | **Losses** | **Value** |
| Mortgage-backed securities, collateralized mortgage obligations and pass-through securities | $ 7,665 | $ 52 | $ 128 | $ 7,589 |
| U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities | 2,736 | 13 | 31 | 2,718 |
| Obligations of states, municipalities and political subdivisions | 35,326 | 661 | 80 | 35,907 |
| Debt securities issued by foreign governments | 1,550 | 12 | 10 | 1,552 |
| All other corporate bonds | 14,866 | 165 | 247 | 14,784 |
| Redeemable preferred stock | 101 | 16 | 1 | 116 |
| Total | $ 62,244 | $ 919 | $ 497 | $ 62,666 |

### Equity Securities

The cost and fair value of investments in equity securities were as follows:

| | | Gross Unrealized | | Fair |
|---|---|---|---|---|
| **(at June 30, 2007, in millions)** | **Cost** | **Gains** | **Losses** | **Value** |
| Common stock | **$ 111** | **$ 29** | **$** | **$ 140** |
| Non-redeemable preferred stock | **321** | **11** | **8** | **324** |
| Total | **$ 432** | **$ 40** | **$ 8** | **$ 464** |

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 3. INVESTMENTS, Continued

| (at December 31, 2006, in millions) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Common stock | $ 88 | $ 27 | $ | $ 115 |
| Non-redeemable preferred stock | 348 | 15 | 5 | 358 |
| Total | $ 436 | $ 42 | $ 5 | $ 473 |

**Other Investments**

*Venture Capital*

The cost and fair value of investments in venture capital were as follows:

| (at June 30, 2007, in millions) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Venture capital | **$ 68** | **$ 16** | **$** | **$ 84** |

| (at December 31, 2006, in millions) | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Venture capital | $ 392 | $ 109 | $ 1 | $ 500 |

In May 2007, the Company completed the bundled sale of a substantial portion of its venture capital portfolio for total net proceeds of $397 million, which are included on the consolidated statement of cash flow in proceeds from sales of other investments. The sale resulted in the realization of $81 million pretax ($52 million after-tax) of previously unrealized net investment gains that had been recorded as a component of accumulated other changes in equity from nonowner sources.

**Variable Interest Entities (VIEs)**

The following entities are consolidated:

- Municipal Trusts The Company owns interests in various municipal trusts that were formed to allow the Company to generate investment income in a manner consistent with its investment objectives and tax position. As of June 30, 2007 and December 31, 2006, there were 33 and 35 such trusts, respectively, which held a combined total of $376 million and $391 million, respectively, in municipal securities, of which $65 million and $76 million, respectively, were owned by outside investors. The net carrying value of the trusts owned by the Company at June 30, 2007 and December 31, 2006 was $311 million and $315 million, respectively.

The Company has significant interests in the following VIEs, which are not consolidated because the Company is not considered to be the primary beneficiary:

- The Company has a significant variable interest in two real estate entities. These investments have total assets of approximately $293 million and $305 million as of June 30, 2007 and December 31, 2006, respectively. The carrying value of the Company s share of these investments was approximately $28 million at June 30, 2007 and $33 million at December 31, 2006. The Company has an unfunded commitment of $12 million associated with one of these funds. The Company s exposure to loss is limited to the investment carrying amounts reported in the consolidated balance sheet and the unfunded commitment amount. The purpose of the Company s involvement in these entities is to generate investment returns.

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**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 3. INVESTMENTS, Continued

- The Company has a significant variable interest in Camperdown UK Limited, which the Company sold in December 2003. The Company s variable interest resulted from an agreement to indemnify the purchaser in the event a specified reserve deficiency develops, a reserve-related foreign exchange impact occurs, or a foreign tax adjustment is imposed on a pre-sale reporting period. The maximum amount of this indemnification obligation is $188 million. The fair value of this obligation as of June 30, 2007 and December 31, 2006 was $67 million and $65 million, respectively. See Guarantees section of note 11.

The Company has other significant interests in variable interest entities that are not material.

**Unrealized Investment Losses**

The following tables summarize, for all investment securities in an unrealized loss position at June 30, 2007 and December 31, 2006, the aggregate fair value and gross unrealized losses by length of time those investments have been continuously in an unrealized loss position.

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| (at June 30, 2007, in millions) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **Fixed maturities** | | | | | | |
| Mortgage-backed securities, collateralized mortgage obligations and pass-through securities | $ 1,948 | $ 35 | $ 3,883 | $ 165 | $ 5,831 | $ 200 |
| U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities | 527 | 2 | 1,029 | 38 | 1,556 | 40 |
| Obligations of states, municipalities and political subdivisions | 19,328 | 304 | 3,851 | 106 | 23,179 | 410 |
| Debt securities issued by foreign governments | 758 | 8 | 739 | 11 | 1,497 | 19 |
| All other corporate bonds | 4,702 | 86 | 6,935 | 273 | 11,637 | 359 |
| Redeemable preferred stock | 23 | 1 | 4 | 3 | 27 | 4 |
| Total fixed maturities | 27,286 | 436 | 16,441 | 596 | 43,727 | 1,032 |
| **Equity securities** | | | | | | |
| Common stock | | | | | | |
| Non-redeemable preferred stock | 99 | 4 | 63 | 4 | 162 | 8 |
| Total equity securities | 99 | 4 | 63 | 4 | 162 | 8 |
| **Venture capital** | | | | | | |
| Total | $ 27,385 | $ 440 | $ 16,504 | $ 600 | $ 43,889 | $ 1,040 |

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**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 3. INVESTMENTS, Continued

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| (at December 31, 2006, in millions) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **Fixed maturities** | | | | | | |
| Mortgage-backed securities, collateralized mortgage obligations and pass-through securities | $ 1,245 | $ 11 | $ 4,125 | $ 117 | $ 5,370 | $ 128 |
| U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities | 1,014 | 2 | 964 | 29 | 1,978 | 31 |
| Obligations of states, municipalities and political subdivisions | 4,468 | 16 | 4,077 | 64 | 8,545 | 80 |
| Debt securities issued by foreign governments | 861 | 6 | 406 | 4 | 1,267 | 10 |
| All other corporate bonds | 3,690 | 36 | 6,325 | 211 | 10,015 | 247 |
| Redeemable preferred stock | 1 | | 5 | 1 | 6 | 1 |
| Total fixed maturities | 11,279 | 71 | 15,902 | 426 | 27,181 | 497 |
| **Equity securities** | | | | | | |
| Common stock | 3 | | 1 | | 4 | |
| Non-redeemable preferred stock | 50 | 1 | 53 | 4 | 103 | 5 |
| Total equity securities | 53 | 1 | 54 | 4 | 107 | 5 |
| **Venture capital** | | | 14 | 1 | 14 | 1 |
| Total | $ 11,332 | $ 72 | $ 15,970 | $ 431 | $ 27,302 | $ 503 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Fixed maturities | **$ 7** | $ | **$ 8** | $ |
| Equity securities | **2** | | **3** | 1 |
| Venture capital | | 3 | **7** | 8 |
| Other investments (excluding venture capital) | | | | 4 |
| Total | **$ 9** | $ 3 | **$ 18** | $ 13 |

**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued**

## 4. GOODWILL AND OTHER INTANGIBLE ASSETS

**Goodwill**

The following table presents the carrying amount of the Company s goodwill by segment at June 30, 2007 and December 31, 2006: