

TRAVELERS COMPANIES, INC.

FORM 10-K (Annual Report)

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Stock Option Awards

Stock option awards granted to eligible officers and key employees have a ten-year term. Prior to January 1, 2007, stock options were granted with an exercise price equal to the fair market value of the Company's common stock on the day preceding the date of grant. Beginning January 1, 2007, all stock options are granted with an exercise price equal to the closing price of the Company's common stock on the date of grant. The stock options granted generally vest upon meeting certain years of service criteria. Except as the Compensation Committee of the Board may allow in the future, stock options cannot be sold or transferred by the participant. The stock options granted under the 2004 Incentive Plan vest at the end of three years (cliff vest).

In addition to the stock option awards described above, certain stock option awards that were granted under legacy plans permit an employee exercising an option to be granted a new option (a reload option) at an exercise price equal to the closing price of the Company's common stock on the date on which the original option is exercised. The reload option is permitted on certain stock option awards granted prior to January 2003 at an amount equal to the number of shares of the common stock used to satisfy both the exercise price and withholding taxes due upon exercise of an option and vest either six months or one year after the grant date and are exercisable for the remaining term of the related original option.

The fair value of each option award is estimated on the date of grant by application of a variation of the Black-Scholes option pricing model using the assumptions noted in the following table. The expected term of newly granted stock options is the time to vest plus half the remaining time to expiration. This considers the vesting restriction and represents an even pattern of exercise behavior over the remaining term. Reload options are exercisable for the remaining term of the original option and therefore would generally have a shorter expected term. The expected volatility is based on the average historical volatility of the common stock of an industry peer group of entities, due to the limited Company stock history, over the estimated option term based on the mid-month of the option grant. The expected dividend is based upon the Company's current quarter dividend annualized and assumed to be constant over the expected option term. The risk-free interest rate for each option is the interpolated market yield for the mid-month of the option grant on a U.S. Treasury bill with a term comparable to the expected option term of the granted stock option. Shares received through option exercises under the reload program are subject to restriction on sale. A 10% discount, as measured by the estimated cost of protecting against changes in market value, has been applied to the fair value of reload options granted to reflect these sales restrictions. The following assumptions were used in estimating the fair value of options on grant date for the years ended December 31, 2009, 2008 and 2007:

2009	Original Grants	Reload Grants
Expected term of stock options	6 years	1 - 2 years
Expected volatility of the Company's stock	28.2% - 34.1%	36.5% - 55.1%
Weighted average volatility	32.4%	42.9%
Expected annual dividend per share	\$1.20 - \$1.32	\$1.20 - \$1.32
Risk-free rate	2.07% - 2.85%	0.29% - 1.21%

2008	Original Grants	Reload Grants
Expected term of stock options	6 - 7 years	1 - 3 years
Expected volatility of the Company's stock	22.8% - 29.9%	19.1% - 31.4%
Weighted average volatility	23.1%	23.9%
Expected annual dividend per share	\$1.16 - \$1.20	\$1.16 - \$1.20
Risk-free rate	2.61% - 3.75%	1.36% - 3.42%

2007	Original Grants	Reload Grants
Expected term of stock options	6 - 7 years	1 - 3 years
Expected volatility of the Company's stock	22.5% - 26.9%	14.3% - 19.7%
Weighted average volatility	24.9%	16.5%
Expected annual dividend per share	\$1.04 - \$1.16	\$1.04 - \$1.16
Risk-free rate	3.79% - 5.10%	3.34% - 5.06%

A summary of stock option activity under the Company's 2004 Incentive Plan and legacy share-based incentive compensation plans as of and for the year ended December 31, 2009 is as follows:

Stock Options	Number	Weighted Average Exercise Price	Weighted Average Contractual Life Remaining	Aggregate Intrinsic Value (\$ in millions)
Outstanding, beginning of year	32,799,773	\$ 44.97		
Granted:				
Original	3,056,802	39.58		
Reload	667,652	47.34		
Exercised	(5,100,362)	38.60		
Forfeited or expired	(1,338,198)	46.80		
Outstanding, end of year	<u>30,085,667</u>	<u>\$ 45.48</u>	<u>4.0 Years</u>	<u>\$ 164</u>
Vested at end of year(1)	<u>25,076,268</u>	<u>\$ 45.72</u>	<u>3.2 Years</u>	<u>\$ 133</u>
Exercisable at end of year	<u>21,883,977</u>	<u>\$ 45.68</u>	<u>2.6 Years</u>	<u>\$ 118</u>

(1) Represents awards for which the requisite service has been rendered, including those that are retirement eligible.

The following table presents additional information regarding original and reload grants for the years ended December 31, 2009, 2008 and 2007.

2009	Original Grants	Reload Grants
Weighted average grant-date fair value of options granted (per share)	\$ 9.54	\$ 8.95
Total intrinsic value of options exercised during the year (in millions)	\$ 52	\$ —

2008	Original Grants	Reload Grants
Weighted average grant-date fair value of options granted (per share)	\$ 9.56	\$ 5.80
Total intrinsic value of options exercised during the year (in millions)	\$ 33	\$ 1

2007	Original Grants	Reload Grants
Weighted average grant-date fair value of options granted (per share)	\$ 14.36	\$ 5.31
Total intrinsic value of options exercised during the year (in millions)	\$ 90	\$ 5

On February 2, 2010, the Company, under the 2004 Stock Incentive Plan, granted 2,601,064 stock option awards with an exercise price of \$51.09 per share. The fair value attributable to the stock option awards on the date of grant was \$11.98 per share.

Restricted Stock, Restricted Stock Units, Deferred Stock and Performance Share Award Programs

The Company, commencing with equity grants on or after January 1, 2007, issues restricted stock unit awards to eligible officers and key employees under the Equity Awards program established pursuant to the 2004 Incentive Plan. A restricted stock unit represents the right to receive a share of common stock. These restricted stock unit awards are granted at market price, generally vest three years from the date of grant, do not have voting rights and the underlying shares of common stock are not issued until the vesting criteria is satisfied.

The Company also has a Performance Share Awards Program pursuant to the 2004 Incentive Plan which became effective beginning in 2006. Under the program, the Company may issue performance share awards to certain employees of the Company who hold positions of Vice President (or its equivalent) or above. The performance awards provide the recipient the right to earn shares of the Company's common stock based upon the Company's attainment of certain performance goals. The performance goals for performance awards are based on the Company's adjusted return on equity over a three-year performance period. Vesting of any performance shares is contingent upon the Company attaining the relevant performance period minimum threshold return on equity. If the performance period return on equity is below the minimum threshold, none of the shares will vest. If performance meets or exceeds the minimum performance threshold, a range of performance shares will vest (50%-160% for awards granted prior to and including February 2009; 50%-150% for awards granted in February 2010 and thereafter), depending on the actual return on equity attained.

The fair value of restricted stock units, deferred stock and performance shares is measured at the market price of the Company stock at date of grant.

The total fair value of shares that vested during the years ended December 31, 2009, 2008 and 2007 was \$78 million, \$82 million and \$99 million, respectively.

A summary of restricted stock units, deferred stock awards and performance share activity under the Company's 2004 Incentive Plan and legacy plans as of and for the year ended December 31, 2009 is as follows:

Other Equity Instruments	Restricted and Deferred Shares		Performance Shares	
	Number	Weighted Average Grant-Date Fair Value	Number	Weighted Average Grant-Date Fair Value
Outstanding, beginning of year	3,350,954	\$ 47.33	1,450,028	\$ 49.87
Granted	1,543,909	39.53	993,541	39.50
))	
Vested	(1,351,057)(1)	44.29	(833,795)(2)	52.58
Forfeited	(161,258)	45.78	(136,393)	45.70
Performance-based adjustment	—	—	236,581(3)	50.67
Outstanding, end of year	<u>3,382,548</u>	\$ 45.05	<u>1,709,962</u>	\$ 42.93

- (1) Represents awards for which the requisite service has been rendered.
- (2) Reflects the number of performance shares attributable to the performance goals attained over the completed performance period (3 years) and for which service conditions have been met.

- (3) Represents the current year change in estimated performance shares to reflect the attainment of performance goals for the awards that were granted in each of the years 2006 through 2009.

On February 2, 2010, the Company, under the 2004 Stock Incentive Plan, granted 1,861,814 common stock awards in the form of restricted stock units, deferred stock and performance share awards to participating officers, non-employee directors and other key employees. The restricted stock units and deferred stock awards totaled 1,020,839 shares while the performance share awards totaled 840,975 shares. The fair value per share attributable to the common stock awards on the date of grant was \$51.09.

Share-Based Compensation Cost Recognition

The amount of compensation cost for awards subject to a service condition is based on the number of shares expected to be issued and is recognized over the time period for which service is to be provided (requisite service period). Awards granted to retiree-eligible or to employees who become retiree-eligible before an award's vesting date are considered to have met the requisite service condition. The compensation cost for awards subject to a performance condition is based upon the probable outcome of the performance condition, which on the grant date reflects an estimate of attaining 100% of the performance shares granted. The compensation cost reflects an estimated annual forfeiture rate from 3.5% to 5% over the requisite service period of the awards. That estimate is revised if subsequent information indicates that the actual number of instruments expected to vest is likely to differ from previous estimates. Compensation costs for awards are recognized on a straight-line basis over the requisite service period. For awards that have a graded vesting schedule, the compensation cost is recognized on a straight-line basis over the requisite service period for each separate vesting portion of the award as if the award was, in substance, multiple awards. The total compensation cost for all share-based incentive compensation awards recognized in earnings for the years ended December 31, 2009, 2008 and 2007 was \$127 million, \$123 million and \$125 million, respectively. Included in these amounts are compensation cost adjustments of \$11 million, \$6 million and \$5 million, for the years ended December 31, 2009, 2008 and 2007, respectively, that reflected the cost associated with the updated estimate of performance shares due to attaining certain performance levels from the date of the initial grant of the performance awards. The related tax benefits recognized in earnings were \$44 million, \$42 million and \$42 million for the years ended December 31, 2009, 2008 and 2007, respectively.

At December 31, 2009, there was \$111 million of total unrecognized compensation cost related to all nonvested share-based incentive compensation awards. This includes stock options, restricted stock, restricted stock units, deferred stock and performance shares granted under the Company's 2004 Incentive Plan. The unrecognized compensation cost is expected to be recognized over a weighted-average period of 1.7 years.

Cash received from the exercise of employee stock options under share-based compensation plans totaled \$180 million and \$89 million in 2009 and 2008, respectively. The tax benefit realized for tax deductions from employee stock options exercised during 2009 and 2008 totaled \$17 million and \$12 million, respectively.

Consent of Independent Registered Public Accounting Firm

The Board of Directors
The Travelers Companies, Inc.:

We consent to the incorporation by reference in the registration statements (SEC File No. 33-56987, No. 333-50943, No. 333-63114, No. 333-63118, No. 333-65726, No. 333-107698, No. 333-107699, No. 333-114135, No. 333-117726, No. 333-120998, No. 333-128026, No. 333-157091 and No. 333-157092) on Form S-8 and (SEC File No. 333-156132) on Form S-3 of The Travelers Companies, Inc. and subsidiaries of our reports dated February 18, 2010, with respect to the consolidated balance sheet of The Travelers Companies, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009, and all related financial statement schedules, and the effectiveness of internal control over financial reporting as of December 31, 2009, which reports appear in the December 31, 2009 annual report on Form 10-K of The Travelers Companies, Inc.

Our reports refer to a change in the Company's method of accounting for other-than-temporary impairments of debt securities as of April 1, 2009 due to the adoption of new FASB guidance.

/s/ KPMG LLP
KPMG LLP

Minneapolis, Minnesota
February 18, 2010