

HERBALIFE LTD.
Form 10-Q
October 31, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2011

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: 1-32381
HERBALIFE LTD.**

(Exact name of registrant as specified in its charter)

Cayman Islands
*(State or other jurisdiction of
incorporation or organization)*

98-0377871
*(I.R.S. Employer
Identification No.)*

**P.O. Box 309GT
Ugland House, South Church Street
Grand Cayman, Cayman Islands**
(Address of principal executive offices) (Zip code)
(213) 745-0500
(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 No

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

Indicate by check mark 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 Exchange 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 Exchange Act). Yes No

Number of shares of registrant's common shares outstanding as of October 26, 2011 was 116,322,699

HERBALIFE LTD.

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HERBALIFE LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2011	December 31, 2010
	(In thousands, except share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 261,521	\$ 190,550
Receivables, net of allowance for doubtful accounts of \$2,199 (2011) and \$3,202 (2010)	112,475	85,612
Inventories	222,501	182,467
Prepaid expenses and other current assets	93,715	93,963
Deferred income taxes	43,662	42,994
 Total current assets	 733,874	 595,586
 Property, at cost, net of accumulated depreciation and amortization of \$179,713 (2011) and \$166,912 (2010)	 182,772	 177,427
Deferred compensation plan assets	19,063	18,536
Deferred financing costs, net	5,091	998
Other assets	29,833	25,880
Marketing related intangibles and other intangible assets, net	311,935	310,894
Goodwill	105,488	102,899
 Total assets	 \$ 1,388,056	 \$ 1,232,220
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 61,857	\$ 43,784
Royalty overrides	190,697	162,141
Accrued compensation	69,646	69,376
Accrued expenses	145,150	141,867
Current portion of long-term debt	1,762	3,120
Advance sales deposits	60,129	35,145
Income taxes payable	21,304	15,383
 Total current liabilities	 550,545	 470,816
 NON-CURRENT LIABILITIES:		
Long-term debt, net of current portion	220,298	175,046
Deferred compensation plan liability	22,290	20,167
Deferred income taxes	55,844	55,572
Other non-current liabilities	22,600	23,407

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Total liabilities	871,577	745,008
CONTINGENCIES		
SHAREHOLDERS EQUITY:		
Common shares, \$0.001 par value; 1.0 billion shares authorized; 116.1 million (2011) and 117.8 million (2010) shares outstanding	116	118
Paid-in-capital in excess of par value	280,515	248,693
Accumulated other comprehensive loss	(36,012)	(27,285)
Retained earnings	271,860	265,686
Total shareholders equity	516,479	487,212
Total liabilities and shareholders equity	\$ 1,388,056	\$ 1,232,220

See the accompanying notes to unaudited condensed consolidated financial statements.

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HERBALIFE LTD.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In thousands, except per share amounts)			
Product sales	\$ 763,272	\$ 588,635	\$ 2,190,153	\$ 1,705,230
Shipping & handling revenues	131,946	99,796	379,815	290,640
Net sales	895,218	688,431	2,569,968	1,995,870
Cost of sales	175,308	133,265	509,124	410,298
Gross profit	719,910	555,166	2,060,844	1,585,572
Royalty overrides	290,842	224,061	844,451	656,160
Selling, general & administrative expenses	277,721	230,150	788,472	648,143
Operating income	151,347	100,955	427,921	281,269
Interest expense, net	345	2,192	3,848	6,291
Income before income taxes	151,002	98,763	424,073	274,978
Income taxes	42,980	19,879	116,852	62,048
NET INCOME	\$ 108,022	\$ 78,884	\$ 307,221	\$ 212,930
Earnings per share:				
Basic	\$ 0.92	\$ 0.67	\$ 2.60	\$ 1.79
Diluted	\$ 0.87	\$ 0.63	\$ 2.44	\$ 1.69
Weighted average shares outstanding:				
Basic	116,975	118,442	118,059	119,286
Diluted	124,275	125,613	125,889	126,216
Dividends declared per share	\$ 0.20	\$ 0.13	\$ 0.53	\$ 0.33

See the accompanying notes to unaudited condensed consolidated financial statements.

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HERBALIFE LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended	
	September	September 30,
	30,	2010
	2011	2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 307,221	\$ 212,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	54,440	51,755
Excess tax benefits from share-based payment arrangements	(24,030)	(6,572)
Share-based compensation expenses	17,244	16,870
Amortization of discount and deferred financing costs	721	374
Deferred income taxes	(7,000)	(16,989)
Unrealized foreign exchange transaction loss (gain)	8,324	(7,536)
Write-off of deferred financing costs	914	
Foreign exchange loss from adoption of highly inflationary accounting in Venezuela		15,131
Other	1,383	2,911
Changes in operating assets and liabilities:		
Receivables	(31,834)	(13,965)
Inventories	(51,649)	(32,921)
Prepaid expenses and other current assets	(3,733)	5,744
Other assets	(4,742)	(2,328)
Accounts payable	19,484	12,852
Royalty overrides	33,851	3,601
Accrued expenses and accrued compensation	7,579	11,622
Advance sales deposits	27,416	32,399
Income taxes payable	35,914	(16,955)
Deferred compensation plan liability	2,123	2,198
NET CASH PROVIDED BY OPERATING ACTIVITIES	393,626	271,121
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property	(61,514)	(42,199)
Proceeds from sale of property	213	64
Deferred compensation plan assets	(527)	(371)
NET CASH USED IN INVESTING ACTIVITIES	(61,828)	(42,506)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(62,177)	(38,934)
Borrowings from long-term debt	791,700	338,000
Principal payments on long-term debt	(747,896)	(379,465)
Deferred financing costs	(5,728)	
Share repurchases	(268,795)	(106,163)

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Excess tax benefits from share-based payment arrangements	24,030	6,572
Proceeds from exercise of stock options and sale of stock under employee stock purchase plan	15,947	11,521
NET CASH USED IN FINANCING ACTIVITIES	(252,919)	(168,469)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(7,908)	(17,457)
NET CHANGE IN CASH AND CASH EQUIVALENTS	70,971	42,689
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	190,550	150,801
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 261,521	\$ 193,490
CASH PAID DURING THE PERIOD		
Interest paid	\$ 6,457	\$ 7,195
Income taxes paid	\$ 88,079	\$ 84,120

See the accompanying notes to unaudited condensed consolidated financial statements.

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HERBALIFE LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

Herbalife Ltd., a Cayman Islands exempt limited liability company, or Herbalife, was incorporated on April 4, 2002. Herbalife Ltd. (and together with its subsidiaries, the Company) is a leading global network marketing company that sells weight management, nutritional supplements, energy, sports & fitness products and personal care products through a network of approximately 2.5 million independent distributors, except in China, where the Company sells its products through retail stores, sales representatives and independent service providers. The Company reports revenue in six geographic regions: North America; Mexico; South and Central America; EMEA, which consists of Europe, the Middle East and Africa; Asia Pacific (excluding China); and China.

2. Significant Accounting Policies***Basis of Presentation***

The unaudited interim financial information of the Company has been prepared in accordance with Article 10 of the Securities and Exchange Commission's, or the SEC, Regulation S-X. Accordingly, it does not include all of the information required by generally accepted accounting principles in the U.S., or U.S. GAAP, for complete financial statements. The condensed consolidated balance sheet at December 31, 2010 was derived from the audited financial statements at that date and does not include all the disclosures required by U.S. GAAP. The Company's unaudited condensed consolidated financial statements as of September 30, 2011, and for the three and nine months ended September 30, 2011 and 2010, include Herbalife and all of its direct and indirect subsidiaries. In the opinion of management, the accompanying financial information contains all adjustments, consisting of normal recurring adjustments, necessary to present fairly the Company's unaudited condensed consolidated financial statements as of September 30, 2011, and for the three and nine months ended September 30, 2011 and 2010. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010, or the 2010 10-K. Operating results for the three and nine months ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

On April 28, 2011, the Company's shareholders approved a two-for-one stock split, or the stock split, of the Company's common shares. One additional common share was distributed to the Company's shareholders on or around May 17, 2011, for each common share held on May 10, 2011. All references in the financial statements and notes to number of shares and per share amounts have been retrospectively adjusted for all periods presented to reflect the stock split.

New Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2011-08, *Testing Goodwill for Impairment*. This ASU permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity concludes it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then there is no need to perform the two-step impairment test. This ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of this ASU will not have a material impact on the Company's consolidated financial statements, as it is intended to simplify the assessment for goodwill impairment.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. This ASU will require companies to present the components of net and comprehensive income in either one or two consecutive financial statements and eliminates the option to present other comprehensive income in the statement of changes in shareholders' equity. This ASU is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. The Company is currently evaluating the potential impact of this adoption on its consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. This ASU expands existing disclosure requirements for fair value measurements and provides additional information on how to measure

fair value. The Company is required to apply this ASU prospectively for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the potential impact of this adoption on its consolidated financial statements.

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In the second quarter of 2011, the Company changed its method of accounting for excess tax benefits recognized as a result of the exercise of employee stock options, stock appreciation rights, or SARs, and other share-based equity grants, from the tax-law-ordering method to the with-and-without method. Under the tax law ordering method, the deduction for share-based compensation is applied against income tax liabilities before other credits are applied, such as foreign tax credits. The with-and-without method applies the deduction for share-based compensation against taxable income after other credits have been applied against taxable income, to the extent allowable and subject to applicable limitations. The with-and-without method separately determines the impact of the tax benefit from share-based compensation after considering the tax effects related to the Company's on-going operations. A benefit is recorded when deductions for share-based compensation reduces income taxes payable or increases income taxes refund receivable. The Company believes that the with-and-without method is a preferable method of determining the benefit applicable to share-based compensation because it better reflects the Company's ongoing operations. This change in accounting method primarily impacts the allocation of income taxes and tax benefits between continuing operations, deferred tax items, and additional paid in capital for financial reporting purposes, but it does not have any impact on the ultimate amount of income tax reported on the Company's income tax returns and it does not impact the Company's income taxes payable included within its accompanying consolidated balance sheet. This change in accounting principle does not impact the consolidated financial statements related to fiscal years prior to 2010.

This change in accounting principle is applied to all periods presented and the following tables summarize the impact of this change on the Company's consolidated financial statements, and as applicable, to the notes to the consolidated financial statements:

Consolidated Balance Sheet

	December 31, 2010	
	As	
	Previously Reported	As Adjusted
	(in thousands)	
Paid-in capital in excess of par value	\$ 257,375	\$ 248,693
Retained earnings	\$ 257,004	\$ 265,686

Consolidated Statements of Income

	Three Months Ended September 30, 2010		Nine Months Ended September 30, 2010	
	As		As	
	Previously Reported	As Adjusted	Previously Reported	As Adjusted
	(In thousands, except per share amount)			
Income Taxes	\$ 23,024	\$ 19,879	\$ 65,435	\$ 62,048
Net Income	\$ 75,739	\$ 78,884	\$ 209,543	\$ 212,930
Basic earnings per share (1)	\$ 0.64	\$ 0.67	\$ 1.76	\$ 1.79
Diluted earnings per share (1)	\$ 0.61	\$ 0.63	\$ 1.68	\$ 1.69

(1) Basic and diluted earnings per share, as previously reported, for the three and nine months ended September 30, 2010, have also been adjusted to reflect the stock split.

Common Share Amounts Used to Compute Basic and Diluted Earnings Per Share

Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
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	As Previously Reported (1)	As Adjusted	As Previously Reported (1)	As Adjusted
		(In thousands)		
Weighted average shares used in basic computations	118,442	118,442	119,286	119,286
Dilutive effect of exercise of equity grants outstanding	5,010	6,731	4,800	6,516
Dilutive effect of warrants	440	440	414	414
Weighted average shares used in diluted computations	123,892	125,613	124,500	126,216

(1) Basic and diluted weighted shares outstanding, as previously reported, for the three and nine months ended September 30, 2010, have been adjusted to reflect the stock split.

Table of Contents**Consolidated Statement of Cash Flows**

	Nine Months Ended September 30, 2010	
	As	
	Previously Reported	As Adjusted
	(In thousands)	
Net Income	\$ 209,543	\$ 212,930
Excess tax benefits from share-based payment arrangements	\$ (9,959)	\$ (6,572)
Income taxes payable	\$ (13,568)	\$ (16,955)
Net cash provided by operating activities	\$ 267,734	\$ 271,121
Excess tax benefits from share-based payment arrangements	\$ 9,959	\$ 6,572
Net cash used in financing activities	\$ (165,082)	\$ (168,469)

If the Company had not changed from the prior tax law ordering method of accounting for excess tax benefits in the second quarter of fiscal year 2011, income taxes, net income and earnings per share would have been reflected as noted below:

Consolidated Statements of Income

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	As Computed Under Prior Method (In thousands, except per share amount)	
Income Taxes	\$ 44,594	\$ 120,800
Net Income	\$ 106,408	\$ 303,273
Basic earnings per share	\$ 0.91	\$ 2.57
Diluted earnings per share	\$ 0.87	\$ 2.45

Venezuela

In February 2011, Herbalife Venezuela purchased U.S. dollar denominated bonds with a face value of \$20 million U.S. dollars in a bond offering from Petróleos de Venezuela, S.A., a Venezuelan state-owned petroleum company, for 86 million Bolivars and then immediately sold the bonds for \$15 million U.S. dollars, resulting in an average effective conversion rate of 5.7 Bolivars per U.S. dollar. The 86 million Bolivars were previously remeasured at the regulated system rate, or SITME rate, of 5.3 Bolivars per U.S. dollar and recorded as cash and cash equivalents of \$16.3 million on the Company's consolidated balance sheet at December 31, 2010. This Bolivar to U.S. dollar conversion resulted in the Company recording a net pre-tax loss of \$1.3 million U.S. dollars during the first quarter of 2011 which is included in its condensed consolidated statement of income for the nine months ended September 30, 2011.

As of September 30, 2011, Herbalife Venezuela's net monetary assets and liabilities denominated in Bolivars was approximately \$21.5 million, and included approximately \$29.0 million in Bolivar denominated cash and cash equivalents. The majority of these Bolivar denominated assets and liabilities were remeasured at the SITME rate. Although Venezuela is an important market in the Company's South and Central America region, Herbalife Venezuela's net sales represented less than 2% of the Company's consolidated net sales for both the nine months ended September 30, 2011 and 2010, and its total assets represented less than 3% of the Company's consolidated total assets as of both September 30, 2011 and December 31, 2010.

See the Company's 2010 10-K for further information on Herbalife Venezuela and Venezuela's highly inflationary economy.

3. Inventories

Inventories consist primarily of finished goods available for resale and the following are the major classes of inventory:

	September 30, 2011	December 31, 2010
	(In millions)	
Raw materials	\$ 23.3	\$ 13.7
Work in process	2.0	0.6
Finished goods	197.2	168.2
Total	\$ 222.5	\$ 182.5

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Long-term debt consists of the following:

	September 30, 2011	December 31, 2010
	(In millions)	
Borrowings under the prior senior secured credit facility	\$	\$ 174.9
Borrowings under the new senior secured revolving credit facility	220.0	
Capital leases	1.9	2.9
Other debt	0.2	0.3
 Total	 222.1	 178.1
Less: current portion	1.8	3.1
 Long-term portion	 \$ 220.3	 \$ 175.0

Interest expense was \$3.1 million and \$2.7 million for the three months ended September 30, 2011 and 2010, respectively, and \$9.5 million and \$7.7 million for the nine months ended September 30, 2011 and 2010, respectively. Interest expense for the nine months ended September 30, 2011 included a \$0.9 million write-off of unamortized deferred financing costs resulting from the extinguishment of the prior senior secured credit facility, or the Prior Credit Facility, as discussed below.

On March 9, 2011, the Company entered into a \$700.0 million senior secured revolving credit facility, or the New Credit Facility, with a syndicate of financial institutions as lenders and terminated its Prior Credit Facility that consisted of a term loan and a revolving credit facility. The New Credit Facility has a five year maturity and expires on March 9, 2016. During March 2011, U.S. dollar borrowings under the New Credit Facility incurred interest at the base rate plus a margin of 0.75% or LIBOR plus a margin of 1.75%. After March 2011, based on the Company's consolidated leverage ratio, U.S. dollar borrowings under the New Credit Facility bear interest at either LIBOR plus the applicable margin between 1.50% and 2.50% or the base rate plus the applicable margin between 0.50% and 1.50%. The Company, based on its consolidated leverage ratio, pays a commitment fee between 0.25% and 0.50% per annum on the unused portion of the New Credit Facility. The New Credit Facility also permits the Company to borrow limited amounts in Mexican Peso and Euro currencies based on variable rates. The base rate under the New Credit Facility represents the highest of the Federal Funds Rate plus 0.50%, one-month LIBOR plus 1.00%, and the prime rate offered by Bank of America.

In March 2011, the Company used \$196.0 million in U.S. dollar borrowings under the New Credit Facility to repay all amounts outstanding under the Prior Credit Facility. The Company incurred approximately \$5.7 million of debt issuance costs in connection with the New Credit Facility. These debt issuance costs were recorded as deferred financing costs on the Company's condensed consolidated balance sheet and are being amortized over the term of the New Credit Facility. On September 30, 2011 and December 31, 2010, the weighted average interest rate for borrowings under the New Credit Facility and the Prior Credit Facility was 1.72% and 1.75%, respectively.

The New Credit Facility requires the Company to comply with a leverage ratio and an interest coverage ratio. In addition, the New Credit Facility contains customary covenants, including covenants that limit or restrict the Company's ability to incur liens, incur indebtedness, make investments, dispose of assets, make certain restricted payments, pay dividends, repurchase its common shares, merge or consolidate and enter into certain transactions with affiliates. As of September 30, 2011, the Company was compliant with its debt covenants.

During the three months ended March 31, 2011, the Company borrowed \$235.7 million and \$54.0 million under the New Credit Facility and Prior Credit Facility, respectively, and paid a total of \$55.7 million and \$228.9 million of the New Credit Facility and Prior Credit Facility, respectively. During the three months ended June 30, 2011, the Company borrowed \$101.0 million under the New Credit Facility and paid a total of \$123.0 million of the New Credit

Facility. During the three months ended September 30, 2011, the Company borrowed \$401.0 million under the New Credit Facility and paid a total of \$339.0 million of the New Credit Facility. As of September 30, 2011, the U.S. dollar amount outstanding under the New Credit Facility was \$220.0 million. There were no outstanding foreign currency borrowings as of September 30, 2011 under the New Credit Facility. As of December 31, 2010, the amounts outstanding under the Prior Credit Facility, consisting of a term loan and revolving facility, were \$143.9 million and \$31.0 million, respectively.

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The Company is from time to time engaged in routine litigation. The Company regularly reviews all pending litigation matters in which it is involved and establishes reserves deemed appropriate by management for these litigation matters when a probable loss estimate can be made.

As a marketer of dietary and nutritional supplements and other products that are ingested by consumers or applied to their bodies, the Company has been and is currently subjected to various product liability claims. The effects of these claims to date have not been material to the Company, and the reasonably possible range of exposure on currently existing claims is not material to the Company. The Company believes that it has meritorious defenses to the allegations contained in the lawsuits. The Company currently maintains product liability insurance with an annual deductible of \$10 million.

Certain of the Company's subsidiaries have been subject to tax audits by governmental authorities in their respective countries. In certain of these tax audits, governmental authorities are proposing that significant amounts of additional taxes and related interest and penalties are due. The Company and its tax advisors believe that there are substantial defenses to their allegations that additional taxes are owed, and the Company is vigorously contesting the additional proposed taxes and related charges. On May 7, 2010, the Company received an assessment from the Mexican Tax Administration Service in an amount equivalent to approximately \$84 million, translated at the period ended spot rate, for various items, the majority of which was Value Added Tax, or VAT, allegedly owed on certain of the Company's products imported into Mexico during the years 2005 and 2006. This assessment is subject to interest and inflationary adjustments. On July 8, 2010, the Company initiated a formal administrative appeal process. On May 13, 2011, the Mexican Tax Administration Service issued a resolution on the Company's administrative appeal. The resolution nullified the assessment. Since, the Mexican Tax Administration Service can further review the tax audit findings and re-issue some or all of the original assessment, the Company commenced litigation in the Tax Court of Mexico in August 2011 to dispute the assertions made by the Mexican Tax Administration Service in the case. Prior to the nullification the Company entered into agreements with certain insurance companies to allow for the potential issuance of surety bonds in support of its appeal of the assessment. Such surety bonds, if issued, would not affect the availability of the Company's New Credit Facility. These arrangements with the insurance companies remain in place in the event that the assessment is re-issued. The Company has not recorded a provision as the Company, based on its analysis and guidance from its advisors, does not believe a loss would be probable if the assessment is re-issued or if any additional assessment is issued. Further, the Company is currently unable to reasonably estimate a possible loss or range of loss that could result from an unfavorable outcome if the assessment was re-issued or any additional assessments were to be issued for these or other periods. The Company believes that it has meritorious defenses if the assessment is re-issued or would have meritorious defenses if any additional assessment is issued.

These matters may take several years to resolve. While the Company believes it has meritorious defenses, it cannot be sure of their ultimate resolution. Although the Company has reserved amounts for certain matters that the Company believes represent the most likely outcome of the resolution of these related disputes, if the Company is incorrect in the assessment, the Company may have to record additional expenses, when it becomes probable that an increased potential liability is warranted.

6. Comprehensive Income

Total comprehensive income consisted of the following:

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	30,	30,	30,	30,
	2011	2010	2011	2010
	(In millions)			
Net income	\$ 108.0	\$ 78.9	\$ 307.2	\$ 212.9
Unrealized gain (loss) on derivative instruments, net of taxes	3.6	(9.3)	3.8	(4.7)
Foreign currency translation adjustment	(32.7)	23.8	(12.5)	3.5

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Comprehensive income	\$	78.9	\$	93.4	\$	298.5	\$	211.7
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Table of Contents**7. Segment Information**

The Company is a network marketing company that sells a wide range of weight management products, nutritional supplements and personal care products within one industry segment as defined under the FASB Accounting Standards Codification, or ASC Topic 280, *Segment Reporting*. The Company's products are manufactured by third party providers and by the Company in its Suzhou, China facility and in its Lake Forest, California facility, and are then sold to independent distributors who sell Herbalife products to retail consumers or other distributors. Revenues reflect sales of products by the Company to distributors and are categorized based on geographic location.

As of September 30, 2011, the Company sold products in 78 countries throughout the world and is organized and managed by geographic regions. The Company aggregates its operating segments, excluding China, into one reporting segment, or the Primary Reporting Segment, as management believes that the Company's operating segments have similar operating characteristics and similar long term operating performance. In making this determination, management believes that the operating segments are similar in the nature of the products sold, the product acquisition process, the types of customers to whom products are sold, the methods used to distribute the products, and the nature of the regulatory environment. China has been identified as a separate reporting segment as it does not meet the criteria for aggregation. The operating information for the Primary Reporting Segment and China, and sales by product line are as follows:

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2011	2010	2011	2010
	(In millions)			
Net Sales:				
Primary Reporting Segment				
United States	\$ 175.1	\$ 150.6	\$ 516.7	\$ 458.9
Mexico	112.9	83.5	330.7	236.3
Others	552.2	402.7	1,570.5	1,165.5
Total Primary Reporting Segment	840.2	636.8	2,417.9	1,860.7
China	55.0	51.6	152.1	135.2
Total Net Sales	\$ 895.2	\$ 688.4	\$ 2,570.0	\$ 1,995.9
Contribution Margin(1)(2):				
Primary Reporting Segment				
United States	\$ 79.2	\$ 64.9	\$ 225.3	\$ 196.0
Mexico	48.1	36.4	139.5	93.5
Others	252.5	183.9	717.0	517.4
Total Primary Reporting Segment	379.8	285.2	1,081.8	806.9
China	49.2	46.0	134.6	122.5
Total Contribution Margin	\$ 429.0	\$ 331.2	\$ 1,216.4	\$ 929.4
Selling, general and administrative expenses	277.7	230.2	788.5	648.1
Interest expense, net	0.3	2.2	3.8	6.3
Income before income taxes	151.0	98.8	424.1	275.0

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Income taxes		43.0		19.9		116.9		62.1
Net Income	\$	108.0	\$	78.9	\$	307.2	\$	212.9

Net sales by product line:

Weight Management	\$	560.1	\$	428.1	\$	1,611.0	\$	1,245.8
Targeted Nutrition		205.3		160.4		582.8		458.9
Energy, Sports and Fitness		45.7		31.9		124.6		87.8
Outer Nutrition		35.4		30.2		109.0		92.2
Literature, promotional and other(3)		48.7		37.8		142.6		111.2
Total Net Sales	\$	895.2	\$	688.4	\$	2,570.0	\$	1,995.9

Net sales by geographic region:

North America	\$	180.7	\$	155.5	\$	532.9	\$	473.2
Mexico		112.9		83.5		330.7		236.3
South and Central America		143.7		95.0		399.1		269.2
EMEA		147.7		121.2		463.6		387.6
Asia Pacific		255.2		181.6		691.6		494.4
China		55.0		51.6		152.1		135.2
Total Net Sales	\$	895.2	\$	688.4	\$	2,570.0	\$	1,995.9

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- (1) Contribution margin consists of net sales less cost of sales and royalty overrides. See Part I, Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* in this Quarterly Report on Form 10-Q for a description of net sales, cost of sales and royalty overrides.
- (2) Compensation to China sales employees and service fees to China independent service providers totaling \$25.2 million and \$24.0 million for the three months ended September 30, 2011 and 2010, respectively, and \$70.7 million and \$64.4 million for the nine months ended September 30, 2011 and 2010, respectively, is included in selling, general and administrative expenses while distributor compensation for all other countries is included in contribution margin.
- (3) Product buybacks and returns in all product categories are included in the literature, promotional and other category.

As of September 30, 2011 and December 31, 2010, total assets for the Company's Primary Reporting Segment were \$1,305.9 million and \$1,162.1 million, respectively. As of September 30, 2011 and December 31, 2010, total assets for the China segment were \$82.2 million and \$70.1 million, respectively.

8. Share-Based Compensation

The Company has share-based compensation plans, which are more fully described in Note 9, *Share-based Compensation*, to the Consolidated Financial Statements in the 2010 10-K. During the nine months ended September 30, 2011, the Company granted stock awards subject to continued service, consisting of stock units and SARs, with vesting terms fully described in the 2010 10-K. There were no stock options granted during the three and nine months ended September 30, 2011 and 2010.

In August 2011, the Company granted 0.9 million SARs subject to service, market and performance conditions to its Chairman and Chief Executive Officer. These awards will vest on December 31, 2014, subject to his continued employment through that date, the Company's stock price appreciating and exceeding a targeted price, and the Company's achievement of certain volume point performance targets. The fair value of these SARs was determined on the date of the grant using the Monte Carlo lattice model.

For the three months ended September 30, 2011 and 2010, share-based compensation expense amounted to \$6.1 million each period. For the nine months ended September 30, 2011 and 2010, share-based compensation expense amounted to \$17.2 million and \$16.9 million, respectively. As of September 30, 2011, the total unrecognized compensation cost related to all non-vested stock awards was \$47.3 million and the related weighted-average period over which it is expected to be recognized is approximately 2.0 years.

All share and per share data have been adjusted for the two-for-one stock split discussed in Note 2, *Significant Accounting Policies*.

The following tables summarize the activity under all share-based compensation plans for the nine months ended September 30, 2011:

Stock Options & SARs	Awards (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In millions)
Outstanding at December 31, 2010	12,780	\$ 14.38	5.7 years	\$ 253.1
Granted(1)	2,081	\$ 54.82		
Exercised	(2,826)	\$ 12.54		
Forfeited	(132)	\$ 19.83		

Outstanding at September 30, 2011	11,903	\$	21.83	5.6 years	\$	382.1
Exercisable at September 30, 2011	5,094	\$	12.98	4.1 years	\$	206.9

(1) Includes 0.9 million SARs which are subject to service, market and performance conditions.

The weighted-average grant date fair value of SARs granted during the three months ended September 30, 2011 and 2010 was \$17.40 and \$11.02, respectively. The weighted-average grant date fair value of SARs granted during the nine months ended September 30, 2011 and 2010 was \$19.63 and \$9.31, respectively. The total intrinsic value of stock options and SARs exercised during the three months ended September 30, 2011 and 2010, was \$36.8 million and \$25.8 million, respectively. The total intrinsic value of stock options and SARs exercised during the nine months ended September 30, 2011 and 2010, was \$100.9 million and \$39.3 million, respectively.

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Incentive Plan and Independent Directors Stock Units	Shares (In thousands)	Weighted Average Grant Date Fair Value
Outstanding and nonvested December 31, 2010	1,160.5	\$ 13.76
Granted	24.3	\$ 42.55
Vested	(453.5)	\$ 17.77
Forfeited	(10.8)	\$ 12.18
Outstanding and nonvested at September 30, 2011	720.5	\$ 12.23

The total vesting date fair value of stock units which vested during the three months ended September 30, 2011 and 2010, was \$0.5 million and \$0.4 million, respectively. The total vesting date fair value of stock units which vested during the nine months ended September 30, 2011 and 2010, was \$8.1 million and \$7.3 million, respectively.

The Company recognizes excess tax benefits associated with share-based compensation to shareholders equity only when realized. When assessing whether excess tax benefits relating to share-based compensation have been realized, the Company follows the with-and-without approach which was adopted in the second quarter of 2011. Under this approach, excess tax benefits related to share-based compensation are not deemed to be realized until after the utilization of all other tax benefits available to the Company, which are also subject to applicable limitations. As of September 30, 2011, and December 31, 2010, the Company had \$12.6 million and \$8.7 million, respectively, of unrealized excess tax benefits. See Note 2, *Significant Accounting Policies*, for further discussion of the Company's change in accounting principle from the tax-law-ordering method to the with-and-without approach.

9. Income Taxes

As of September 30, 2011, the total amount of unrecognized tax benefits, related interest and penalties was \$32.4 million, \$5.6 million and \$1.3 million, respectively. During the nine months ended September 30, 2011, the Company recorded tax, interest and penalties related to uncertain tax positions of \$5.1 million, \$1.2 million and \$0.2 million, respectively, and reduced uncertain tax positions due to the expiration of statutes of limitations for tax, interest and penalties of \$3.6 million, \$1.1 million and \$0.1 million, respectively. During the nine months ended September 30, 2011, uncertain tax positions were also reduced by foreign currency translation adjustments of \$0.9 million, resulting in a year to date net increase in unrecognized tax benefits and related interest and penalties of \$0.8 million. The unrecognized tax benefits relate primarily to uncertainties from international transfer pricing issues and the deductibility of certain operating expenses in various jurisdictions. If the total amount of unrecognized tax benefits were recognized, \$32.4 million of unrecognized tax benefits, \$5.6 million of interest and \$1.3 million of penalties would impact the effective tax rate.

During the nine months ended September 30, 2011, the Company benefited from the terms of a tax holiday in the People's Republic of China. The tax holiday commenced on January 1, 2008 and will conclude on December 31, 2012. Under the terms of the holiday, the Company was subject to a zero tax rate in China during 2008 and 2009, 11% tax rate in 2010, and is subject to a graduated rate of 12% in 2011. The tax rate will gradually increase to a maximum rate of 25% in 2013.

10. Derivative Instruments and Hedging Activities***Interest Rate Risk Management***

The Company engages in an interest rate hedging strategy for which the hedged transactions are forecasted interest payments on the Company's New Credit Facility, which is a variable rate credit facility. The hedged risk is the variability of forecasted interest rate cash flows, where the hedging strategy involves the purchase of interest rate swaps. For the outstanding cash flow hedges on interest rate exposures at September 30, 2011, the Company is

hedging certain of its monthly interest rate exposures over approximately one year and ten months.

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During August 2009, the Company entered into four interest rate swap agreements with an effective date of December 31, 2009. The agreements collectively provide for the Company to pay interest for less than a four-year period at a weighted average fixed rate of 2.78% on notional amounts aggregating to \$140.0 million while receiving interest for the same period at the one month LIBOR rate on the same notional amounts. These agreements will expire in July 2013. These swaps at inception were designated as cash flow hedges against the variability in the LIBOR interest rate on the Company's term loan under the Prior Credit Facility or against the variability in the LIBOR interest rate on the replacement debt. The Company's term loan under the Prior Credit Facility was terminated in March 2011 and refinanced with the New Credit Facility as discussed further in Note 4, *Long-Term Debt*. The Company's swaps remain effective and continue to be designated as cash flow hedges against the variability in certain LIBOR interest rate borrowings under the New Credit Facility at LIBOR plus 1.50% to 2.50%, fixing the Company's weighted average effective rate on the notional amounts at 4.28% to 5.28%. There was no hedge ineffectiveness recorded as result of this refinancing event.

The Company assesses hedge effectiveness and measures hedge ineffectiveness at least quarterly. During the three and nine months ended September 30, 2011 and 2010, the ineffective portion relating to these hedges was immaterial and the hedges remained effective as of September 30, 2011. Consequently, all changes in the fair value of the derivatives are deferred and recorded in other comprehensive income (loss) until the related forecasted transactions are recognized in the consolidated statements of income. The fair value of the interest rate swap agreements are based on third-party bank quotes. At September 30, 2011 and December 31, 2010, the Company recorded the interest rate swaps as liabilities at their fair value of \$6.0 million and \$6.6 million, respectively.

Foreign Currency Instruments

The Company also designates certain foreign currency derivatives, such as certain foreign currency forward and option contracts, as freestanding derivatives for which hedge accounting does not apply. The changes in the fair market value of these freestanding derivatives are included in selling, general and administrative expenses in the Company's consolidated statements of income. The Company uses foreign currency forward contracts to hedge foreign-currency-denominated intercompany transactions and to partially mitigate the impact of foreign currency fluctuations. The Company also uses foreign currency option contracts to partially mitigate the impact of foreign currency fluctuations. The fair value of the forward and option contracts are based on third-party bank quotes.

The Company designates as cash-flow hedges those foreign currency forward contracts it entered into to hedge forecasted inventory purchases and intercompany management fees that are subject to foreign currency exposures. Forward contracts are used to hedge forecasted inventory purchases over specific months. Changes in the fair value of these forward contracts, excluding forward points, designated as cash-flow hedges are recorded as a component of accumulated other comprehensive income (loss) within shareholders' equity, and are recognized in cost of sales in the consolidated statement of income during the period which approximates the time the hedged inventory is sold. The Company also hedges forecasted intercompany management fees over specific months. These contracts allow the Company to sell Euros in exchange for U.S. dollars at specified contract rates. Changes in the fair value of these forward contracts designated as cash flow hedges are recorded as a component of accumulated other comprehensive income (loss) within shareholders' equity, and are recognized in selling, general and administrative expenses in the consolidated statement of income during the period when the hedged item and underlying transaction affect earnings.

As of September 30, 2011, and December 31, 2010, the aggregate notional amounts of cash-flow designated hedge foreign currency contracts outstanding were approximately \$41.2 million and \$32.1 million, respectively. At September 30, 2011, these outstanding contracts were expected to mature over the next twelve months. The Company's derivative financial instruments are recorded on the consolidated balance sheet at fair value based on third-party bank quotes. As of September 30, 2011, the Company recorded assets at fair value of \$2.1 million and liabilities at fair value of \$0.2 million relating to all outstanding foreign currency contracts designated as cash-flow hedges. As of December 31, 2010, the Company recorded assets at fair value of \$0.6 million and liabilities at fair value of \$0.8 million relating to all outstanding foreign currency contracts designated as cash-flow hedges. The Company assesses hedge effectiveness and measures hedge ineffectiveness at least quarterly. During the three and nine months ended September 30, 2011 and 2010, the ineffective portion relating to these hedges was immaterial and the hedges remained effective as of September 30, 2011.

As of September 30, 2011, and December 31, 2010, the majority of the Company's outstanding foreign currency forward contracts had maturity dates of less than twelve months with the majority of freestanding derivatives expiring within one month and three months, respectively. There were no foreign currency option contracts outstanding as of September 30, 2011, and December 31, 2010. See Part I, Item 3 *Quantitative and Qualitative Disclosures About Market Risk* in this Quarterly Report on Form 10-Q for foreign currency instruments outstanding as of September 30, 2011.

Table of Contents**Gains and Losses on Derivative Instruments**

The following table summarizes gains (losses) relating to derivative instruments recorded in other comprehensive income (loss) during the three and nine months ended September 30, 2011 and 2010:

	Amount of Gain (Loss) Recognized in Other Comprehensive Income (Loss)			
	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In millions)			

Derivatives designated as hedging instruments:

Foreign exchange currency contracts relating to inventory and intercompany management fee hedges

\$	3.5	\$	(8.1)	\$	1.0	\$	5.3
\$	(0.7)	\$	(2.4)	\$	(2.2)	\$	(8.2)

Interest rate swaps

The following table summarizes gains (losses) relating to derivative instruments recorded to income during the three and nine months ended September 30, 2011 and 2010:

Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income			
	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In millions)			

Derivatives designated as hedging instruments:

Foreign exchange currency contracts relating to inventory hedges and intercompany management fee hedges

\$	(0.3)	\$	0.1	\$	(0.3)	\$	
----	-------	----	-----	----	-------	----	--

(1)

Derivatives not designated as hedging instruments:

Foreign exchange currency contracts relating to selling, general and administrative expenses

\$	2.7	\$	2.0	\$	3.8	\$	(7.3)
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(1) For foreign exchange contracts designated as hedging instruments, the amounts recognized in income (loss) represent the amounts excluded from the assessment of hedge effectiveness. There were no ineffective amounts recorded for derivatives designated as hedging instruments.

The following table summarizes gains (losses) relating to derivative instruments reclassified from accumulated other comprehensive loss into income during the three and nine months ended September 30, 2011 and 2010:

Location of Gain

	(Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income			
		For the Three Months Ended September 30, 2011		For the Nine Months Ended September 30, 2010	
		September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
		(In millions)			
Derivatives designated as hedging instruments:					
Foreign exchange currency contracts relating to inventory hedges	Cost of sales	\$	\$	1.1	\$ (0.3) \$ 0.4
Foreign exchange currency contracts relating to intercompany management fee hedges	Selling, general and administrative expenses	\$ (0.7)	\$	1.9	\$ (2.2) \$ 6.5
Interest rate contracts	Interest expense, net	\$ (0.9)	\$	(0.9)	\$ (2.7) \$ (2.7)
The Company reports its derivatives at fair value as either assets or liabilities within its condensed consolidated balance sheet. See Note 13, <i>Fair Value Measurements</i> , for information on derivative fair values and their condensed consolidated balance sheet location as of September 30, 2011, and December 31, 2010.					

Table of Contents**11. Shareholders Equity*****Dividends***

The declaration of future dividends is subject to the discretion of the Company's board of directors and will depend upon various factors, including the Company's earnings, financial condition, restrictions imposed by the New Credit Facility and the terms of any other indebtedness that may be outstanding, cash requirements, future prospects and other factors deemed relevant by its board of directors. The New Credit Facility entered into on March 9, 2011, permits payments of dividends as long as no default or event of default exists and the consolidated leverage ratio specified in the New Credit Facility is not exceeded.

On February 22, 2011, the Company announced that its board of directors approved a cash dividend of \$0.13 per common share in an aggregate amount of \$14.8 million that was paid to shareholders on March 22, 2011. On May 2, 2011, the Company announced that its board of directors approved a cash dividend of \$0.20 per common share in an aggregate amount of \$23.9 million that was paid to shareholders on June 7, 2011. On August 1, 2011, the Company announced that its board of directors approved a cash dividend of \$0.20 per common share in an aggregate amount of \$23.5 million that was paid to shareholders on August 29, 2011.

The aggregate amount of dividends declared and paid during the three months ended September 30, 2011 and 2010, were \$23.5 million and \$14.9 million, respectively. The aggregate amount of dividends declared and paid during the nine months ended September 30, 2011 and 2010, were \$62.2 million and \$39.0 million, respectively.

Share Repurchases

On April 30, 2009, the Company announced that its board of directors authorized a program for the Company to repurchase up to \$300 million of Herbalife common shares during the next two years, at such times and prices as determined by the Company's management. On May 3, 2010, the Company's board of directors approved an increase to the share repurchase authorization from \$300 million to \$1 billion. In addition, the Company's board of directors approved the extension of the expiration date of the share repurchase program from April 2011 to December 2014. The New Credit Facility permits repurchase of common shares as long as no default or event of default exists and the consolidated leverage ratio specified in the New Credit Facility is not exceeded.

The Company did not repurchase any common shares in the open market during the three months ended March 31, 2011. During the three months ended June 30, 2011, the Company repurchased approximately 1.8 million of its common shares through open market purchases at an aggregate cost of approximately \$98.8 million or an average cost of \$54.15 per share. During the three months ended September 30, 2011, the Company repurchased approximately 2.8 million of its common shares through open market purchases at an aggregate cost of approximately \$150.0 million or an average cost of \$54.06 per share. As of September 30, 2011, the remaining authorized capacity under the Company's share repurchase program was approximately \$527.9 million.

The aggregate purchase price of any common shares repurchased is reflected as a reduction to shareholders' equity. The Company allocates the purchase price of the repurchased shares as a reduction to retained earnings, common shares and additional paid-in-capital.

The number of shares issued upon vesting or exercise for certain restricted stock units and SARs granted, pursuant to the Company's share-based compensation plans, is net of the minimum statutory withholding requirements that the Company pays on behalf of its employees. Although shares withheld are not issued, they are treated as common share repurchases in the Company's condensed consolidated financial statements, as they reduce the number of shares that would have been issued upon vesting. These shares do not count against the authorized capacity under the Company's share repurchase program described above.

Stock Split

On April 28, 2011, the Company's shareholders approved a 2-for-1 split of the Company's common shares. One additional common share was distributed to the Company's shareholders on or around May 17, 2011, for each common share held on May 10, 2011. All common shares subject to outstanding equity awards and warrants, as well as the number of common shares reserved for issuance under the Company's share-based compensation plans, were adjusted proportionately.

Table of Contents**12. Earnings Per Share**

Basic earnings per share represents net income for the period common shares were outstanding, divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share represents net income divided by the weighted average number of common shares outstanding, inclusive of the effect of dilutive securities such as outstanding stock options, SARs, stock units and warrants.

The following are the common share amounts used to compute the basic and diluted earnings per share for each period:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
	(in thousands)			
Weighted average shares used in basic computations	116,975	118,442	118,059	119,286
Dilutive effect of exercise of equity grants outstanding	7,034	6,731	7,572	6,516
Dilutive effect of warrants	266	440	258	414
 Weighted average shares used in diluted computations	 124,275	 125,613	 125,889	 126,216

There were an aggregate of 2.0 million and 2.1 million of equity grants that were outstanding during the three and nine months ended September 30, 2011, and an aggregate of 1.6 million and 3.4 million of equity grants that were outstanding during the three and nine months ended September 30, 2010, respectively, consisting of stock options, SARs, and stock units, but were not included in the computation of diluted earnings per share because their effect would be anti-dilutive.

13. Fair Value Measurements

The Company applies the provisions of FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, or ASC 820, for its financial and non-financial assets and liabilities. ASC 820 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. ASC 820 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 inputs are unobservable inputs for the asset or liability.

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The Company measures certain assets and liabilities at fair value as discussed throughout the notes to its consolidated financial statements. Foreign exchange currency contracts and interest rate swaps are valued using standard calculations and models. Foreign exchange currency contracts are valued primarily based on inputs such as observable forward rates, spot rates and foreign currency exchange rates at the reporting period ended date. Interest rate swaps are valued primarily based on inputs such as LIBOR and swap yield curves at the reporting period ended date. Assets or liabilities that have recurring measurements and are measured at fair value consisted of only Level 2 derivatives and are shown below at their gross values at September 30, 2011 and December 31, 2010:

Fair Value Measurements at Reporting Date Using

		Significant Other Observable Inputs (Level 2)	Significant Other Observable Inputs (Level 2) Fair Value at December 31, 2010
	Derivative Balance Sheet Location	Fair Value at September 30, 2011 (in millions)	
ASSETS:			
Derivatives designated as cash flow hedging instruments:			
Foreign exchange currency contracts relating to intercompany management fee hedges	Prepaid expenses and other current assets	\$ 2.1	\$ 0.6
Derivatives not designated as cash flow hedging instruments:			
Foreign exchange currency contracts	Prepaid expenses and other current assets	\$ 0.5	\$ 2.3
		\$ 2.6	\$ 2.9
LIABILITIES:			
Derivatives designated as cash flow hedging instruments:			
Foreign exchange currency contracts relating to inventory and intercompany management fee hedges	Accrued expenses	\$ 0.2	\$ 0.8
Interest rate swaps	Accrued expenses	\$ 6.0	\$ 6.6
Derivatives not designated as hedging instruments:			
Foreign exchange currency contracts	Accrued expenses	\$ 2.9	\$ 3.0
		\$ 9.1	\$ 10.4

14. Subsequent Events

On October 31, 2011, the Company announced that its board of directors approved a cash dividend of \$0.20 per common share, payable on November 28, 2011 to shareholders of record as of November 14, 2011.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a global network marketing company that sells weight management products, nutritional supplements, energy, sports & fitness products and personal care products. We pursue our mission of "changing people's lives" by providing a financially rewarding business opportunity to distributors and quality products to distributors and their customers who seek a healthy lifestyle. We are one of the largest network marketing companies in the world with net sales of approximately \$2.7 billion for the year ended December 31, 2010. As of September 30, 2011, we sold our products in 78 countries through a network of approximately 2.5 million independent distributors. In China, we sell our products through retail stores, sales representatives and independent service providers. Due to changes in China's labor laws, effective in the third quarter of 2011, we no longer have sales employees in China as they have been transferred into independent service providers. We believe the quality of our products and the effectiveness of our distribution network, coupled with geographic expansion, has been the primary reasons for our success throughout our 31-year operating history.

Our products are grouped in four principal categories: weight management, targeted nutrition, energy, sports & fitness and Outer Nutrition, along with literature and promotional items. Our products are often sold in programs that are comprised of a series of related products and literature designed to simplify weight management and nutrition for consumers and maximize our distributors' cross-selling opportunities.

Industry-wide factors that affect us and our competitors include the global obesity epidemic and the aging of the worldwide population, which are driving demand for nutrition and wellness-related products along with the global increase in under and unemployment which can affect the recruitment and retention of distributors seeking part time or full time income opportunities.

While we continue to monitor the current global financial crisis, we remain focused on the opportunities and challenges in retailing of our products, recruiting and retaining distributors, improving distributor productivity, opening new markets, further penetrating existing markets, globalizing successful Distributor Methods of Operation, or DMO, such as Nutrition Clubs and Weight Loss Challenges, introducing new products and globalizing existing products, developing niche market segments and further investing in our infrastructure. Management also continues to monitor the Venezuela market and especially the limited ability to repatriate cash.

We report revenue from our six regions:

North America;

Mexico;

South and Central America;

EMEA, which consists of Europe, the Middle East and Africa;

Asia Pacific (excluding China); and

China.

Volume Points by Geographic Region

A key non-financial measure we focus on is Volume Points on a Royalty Basis, or Volume Points, which is essentially our weighted average measure of product sales volume. Volume Points, which are unaffected by exchange rates or price increases, are used by management as a proxy for sales trends because in general, an increase in Volume Points in a particular geographic region or country indicates an increase in our local currency net sales while a decrease in Volume Points in a particular geographic region or country indicates a decrease in our local currency net sales.01pt 10.0pt;text-indent:-10.0pt;">Balance, end of period

Common stock

Balance, beginning of year

19,593

19,242

Employee share-based compensation

276

94

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37

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Compensation amortization under share-based plans and other changes

111

97

Balance, end of period

19,980

19,433

Retained earnings

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Balance, beginning of year

16,315

13,314

Cumulative effect of adoption of updated accounting guidance at April 1, 2009

71

Net income

2,322

2,337

Dividends

(515

)

(521

)

Other

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39

(4

)

7

Balance, end of period

18,118

15,208

Accumulated other changes in equity from nonowner sources, net of tax

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Balance, beginning of year

1,219

(900

)

Cumulative effect of adoption of updated accounting guidance at April 1, 2009

(71

)

Change in net unrealized gain (loss) on investment securities:

Having no credit losses recognized in the consolidated statement of income

1,061

2,348

Having credit losses recognized in the consolidated statement of income

68

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41

Net change in unrealized foreign currency translation and other changes

24

177

Balance, end of period

2,372

1,657

Treasury stock (at cost)

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42

Balance, beginning of year

(9,791

)

(6,426

)

Treasury shares acquired share repurchase authorization

(3,400

)

(1,750

)

Net shares acquired related to employee share-based compensation plans

(54

)

(43

)

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Balance, end of period

(13,245

)

(8,219

)

Total common shareholders' equity

27,225

28,079

Total shareholders' equity

\$

27,295

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44

\$

28,160

Common shares outstanding

Balance, beginning of year

520.3

585.1

Treasury shares acquired share repurchase authorization

(66.8)

)

(39.3

)

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Net shares issued under employee share-based compensation plans

7.0

2.1

Balance, end of period

460.5

547.9

Summary of changes in equity from nonowner sources

Net income

\$

2,322

\$

2,337

Other changes in equity from nonowner sources, net of tax

1,153

2,628

Total changes in equity from nonowner sources

\$

3,475

\$

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See notes to consolidated financial statements (unaudited).

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)

(in millions)

For the nine months ended September 30,	2010	2009
Cash flows from operating activities		
Net income	\$ 2,322	\$ 2,337
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized investment (gains) losses	(220)	172
Depreciation and amortization	608	602
Deferred federal income tax expense	149	46
Amortization of deferred acquisition costs	2,845	2,864
Equity in (income) loss from other investments	(161)	211
Premiums receivable	(228)	88
Reinsurance recoverables	754	893
Deferred acquisition costs	(2,928)	(2,915)
Claims and claim adjustment expense reserves	(1,112)	(799)
Unearned premium reserves	418	252
Other	(55)	(547)
Net cash provided by operating activities	2,392	3,204
Cash flows from investing activities		
Proceeds from maturities of fixed maturities	3,881	3,769
Proceeds from sales of investments:		
Fixed maturities	3,281	2,206
Equity securities	157	37
Real estate	10	
Other investments	426	217
Purchases of investments:		
Fixed maturities	(5,167)	(6,350)
Equity securities	(29)	(22)
Real estate	(15)	(12)
Other investments	(373)	(262)
Net purchases of short-term securities	(66)	(1,345)
Securities transactions in course of settlement	(240)	588
Other	(220)	(271)
Net cash provided by (used in) investing activities	1,645	(1,445)
Cash flows from financing activities		
Payment of debt	(275)	(143)
Issuance of debt		494
Dividends paid to shareholders	(512)	(518)
Issuance of common stock employee share options	267	76
Treasury stock acquired share repurchase authorization	(3,441)	(1,720)
Treasury stock acquired net employee share-based compensation	(40)	(29)
Excess tax benefits from share-based payment arrangements	6	4
Net cash used in financing activities	(3,995)	(1,836)
Effect of exchange rate changes on cash	1	13

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Net increase (decrease) in cash		43		(64)
Cash at beginning of year		255		350
Cash at end of period	\$	298	\$	286
Supplemental disclosure of cash flow information				
Income taxes paid	\$	511	\$	573
Interest paid	\$	263	\$	248

See notes to consolidated financial statements (unaudited).

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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. All material intercompany transactions and balances have been eliminated. Certain reclassifications have been made to the 2009 interim consolidated financial statements and notes to conform to the 2010 presentation. 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 2009 Annual Report on Form 10-K.

The preparation of the interim consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the interim consolidated financial statements and the reported amounts of revenues and claims and expenses during the reporting period. Actual results could differ from those estimates.

Adoption of Accounting Standards Updates

Amendments to Accounting for Variable Interest Entities

In June 2009, the FASB issued updated guidance on the accounting for variable interest entities that eliminates the concept of a qualifying special-purpose entity and the quantitative-based risks and rewards calculation for determining which company, if any, has a controlling financial interest in a variable interest entity. The updated guidance requires an analysis of whether a company has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary.

The updated guidance is effective for all variable interest entities owned on or formed after January 1, 2010. The adoption of this guidance did not have any effect on the Company's results of operations, financial position or liquidity.

Accounting Standard Not Yet Adopted

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued updated guidance to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that had not previously been capitalized by a reporting entity, the entity may elect not to capitalize those costs.

The updated guidance is effective for periods ending after December 15, 2011. The adoption of this guidance is not expected to have any impact on the Company's results of operations, financial position or 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 currently 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 specific business segments are as follows:

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES, Continued

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.

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

Financial, Professional & International Insurance

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

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.

2. SEGMENT INFORMATION

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The following tables summarize the components of the Company's revenues, operating income and total assets by reportable business segments:

(for the three months ended September 30, in millions)	Business Insurance	Financial, Professional & International Insurance	Personal Insurance	Total Reportable Segments
2010				
Premiums	\$ 2,736	\$ 820	\$ 1,866	\$ 5,422
Net investment income	514	110	111	735
Fee income	64			64
Other revenues	10	7	18	35
Total operating revenues (1)	\$ 3,324	\$ 937	\$ 1,995	\$ 6,256
Operating income (1)	\$ 543	\$ 212	\$ 168	\$ 923
2009				
Premiums	\$ 2,768	\$ 861	\$ 1,792	\$ 5,421
Net investment income	529	118	116	763
Fee income	72			72
Other revenues	14	7	20	41
Total operating revenues (1)	\$ 3,383	\$ 986	\$ 1,928	\$ 6,297
Operating income (1)	\$ 668	\$ 167	\$ 149	\$ 984

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

2. SEGMENT INFORMATION, Continued

(for the nine months ended September 30, in millions)	Business Insurance	Financial, Professional & International Insurance	Personal Insurance	Total Reportable Segments
2010				
Premiums	\$ 8,027	\$ 2,499	\$ 5,466	\$ 15,992
Net investment income	1,579	331	340	2,250
Fee income	219			219
Other revenues	23	20	56	99
Total operating revenues (1)	\$ 9,848	\$ 2,850	\$ 5,862	\$ 18,560
Operating income (1)	\$ 1,677	\$ 470	\$ 246	\$ 2,393
2009				
Premiums	\$ 8,295	\$ 2,472	\$ 5,308	\$ 16,075
Net investment income	1,335	329	299	1,963
Fee income	234			234
Other revenues	32	20	62	114
Total operating revenues (1)	\$ 9,896	\$ 2,821	\$ 5,669	\$ 18,386
Operating income (1)	\$ 1,775	\$ 448	\$ 391	\$ 2,614

(1) Operating revenues for reportable business segments exclude net realized investment gains (losses). Operating income for reportable business segments equals net income excluding the after-tax impact of net realized investment gains (losses) and Interest Expense and Other.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

2. SEGMENT INFORMATION, Continued

Business Segment Reconciliations

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue reconciliation				
Earned premiums				
Business Insurance:				
Commercial multi-peril	\$ 760	\$ 726	\$ 2,200	\$ 2,171
Workers compensation	642	627	1,847	1,883
Commercial automobile	488	504	1,430	1,473
Property	411	447	1,257	1,339
General liability	435	463	1,293	1,429
Other		1		
Total Business Insurance	2,736	2,768	8,027	8,295
Financial, Professional & International Insurance:				
Fidelity and surety	247	257	780	757
General liability	220	235	668	696
International	319	335	950	920
Other	34	34	101	99
Total Financial, Professional & International Insurance	820	861	2,499	2,472
Personal Insurance:				
Automobile	932	925	2,757	2,768
Homeowners and other	934	867	2,709	2,540
Total Personal Insurance	1,866	1,792	5,466	5,308
Total earned premiums	5,422	5,421	15,992	16,075
Net investment income	735	763	2,250	1,963
Fee income	64	72	219	234
Other revenues	35	41	99	114
Total operating revenues for reportable segments	6,256	6,297	18,560	18,386
Other revenues		1		10

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Net realized investment gains (losses)		226		29		220		(172)
Total consolidated revenues	\$	6,482	\$	6,327	\$	18,780	\$	18,224
Income reconciliation, net of tax								
Total operating income for reportable segments	\$	923	\$	984	\$	2,393	\$	2,614
Interest Expense and Other (1)		(65)		(70)		(214)		(169)
Total operating income		858		914		2,179		2,445
Net realized investment gains (losses)		147		21		143		(108)
Total consolidated net income	\$	1,005	\$	935	\$	2,322	\$	2,337

(1) The primary component of Interest Expense and Other is after-tax interest expense of \$62 million and \$64 million for the three months ended September 30, 2010 and 2009, respectively, and \$189 million and \$185 million for the nine months ended September 30, 2010 and 2009, respectively. The total for the nine months ended September 30, 2009 included a benefit of \$28 million from the favorable resolution of various prior year tax matters.

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****2. SEGMENT INFORMATION, Continued**

(in millions)	September 30, 2010	December 31, 2009
Asset reconciliation:		
Business Insurance	\$ 79,952	\$ 81,705
Financial, Professional & International Insurance	14,269	13,920
Personal Insurance	13,489	13,328
Total assets for reportable segments	107,710	108,953
Other assets (1)	444	607
Total consolidated assets	\$ 108,154	\$ 109,560

(1) The primary component of other assets at September 30, 2010 was other intangible assets. At December 31, 2009, the primary components were other intangible 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:

(at September 30, 2010, in millions)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$ 1,986	\$ 125	\$	\$ 2,111
Obligations of states, municipalities and political subdivisions	38,594	2,839	8	41,425
Debt securities issued by foreign governments	1,945	72	1	2,016
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	4,308	283	48	4,543
All other corporate bonds	14,159	1,165	31	15,293
Redeemable preferred stock	36	3		39

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Total	\$	61,028	\$	4,487	\$	88	\$	65,427
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(at December 31, 2009, in millions)	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$ 2,490	\$ 85	\$ 1	\$ 2,574
Obligations of states, municipalities and political subdivisions	39,459	1,915	41	41,333
Debt securities issued by foreign governments	1,912	48	3	1,957
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	5,182	190	165	5,207
All other corporate bonds	14,221	623	116	14,728
Redeemable preferred stock	47	2	1	48
Total	\$ 63,311	\$ 2,863	\$ 327	\$ 65,847

Equity Securities

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

(at September 30, 2010, in millions)	Cost	Gross Unrealized Gains	Losses	Fair Value
Common stock	\$ 193	\$ 80	\$ 1	\$ 272
Non-redeemable preferred stock	181	57	4	234
Total	\$ 374	\$ 137	\$ 5	\$ 506

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****3. INVESTMENTS, Continued**

(at December 31, 2009, in millions)	Cost		Gross Unrealized			Fair Value
			Gains	Losses		
Common stock	\$	175	\$	46	\$	219
Non-redeemable preferred stock		198		48		232
Total	\$	373	\$	94	\$	451

Variable Interest Entities

Entities which do not have sufficient equity at risk to allow the entity to finance its activities without additional financial support or in which the equity investors, as a group, do not have the characteristic of a controlling financial interest are referred to as variable interest entities (VIE). A VIE is consolidated by the variable interest holder that is determined to have the controlling financial interest (primary beneficiary) as a result of having both the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or right to receive benefits from the VIE that could potentially be significant to the VIE. The Company determines whether it is the primary beneficiary of an entity subject to consolidation based on a qualitative assessment of the VIE's capital structure, contractual terms, nature of the VIE's operations and purpose and the Company's relative exposure to the related risks of the VIE on the date it becomes initially involved in the VIE. The Company reassesses its VIE determination with respect to an entity on an ongoing basis.

The Company is involved in the normal course of business with VIEs primarily as a passive investor in limited partner equity interests issued by third party VIEs. These include investments in private equity limited partnerships, hedge funds and real estate partnerships where the Company is not related to the general partner. These investments are generally accounted for under the equity method and reported in the Company's consolidated balance sheet as other investments unless the Company is deemed the primary beneficiary. These equity interests generally cannot be redeemed. Distributions from these investments are received by the Company as a result of liquidation of the underlying investments of the funds and/or as income distribution. The Company's maximum exposure to loss with respect to these investments is limited to the investment carrying amounts reported in the Company's consolidated balance sheet and any unfunded commitment. Neither the carrying amounts nor the unfunded commitments related to these VIEs are material.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

3. INVESTMENTS, Continued

Unrealized Investment Losses

The following tables summarize, for all investments in an unrealized loss position at September 30, 2010 and December 31, 2009, the aggregate fair value and gross unrealized losses by length of time those securities have been continuously in an unrealized loss position.

(at September 30, 2010, in millions)	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities						
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$	\$	\$	\$	\$	\$
Obligations of states, municipalities and political subdivisions	341	1	70	7	411	8
Debt securities issued by foreign governments	145	1	14		159	1
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	12	1	552	47	564	48
All other corporate bonds	175	2	307	29	482	31
Redeemable preferred stock			6		6	
Total fixed maturities	673	5	949	83	1,622	88
Equity securities						
Common stock	5	1	5		10	1
Non-redeemable preferred stock	25	1	49	3	74	4
Total equity securities	30	2	54	3	84	5
Total	\$ 703	\$ 7	\$ 1,003	\$ 86	\$ 1,706	\$ 93

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

3. INVESTMENTS, Continued

(at December 31, 2009, in millions)	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities						
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$ 1,018	\$ 1	\$	\$	\$ 1,018	\$ 1
Obligations of states, municipalities and political subdivisions	1,901	24	250	17	2,151	41
Debt securities issued by foreign governments	282	3			282	3
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	313	4	988	161	1,301	165
All other corporate bonds	1,079	22	1,100	94	2,179	116
Redeemable preferred stock	6	1	3		9	1
Total fixed maturities	4,599	55	2,341	272	6,940	327
Equity securities						
Common stock	59	1	17	1	76	2
Non-redeemable preferred stock	9		83	14	92	14
Total equity securities	68	1	100	15	168	16
Total	\$ 4,667	\$ 56	\$ 2,441	\$ 287	\$ 7,108	\$ 343

The following table summarizes, for all fixed maturities and equity securities reported at fair value for which fair value is less than 80% of amortized cost at September 30, 2010, the gross unrealized investment loss by length of time those securities have continuously been in an unrealized loss position of greater than 20% of amortized cost:

(in millions)	Period For Which Fair Value Is Less Than 80% of Amortized Cost				Total
	3 Months or Less	Greater Than 3 Months, 6 Months or Less	Greater Than 6 Months, 12 Months or Less	Greater Than 12 Months	
Fixed maturities					
Mortgage-backed securities	\$	\$ 1	\$	\$ 12	\$ 13
Other		1		20	21

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Total fixed maturities			2			32		34
Equity securities								
Total	\$	\$	2	\$	\$	32	\$	34

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****3. INVESTMENTS, Continued****Impairment Charges**

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

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Fixed maturities				
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$	\$	\$	\$
Obligations of states, municipalities and political subdivisions				
Debt securities issued by foreign governments				
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	1	7	3	65
All other corporate bonds	2	11	7	83
Redeemable preferred stock				
Total fixed maturities	3	18	10	148
Equity securities				
Common stock			2	15
Non-redeemable preferred stock	1		1	64
Total equity securities	1		3	79
Other investments	2	1	7	6
Total	\$ 6	\$ 19	\$ 20	\$ 233

In the second quarter of 2009, the Company adopted updated accounting guidance that changed the reporting of other-than-temporary impairments (OTTI). As a result, the credit component of OTTI on fixed maturities was reported separately effective April 1, 2009, the date of adoption.

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The following tables present a roll-forward of the credit component of OTTI on fixed maturities recognized in the consolidated statement of income for which a portion of the other-than-temporary impairment was recognized in accumulated other changes in equity from nonowner sources for the periods July 1 through September 30, 2010 and 2009, January 1, 2010 through September 30, 2010 and April 1, 2009 through September 30, 2009:

July 1, 2010 through September 30, 2010 (in millions)	Cumulative OTTI Credit Losses Recognized for Securities Held, Beginning of Period	Additions for OTTI Securities Where No Credit Losses Were Previously Recognized	Additions for OTTI Securities Where Credit Losses Have Been Previously Recognized	Reductions Due to Sales/Defaults of Credit- Impaired Securities	Adjustments to Book Value of Credit- Impaired Securities due to Changes in Cash Flows	Cumulative OTTI Credit Losses Recognized for Securities Still Held, End of Period
Fixed maturities						
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	\$ 45	\$	\$ 1	\$	\$	\$ 46
All other corporate bonds	85		1		1	87
Total fixed maturities	\$ 130	\$	\$ 2	\$	\$ 1	\$ 133

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

3. INVESTMENTS, Continued

January 1, 2010 through September 30, 2010 (in millions)	Cumulative OTTI Credit Losses Recognized for Securities Held, Beginning of Period	Additions for OTTI Securities Where No Credit Losses Were Previously Recognized	Additions for OTTI Securities Where Credit Losses Have Been Previously Recognized	Reductions Due to Sales/Defaults of Credit- Impaired Securities	Adjustments to Book Value of Credit- Impaired Securities due to Changes in Cash Flows	Cumulative OTTI Credit Losses Recognized for Securities Still Held, End of Period
Fixed maturities						
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	\$ 46	\$	\$ 3	\$ (3)	\$	\$ 46
All other corporate bonds	93		3	(11)	2	87
Total fixed maturities	\$ 139	\$	\$ 6	\$ (14)	\$ 2	\$ 133

July 1, 2009 through September 30, 2009 (in millions)	Cumulative OTTI Credit Losses Recognized for Securities Held, Beginning of Period	Additions for OTTI Securities Where No Credit Losses Were Previously Recognized	Additions for OTTI Securities Where Credit Losses Have Been Previously Recognized	Reductions Due to Sales/Defaults of Credit- Impaired Securities	Adjustments to Book Value of Credit- Impaired Securities due to Changes in Cash Flows	Cumulative OTTI Credit Losses Recognized for Securities Still Held, End of Period
Fixed maturities						
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	\$ 20	\$ 4	\$ 3	\$	\$ (2)	\$ 25
All other corporate bonds	95	1	7	(4)	1	100
Total fixed maturities	\$ 115	\$ 5	\$ 10	\$ (4)	\$ (1)	\$ 125

April 1, 2009 through September 30, 2009 (in millions)	Cumulative OTTI Credit Losses Recognized for Securities Held, Beginning of Period	Additions for OTTI Securities Where No Credit Losses Were Previously Recognized	Additions for OTTI Securities Where Credit Losses Have Been Previously Recognized	Reductions Due to Sales/Defaults of Credit- Impaired Securities	Adjustments to Book Value of Credit- Impaired Securities due to Changes in Cash Flows	Cumulative OTTI Credit Losses Recognized for Securities Still Held, End of Period
Fixed maturities						
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	\$ 13	\$ 7	\$ 7	\$	\$ (2)	\$ 25
All other corporate bonds	82	8	13	(4)	1	100

Total fixed maturities	\$	95	\$	15	\$	20	\$	(4)	\$	(1)	\$	125
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4. FAIR VALUE MEASUREMENTS

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

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

4. FAIR VALUE MEASUREMENTS, Continued

- Level 1 - Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 - Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the inputs that market participants would use.

Valuation of Investments Reported at Fair Value in Financial Statements

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

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

Fixed Maturities

The Company utilizes a pricing service to estimate fair value measurements for approximately 99% of its fixed maturities. The pricing service utilizes market quotations for fixed maturity securities that have quoted prices in active markets. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value measurements for these securities using its proprietary pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings and matrix pricing. Additionally, the pricing service uses an Option Adjusted Spread model to develop prepayment and interest rate scenarios.

The pricing service evaluates each asset class based on relevant market information, relevant credit information, perceived market movements and sector news. The market inputs utilized in the pricing evaluation, listed in the approximate order of priority, include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the asset class and the market conditions. Depending on the security, the priority of the use of inputs may change or some market inputs may not be relevant. For some securities, additional inputs may be necessary.

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

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

4. FAIR VALUE MEASUREMENTS, Continued

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

The Company holds privately placed corporate bonds and estimates the fair value of these bonds using an internal matrix that is based on market information regarding interest rates, credit spreads and liquidity. The underlying source data for calculating the matrix of credit spreads relative to the U.S. Treasury curve are the Merrill Lynch U.S. Corporate Index and the Merrill Lynch High Yield BB Rated Index. The Company includes the fair value estimates of these corporate bonds in Level 2, since all significant inputs are market observable. As many of these securities are issued by public companies, the Company compares the estimates of fair value to the fair values of these companies' publicly traded debt to test the validity of the internal pricing matrix.

While the vast majority of the Company's municipal bonds are included in Level 2, the Company holds a small number of municipal bonds which are not valued by the pricing service and estimates the fair value of these bonds using an internal pricing matrix with some unobservable inputs that are significant to the valuation. Due to the limited amount of observable market information, the Company includes the fair value estimates for these particular bonds in Level 3. Additionally, the Company holds a small amount of fixed maturities that have characteristics that make them unsuitable for matrix pricing. For these fixed maturities, the Company obtains a quote from a broker (typically a market maker). Due to the disclaimers on the quotes that indicate that the price is indicative only, the Company includes these fair value estimates in Level 3.

Equities – Public Common and Preferred

For public common and preferred stocks, the Company receives prices from a nationally recognized pricing service that are based on observable market transactions and includes these estimates in the amount disclosed in Level 1. The estimated fair value of stocks having transfer restrictions that expire within one year was determined by adjusting the observed market price of the securities for a liquidity discount which takes into consideration the restrictions that existed at September 30, 2010 and is based on market observable inputs. As a result of adjusting the market price to reflect the impact of the transfer restrictions on estimated fair value, the Company discloses these holdings in Level 2. Infrequently, current market quotes in active markets are unavailable for certain non-redeemable preferred stocks held by the Company. In these instances, the Company receives an estimate of fair value from the pricing service that provides fair value estimates for the Company's fixed maturities. The service utilizes some of the same methodologies to price the non-redeemable preferred stocks as it does for the fixed maturities. The Company includes the fair value estimate for these non-redeemable preferred stocks in the amount disclosed in Level 2.

Other Investments

Common Stock with Transfer Restrictions and Other

The estimated fair value of stocks having transfer restrictions that expire after one year was determined using the same methodology described above, and is disclosed in Level 2. The Company holds investments in non-public common and preferred equity securities, with a fair value estimate of \$45 million at September 30, 2010, reported in other investments, where the fair value estimate is determined either internally or by an external fund manager based on recent filings, operating results, balance sheet stability, growth and other business and market sector fundamentals. Due to the significant unobservable inputs in these valuations, the Company includes the total fair value estimate for all of these investments at September 30, 2010 in the amount disclosed in Level 3. The Company holds investments in various publicly-traded securities which are reported in other investments. The \$37 million fair value of these investments at September 30, 2010 is disclosed in Level 1. These investments include securities in the Company's trading portfolio (\$21 million), mutual funds (\$14 million) and other small holdings (\$2 million).

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****4. FAIR VALUE MEASUREMENTS, Continued***Derivatives*

The Company holds non-public warrants in a public company and has convertible bonds containing embedded conversion options that are valued separately from the host bond contract. The Company estimates fair value for the warrants using an option pricing model with observable market inputs. Because the warrants are not market traded and information concerning market participants is not available, the Company includes the fair value estimate of \$100 million at September 30, 2010 in the amount disclosed in Level 3 - other investments.

Fair Value Hierarchy

The following tables present the level within the fair value hierarchy at which the Company's financial assets and financial liabilities are measured on a recurring basis at September 30, 2010 and December 31, 2009.

(at September 30, 2010, in millions)	Total	Level 1	Level 2	Level 3
Invested assets:				
Fixed maturities				
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$ 2,111	\$ 2,094	\$ 17	
Obligations of states, municipalities and political subdivisions	41,425		41,313	112
Debt securities issued by foreign governments	2,016		2,016	
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	4,543		4,542	1
All other corporate bonds	15,293		15,178	115
Redeemable preferred stock	39	38	1	
Total fixed maturities	65,427	2,132	63,067	228
Equity securities				
Common stock	272	263	9	
Non-redeemable preferred stock	234	136	98	

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Total equity securities	506	399	107	
Other investments (1)	191	37	9	145
Total	\$ 66,124	\$ 2,568	\$ 63,183	\$ 373

(1) The amount in Level 3 includes \$100 million of non-public stock purchase warrants of a publicly-held company.

The Company did not have significant transfers between Levels 1 and 2 during the nine months ended September 30, 2010.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

4. FAIR VALUE MEASUREMENTS, Continued

(at December 31, 2009, in millions)	Total	Level 1	Level 2	Level 3
Invested assets:				
Fixed maturities				
U.S. Treasury securities and obligations of U.S. Government and government agencies and authorities	\$ 2,574	\$ 2,517	\$ 57	
Obligations of states, municipalities and political subdivisions	41,333		41,232	101
Debt securities issued by foreign governments	1,957		1,957	
Mortgage-backed securities, collateralized mortgage obligations and pass-through securities	5,207		5,184	23
All other corporate bonds	14,728		14,612	116
Redeemable preferred stock	48	36	12	
Total fixed maturities	65,847	2,553	63,054	240
Equity securities				
Common stock	219	219		
Non-redeemable preferred stock	232	138	94	
Total equity securities	451	357	94	
Other investments (1)	413	46	213	154
Total	\$ 66,711	\$ 2,956	\$ 63,361	\$ 394

(1) The amount in Level 3 includes \$94 million of non-public stock purchase warrants of a publicly-held company.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

4. FAIR VALUE MEASUREMENTS, Continued

The following tables present the changes in the Level 3 fair value category during the three months and nine months ended September 30, 2010, and the twelve months ended December 31, 2009.

Three Months Ended September 30, 2010 (in millions)	Fixed Maturities	Other Investments	Total
Balance at June 30, 2010	\$ 228	\$ 118	\$ 346
Total realized and unrealized investment gains (losses):			
Included in realized investment gains (losses) (1)	2	30	32
Included in increases (decreases) in accumulated other changes in equity from nonowner sources	6	2	8
Purchases, sales and settlements/maturities:			
Purchases			
Sales	(1)	(5)	(6)
Settlements/maturities	(7)		(7)
Gross transfers into Level 3	2		2
Gross transfers out of Level 3	(2)		(2)
Balance at September 30, 2010	\$ 228	\$ 145	\$ 373
Amount of total realized investment gains for the period included in the consolidated statement of income attributable to changes in the fair value of assets still held at the reporting date	\$	\$ 30	\$ 30

(1) Includes impairments on investments held at the end of the period as well as amortization on fixed maturities.

Nine Months Ended September 30, 2010 (in millions)	Fixed Maturities	Other Investments	Total
Balance at December 31, 2009	\$ 240	\$ 154	\$ 394
Total realized and unrealized investment gains (losses):			
Included in realized investment gains (losses) (1)	4	5	9
Included in increases (decreases) in accumulated other changes in equity from nonowner sources	17	(1)	16
Purchases, sales and settlements/maturities:			
Purchases	25		25
Sales	(8)	(13)	(21)

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Settlements/maturities		(29)		(29)
Gross transfers into Level 3		9		9
Gross transfers out of Level 3		(30)		(30)
Balance at September 30, 2010	\$	228	\$	145
			\$	373
Amount of total realized investment gains for the period included in the consolidated statement of income attributable to changes in the fair value of assets still held at the reporting date				
	\$		\$	6
			\$	6

(1) Includes impairments on investments held at the end of the period as well as amortization on fixed maturities.

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****4. FAIR VALUE MEASUREMENTS, Continued**

Twelve Months Ended December 31, 2009 (in millions)	Fixed Maturities	Other Investments	Total
Balance at December 31, 2008	\$ 154	\$ 311	\$ 465
Total realized and unrealized investment gains (losses):			
Included in realized investment gains (losses) (1)	(5)	(4)	(9)
Included in increases (decreases) in accumulated other changes in equity from nonowner sources	11	73	84
Purchases, sales and settlements/maturities:			
Purchases	128	4	132
Sales	(12)		(12)
Settlements/maturities	(18)		(18)
Gross transfers into Level 3	9		9
Gross transfers out of Level 3	(27)	(230)	(257)
Balance at December 31, 2009	\$ 240	\$ 154	\$ 394
Amount of total realized investment gains for the period included in the consolidated statement of income attributable to changes in the fair value of assets still held at the reporting date	\$	\$ 7	\$ 7

(1) Includes impairments on investments held at the end of the period as well as amortization on fixed maturities.

The Company had no financial assets or financial liabilities that were measured at fair value on a non-recurring basis during the nine months ended September 30, 2010 or twelve months ended December 31, 2009.

Financial Instruments Disclosed, But Not Carried, At Fair Value

The Company uses various financial instruments in the normal course of its business. The Company's insurance contracts are excluded from fair value of financial instruments accounting guidance and, therefore, are not included in the amounts discussed below.

The carrying values of cash, short-term securities and investment income accrued approximated their fair values.

The carrying values of \$635 million and \$629 million of financial instruments classified as other assets approximated their fair values at September 30, 2010 and December 31, 2009, respectively. The carrying values of \$3.69 billion and \$3.89 billion of financial instruments classified as other liabilities at September 30, 2010 and December 31, 2009, respectively, also approximated their fair values. Fair value is determined using various methods including discounted cash flows, as appropriate for the various financial instruments.

The carrying value and fair value of the Company's debt at September 30, 2010 were \$6.25 billion and \$7.04 billion, respectively. The respective totals at December 31, 2009 were \$6.53 billion and \$6.82 billion. The Company utilized a pricing service to estimate fair value measurements for approximately 96% of its debt, other than commercial paper, at each of September 30, 2010 and December 31, 2009. The pricing service utilized market quotations for debt that has quoted prices in active markets. For the small amount of the Company's debt securities for which a pricing service is not used, the Company utilized pricing estimates from a nationally recognized broker/dealer to estimate fair value. If estimates of fair value are unavailable from the pricing service or the broker/dealer, the Company produced an estimate of fair value based on internally developed valuation techniques which are based on a discounted cash flow methodology and incorporates all available relevant observable market inputs.

The fair value of commercial paper included in debt outstanding at September 30, 2010 and December 31, 2009 approximated its book value because of its short-term nature.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The following table presents the carrying amount of the Company's goodwill by segment at September 30, 2010 and December 31, 2009:

(in millions)	September 30, 2010	December 31, 2009
Business Insurance	\$ 2,168	\$ 2,168
Financial, Professional & International Insurance	557	557
Personal Insurance	613	613
Other	27	27
Total	\$ 3,365	\$ 3,365

Other Intangible Assets

The following tables present a summary of the Company's other intangible assets by major asset class at September 30, 2010 and December 31, 2009:

(at September 30, 2010, in millions)	Gross Carrying Amount	Accumulated Amortization	Net
Intangible assets subject to amortization			
Customer-related	\$ 935	\$ 768	\$ 167
Fair value adjustment on claims and claim adjustment expense reserves and reinsurance recoverables (1)	191	52	139
Total intangible assets subject to amortization	1,126	820	306
Intangible assets not subject to amortization	216		216
Total other intangible assets	\$ 1,342	\$ 820	\$ 522

(at December 31, 2009, in millions)	Gross Carrying Amount	Accumulated Amortization	Net
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Intangible assets subject to amortization					
Customer-related	\$	935	\$	722	\$ 213
Fair value adjustment on claims and claim adjustment expense reserves and reinsurance recoverables (1)		191		32	159
Total intangible assets subject to amortization		1,126		754	372
Intangible assets not subject to amortization					
Total other intangible assets	\$	1,342	\$	754	\$ 588

(1) The time value of money and the risk margin (cost of capital) components of the intangible asset run off at different rates, and, as such, the amount recognized in income may be a net benefit in some periods and a net expense in other periods.

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****5. GOODWILL AND OTHER INTANGIBLE ASSETS, Continued**

The following table presents a summary of the Company's amortization expense for other intangible assets by major asset class:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Customer-related	\$ 14	\$ 17	\$ 46	\$ 55
Fair value adjustment on claims and claim adjustment expense reserves and reinsurance recoverables	7	7	20	21
Total amortization expense	\$ 21	\$ 24	\$ 66	\$ 76

Intangible asset amortization expense is estimated to be \$20 million for the remainder of 2010, \$69 million in 2011, \$52 million in 2012, \$45 million in 2013 and \$43 million in 2014.

6. DEBT

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

On June 10, 2010, the Company entered into a three-year, \$1.0 billion revolving credit agreement with a syndicate of financial institutions, replacing its five-year, \$1.0 billion credit agreement that expired on that date. No borrowings have been made under the credit agreement since its inception. Pursuant to the credit agreement covenants, the Company must maintain a minimum consolidated net worth (generally defined as shareholders' equity plus certain trust preferred and mandatorily convertible securities, reduced for goodwill and other intangible assets). That threshold is adjusted downward by an amount equal to 70% of the aggregate amount of common stock repurchased by the Company after March 31, 2010, up to a maximum deduction of \$1.75 billion. The threshold was \$14.70 billion at September 30, 2010, and will decline to a minimum of \$14.35 billion during the term of the credit agreement, subject to the Company repurchasing an additional \$500 million of its common stock. The Company must also maintain a ratio of total debt to the sum of total debt plus consolidated net worth of not greater than 0.40 to 1.00. In addition, the credit agreement contains other customary restrictive covenants as well as certain customary events of default, including with respect to a change in control, which is defined to include the acquisition of 35% or more of the Company's voting stock and certain changes in the composition of the Company's board of directors. At September 30, 2010, the Company was in compliance with these

covenants. Generally, the cost of borrowing under this agreement will range from LIBOR plus 100 basis points to LIBOR plus 175 basis points depending on the Company's credit ratings. At September 30, 2010, that cost would have been LIBOR plus 125 basis points, had there been any amounts outstanding under the credit agreement.

7. SHARE REPURCHASE AUTHORIZATION

Since May 2006, the Company's board of directors has approved four common share repurchase authorizations, for a cumulative authorization of up to \$16 billion of shares of the Company's common stock. Under these authorizations, the most recent of which totaled \$6 billion and was approved by the board of directors in October 2009, repurchases may be made from time to time in the open market, pursuant to preset trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934, in private transactions or otherwise. The authorizations do not have a stated expiration date. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including the Company's financial position, earnings, catastrophe losses, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, other investment opportunities (including mergers and acquisitions), market conditions and other factors. During the three months and nine months ended September 30, 2010, the Company repurchased 11.8 million and 66.8 million shares, respectively, under its share repurchase authorization, for a total cost of approximately \$600 million and \$3.40 billion, respectively. The average cost per share repurchased was \$50.73 and \$50.92, respectively. At September 30, 2010, the Company had \$3.11 billion of capacity remaining under the share repurchase authorization.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

8. CHANGES IN EQUITY FROM NONOWNER SOURCES

The Company's total changes in equity from nonowner sources were as follows:

(in millions, after-tax)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	\$ 1,005	\$ 935	\$ 2,322	\$ 2,337
Change in net unrealized gain (loss) on investment securities:				
Having no credit losses recognized in the consolidated statement of income	585	1,322	1,061	2,348
Having credit losses recognized in the consolidated statement of income	24	50	68	103
Other changes	73	27	24	177
Total changes in equity from nonowner sources	\$ 1,687	\$ 2,334	\$ 3,475	\$ 4,965

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

9. EARNINGS PER SHARE

The following is a reconciliation of the income and share data used in the basic and diluted earnings per share computations:

(in millions, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Basic				
Net income, as reported	\$ 1,005	\$ 935	\$ 2,322	\$ 2,337
Preferred stock dividends	(1)	(1)	(2)	(3)
Participating share-based awards allocated income	(8)	(6)	(18)	(16)
Net income available to common shareholders basic	\$ 996	\$ 928	\$ 2,302	\$ 2,318
Diluted				
Net income available to common shareholders	\$ 996	\$ 928	\$ 2,302	\$ 2,318
Effect of dilutive securities:				
Performance shares	1	1	1	1
Convertible preferred stock	1	1	2	3
Zero coupon convertible notes				1
Net income available to common shareholders diluted	\$ 998	\$ 930	\$ 2,305	\$ 2,323
Common shares				
Basic				
Weighted average shares outstanding	465.9	558.4	486.1	572.8
Diluted				
Weighted average shares outstanding	465.9	558.4	486.1	572.8
Weighted average effects of dilutive securities:				
Stock options and performance shares	4.4	3.7	4.4	2.1
Convertible preferred stock	1.7	2.0	1.8	2.1
Zero coupon convertible notes				0.5
Total	472.0	564.1	492.3	577.5
Net Income per Common Share				
Basic	\$ 2.14	\$ 1.66	\$ 4.73	\$ 4.05
Diluted	\$ 2.11	\$ 1.65	\$ 4.68	\$ 4.02

10. SHARE-BASED INCENTIVE COMPENSATION

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The following presents information for fully vested stock option awards at September 30, 2010:

Stock Options	Number	Weighted Average Exercise Price	Weighted Average Contractual Life Remaining	Aggregate Intrinsic Value (\$ in millions)
Vested at end of period (1)	20,707,939	\$ 46.36	3.5 Years	\$ 136
Exercisable at end of period	17,032,080	\$ 46.32	2.6 Years	\$ 116

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

Table of Contents**THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued****10. SHARE-BASED INCENTIVE COMPENSATION, Continued**

The total compensation cost recognized in earnings for all share-based incentive compensation awards was \$27 million for each of the three months ended September 30, 2010 and 2009, respectively, and \$98 million and \$92 million for the nine months ended September 30, 2010 and 2009, respectively. The related tax benefit recognized in the consolidated statement of income was \$0 and \$9 million for the three months ended September 30, 2010 and 2009, respectively, and \$25 million and \$31 million for the nine months ended September 30, 2010 and 2009, respectively.

The total unrecognized compensation cost related to all nonvested share-based incentive compensation awards at September 30, 2010 was \$138 million, which is expected to be recognized over a weighted-average period of 1.8 years. The total unrecognized compensation cost related to all nonvested share-based incentive compensation awards at December 31, 2009 was \$111 million, which was expected to be recognized over a weighted-average period of 1.7 years.

11. PENSION PLANS, RETIREMENT BENEFITS AND SAVINGS PLANS

The following tables summarize the components of net periodic benefit cost for the Company's pension and postretirement benefit plans recognized in the consolidated statement of income.

(for the three months ended September 30, in millions)	Pension Plans		Postretirement Benefit Plans	
	2010	2009	2010	2009
Net Periodic Benefit Cost:				
Service cost	\$ 24	\$ 20	\$ 1	\$
Interest cost on benefit obligation	32	31	4	4
Expected return on plan assets	(46)	(45)	(1)	
Amortization of unrecognized:				
Prior service benefit		(1)		
Net actuarial loss	15	5		
Net expense	\$ 25	\$ 10	\$ 4	\$ 4

(for the nine months ended September 30, in millions)	Pension Plans		Postretirement Benefit Plans	
	2010	2009	2010	2009
Net Periodic Benefit Cost:				
Service cost	\$ 72	\$ 60	\$ 1	\$

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Interest cost on benefit obligation	96	94	11	13
Expected return on plan assets	(138)	(132)	(1)	(1)
Amortization of unrecognized:				
Prior service benefit	(2)	(4)		
Net actuarial loss	45	16		
Net expense	\$ 73	\$ 34	\$ 11	\$ 12

Employer Contributions

In September 2010, the Company made a contribution of \$35 million to its pension plan.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

12. CONTINGENCIES, COMMITMENTS AND GUARANTEES

Contingencies

The following 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 their properties are 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 Company is defending 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.

Asbestos Direct Action Litigation In October 2001 and April 2002, two purported class action suits (*Wise v. Travelers* and *Meninger v. Travelers*) were filed against Travelers Property Casualty Corp. (TPC) and other insurers (not including The St. Paul Companies, Inc. (SPC)) in state court in West Virginia. These and other cases subsequently filed in West Virginia were 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 in violation of state statutes 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 alleging inappropriate handling and settling of asbestos claims were filed in 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, have also been asserted in various state courts against TPC and SPC. The claims asserted in these suits are collectively referred to as the Common Law Claims.

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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. Among the contingencies for each of these settlements is a final 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 (the 1986 Orders).

On August 17, 2004, the bankruptcy court entered an order approving the settlements and clarifying that the 1986 Orders barred the pending Statutory and Hawaii Actions and substantially all Common Law Claims pending against TPC (the Clarifying Order). The Clarifying Order also applies to similar direct action claims that may be filed in the future.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

12. CONTINGENCIES, COMMITMENTS AND GUARANTEES, Continued

On March 29, 2006, the U.S. District Court for the Southern District of New York substantially affirmed the Clarifying Order while vacating that portion of the order 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 the Clarifying Order. On February 29, 2008, TPC and certain other parties to the appeals filed petitions for rehearing and/or rehearing *en banc*, requesting reinstatement of the district court's judgment, which were denied. TPC and certain other parties filed Petitions for Writ of Certiorari in the United States Supreme Court seeking review of the Second Circuit's decision, and on December 12, 2008, the Petitions were granted.

On June 18, 2009, the Supreme Court ruled in favor of TPC, reversing the Second Circuit's February 15, 2008 decision, finding, among other things, that the 1986 Orders are final and generally bar the Statutory and Hawaii actions and substantially all Common Law Claims against TPC. Further, the Supreme Court ruled that the bankruptcy court had jurisdiction to issue the Clarifying Order. However, since the Second Circuit had not ruled on certain additional issues, principally related to procedural matters and the adequacy of notice provided to certain parties, the Supreme Court remanded the case to the Second Circuit for further proceedings on those specific issues. On October 21, 2009, all but one of the objectors to the Clarifying Order requested that the Second Circuit dismiss their appeal of the order approving the settlement, and that request was granted.

On March 22, 2010, the Second Circuit issued an opinion in which it found that the notice of the 1986 Orders provided to the remaining objector was insufficient to bar contribution claims by that objector against TPC. On April 5, 2010, TPC filed a Petition for Rehearing and Rehearing *En Banc* with the Second Circuit, requesting further review of its March 22, 2010 opinion, which was denied on May 25, 2010. On August 18, 2010, TPC filed a Petition for Writ of Certiorari in the United States Supreme Court seeking review of the Second Circuit's March 22, 2010 opinion, and a Petition for a Writ of Mandamus seeking an order from the Supreme Court requiring the Second Circuit to comply with the Supreme Court's June 18, 2009 ruling in TPC's favor. The Supreme Court has not yet ruled on the Petitions. The plaintiffs in the Statutory and Hawaii actions and the Common Law Claims actions filed Motions to Compel with the bankruptcy court on September 2, 2010 and September 3, 2010, respectively, arguing that all conditions precedent to the settlements have been met and seeking to require TPC to pay the settlement amounts. On September 30, 2010, TPC filed an Opposition to the plaintiffs' Motions to Compel on the grounds that the conditions precedent to the settlements, principally the requirement that all contribution claims be barred, have not been met in light of the Second Circuit's March 22, 2010 opinion. A hearing on the Motions to Compel is scheduled for October 21, 2010.

SPC, which is not covered by the Manville bankruptcy court rulings or the settlements described above, is a party to pending direct action cases in Texas state court asserting common law claims. All such cases that are still pending and in which SPC has been served are currently on the inactive docket in Texas state court. If any of those cases becomes active, SPC intends to litigate those cases vigorously. SPC was previously a

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defendant in similar direct actions in Ohio state court. Those actions have all been dismissed following favorable rulings by Ohio trial and appellate courts.

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.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

12. CONTINGENCIES, COMMITMENTS AND GUARANTEES, Continued

Other Proceedings

Broker Anti-Trust Litigation In 2005, four putative class action lawsuits were brought against a number of insurance brokers and insurers, including the Company, 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, 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, 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 appealed the district court's decisions to the U.S. Court of Appeals for the Third Circuit. On August 16, 2010, the Third Circuit affirmed the district court's dismissal of all Sherman Act and RICO claims against certain defendants, including the Company, except for Sherman Act and RICO claims involving the sale of excess casualty insurance through one defendant broker, as well as all state law claims, which they remanded to the district court for further proceedings. On October 1, 2010, defendants, including the Company, filed renewed motions to dismiss the remanded claims. The Company continues to believe that these claims are without merit and intends to defend them vigorously.

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.

Other 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. In addition, 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. 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.

Gain Contingency

On August 20, 2010, in a reinsurance dispute in New York state court captioned *United States Fidelity & Guaranty Company v. American Re-Insurance Company, et al.*, the trial court granted summary judgment for the Company, awarding it \$251 million (after taking into account a settlement with one of the defendants), plus pre-judgment interest in the amount of \$166 million. United States Fidelity and Guaranty Company is a subsidiary of the Company. The \$251 million awarded by the court represents the amount owed to the Company under the terms of the reinsurance agreements and is reported as part of reinsurance recoverables in the Company's consolidated balance sheet. The interest awarded by the Court is treated for accounting purposes as a gain contingency in accordance with FASB Topic 450, *Contingencies*, and accordingly has not been recognized in the Company's consolidated financial statements. When the judgment is entered by the court, post-judgment interest will accrue at the rate of 9 percent (without compounding) on the entire award of \$417 million. The summary judgment ruling, including the award of interest, is subject to appeal. The Company intends to vigorously pursue collection of the amounts awarded in the court's ruling.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

12. CONTINGENCIES, COMMITMENTS AND GUARANTEES, Continued

Other Commitments and Guarantees

Commitments

Investment Commitments The Company has unfunded commitments to private equity limited partnerships and real estate partnerships in which it invests. These commitments were \$1.28 billion and \$1.32 billion at September 30, 2010 and December 31, 2009, respectively.

Guarantees

The Company has contingent obligations for guarantees related to letters of credit, issuance of debt securities, certain investments, third-party loans related to certain investments and various indemnifications, including those related to the sale of business entities. The Company also provides standard indemnifications to service providers in the normal course of business. The indemnification clauses are often standard contractual terms. Certain of these guarantees and indemnifications have no stated or notional amounts or limitation to the maximum potential future payments, and, accordingly, the Company is unable to develop an estimate of the maximum potential payments for such arrangements. At September 30, 2010, the maximum amount of the Company's obligation for guarantees of certain investments and third-party loans related to certain investments that are quantifiable was \$84 million, approximately \$40 million of which would be recoverable from a third party.

In the ordinary course of selling business entities to third parties, the Company has agreed to indemnify purchasers for losses arising out of breaches of representations and warranties with respect to the business entities being sold, covenants and obligations of the Company and/or its subsidiaries following the closing, and in certain cases obligations arising from undisclosed liabilities, adverse reserve development, imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law, or certain named litigation. Such indemnification provisions generally survive for periods ranging from 12 months following the applicable closing date to the expiration of the relevant statutes of limitations, although in some cases there may be other agreed upon term limitations or no term limitations. Certain of these contingent obligations are subject to deductibles which have to be incurred by the obligee before the Company is obligated to make payments. The maximum amount of the Company's contingent obligation for indemnifications related to the sale of business entities that are quantifiable was \$1.34 billion at September 30, 2010, of which \$12 million was recognized on the balance sheet at that date.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

13. CONSOLIDATING FINANCIAL STATEMENTS OF THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

The following interim consolidating financial statements of the Company have been prepared pursuant to Rule 3-10 of Regulation S-X. These interim consolidating financial statements have been prepared from the Company's financial information on the same basis of accounting as the consolidated financial statements. The Travelers Companies, Inc. has fully and unconditionally guaranteed certain debt obligations of TPC, its wholly-owned subsidiary, which totaled \$1.20 billion at September 30, 2010.

Prior to the merger between TPC and SPC, TPC fully and unconditionally guaranteed the payment of all principal, premiums, if any, and interest on certain debt obligations of its wholly-owned subsidiary, Travelers Insurance Group Holdings, Inc. (TIGHI). The Travelers Companies, Inc. has fully and unconditionally guaranteed such guarantee obligations of TPC. TPC is deemed to have no assets or operations independent of TIGHI. Consolidating financial information for TIGHI has not been presented herein because such financial information would be substantially the same as the financial information provided for TPC.

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For the three months ended September 30, 2010

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Revenues					
Premiums	\$ 3,653	\$ 1,769	\$	\$	\$ 5,422
Net investment income	488	244	3		735
Fee income	63	1			64
Net realized investment gains	8	188	30		226
Other revenues	31	5		(1)	35
Total revenues	4,243	2,207	33	(1)	6,482
Claims and expenses					
Claims and claim adjustment expenses	2,161	1,052			3,213
Amortization of deferred acquisition costs	648	318			966
General and administrative expenses	569	265	3		837
Interest expense	18		78	(1)	95
Total claims and expenses	3,396	1,635	81	(1)	5,111
Income (loss) before income taxes	847	572	(48)		1,371
Income tax expense (benefit)	218	158	(10)		366
Equity in net income of subsidiaries			1,043	(1,043)	
Net income	\$ 629	\$ 414	\$ 1,005	\$ (1,043)	\$ 1,005

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Net Realized Investment Gains (Losses)					
Other-than-temporary impairment losses:					
Total gains	\$ 5	\$ 3	\$	\$	\$ 8
Portion recognized in accumulated other changes in equity from nonowner sources	(9)	(5)			(14)
Other-than-temporary impairment losses	(4)	(2)			(6)

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Other net realized investment gains	12	190	30	232
Net realized investment gains	\$ 8	\$ 188	\$ 30	\$ 226

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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For the three months ended September 30, 2009

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Revenues					
Premiums	\$ 3,653	\$ 1,768	\$	\$	\$ 5,421
Net investment income	524	233	6		763
Fee income	74	(2)			72
Net realized investment gains (losses)	12	(11)	28		29
Other revenues	36	7		(1)	42
Total revenues	4,299	1,995	34	(1)	6,327
Claims and expenses					
Claims and claim adjustment expenses	2,084	1,039			3,123
Amortization of deferred acquisition costs	646	321			967
General and administrative expenses	580	301	8		889
Interest expense	18		81	(1)	98
Total claims and expenses	3,328	1,661	89	(1)	5,077
Income (loss) before income taxes	971	334	(55)		1,250
Income tax expense (benefit)	244	85	(14)		315
Equity in net income of subsidiaries			976	(976)	
Net income	\$ 727	\$ 249	\$ 935	\$ (976)	\$ 935

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Net Realized Investment Gains (Losses)					
Other-than-temporary impairment losses:					
Total losses	\$ (16)	\$ (26)	\$ (1)	\$	\$ (43)
Portion recognized in accumulated other changes in equity from nonowner sources	4	20			24
Other-than-temporary impairment losses	(12)	(6)	(1)		(19)

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Other net realized investment gains (losses)	24	(5)	29	48
Net realized investment gains (losses)	\$ 12	\$ (11)	\$ 28	\$ 29

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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For the nine months ended September 30, 2010

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Revenues					
Premiums	\$ 10,786	\$ 5,206	\$ 9	\$	\$ 15,992
Net investment income	1,524	717	9		2,250
Fee income	218	1			219
Net realized investment gains	37	177	6		220
Other revenues	86	14		(1)	99
Total revenues	12,651	6,115	15	(1)	18,780
Claims and expenses					
Claims and claim adjustment expenses	6,663	3,357			10,020
Amortization of deferred acquisition costs	1,893	952			2,845
General and administrative expenses	1,709	796	11		2,516
Interest expense	55		236	(1)	290
Total claims and expenses	10,320	5,105	247	(1)	15,671
Income (loss) before income taxes	2,331	1,010	(232)		3,109
Income tax expense (benefit)	565	273	(51)		787
Equity in net income of subsidiaries			2,503	(2,503)	
Net income	\$ 1,766	\$ 737	\$ 2,322	\$ (2,503)	\$ 2,322

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Net Realized Investment Gains (Losses)					
Other-than-temporary impairment losses:					
Total gains (losses)	\$ 10	\$ (1)	\$	\$	\$ 9
Portion recognized in accumulated other changes in equity from nonowner sources	(19)	(10)			(29)
Other-than-temporary impairment losses	(9)	(11)			(20)

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Other net realized investment gains	46	188	6	240
Net realized investment gains	\$ 37	\$ 177	\$ 6	\$ 220

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

13. CONSOLIDATING FINANCIAL STATEMENTS OF THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES, Continued

CONSOLIDATING STATEMENT OF INCOME (Unaudited)

For the nine months ended September 30, 2009

(in millions)	TPC	Other Subsidiaries	Travelers(1)	Eliminations	Consolidated
Revenues					
Premiums	\$ 10,868	\$ 5,207	\$ 19	\$	\$ 16,075
Net investment income	1,279	665	19		1,963
Fee income	237	(3)			234
Net realized investment losses	(76)	(91)	(5)		(172)
Other revenues	107	19		(2)	124
Total revenues	12,415	5,797	14	(2)	18,224
Claims and expenses					
Claims and claim adjustment expenses	6,441	3,207			9,648
Amortization of deferred acquisition costs	1,914	950			2,864
General and administrative expenses	1,640	852	18		2,510
Interest expense	55		231	(2)	284
Total claims and expenses	10,050	5,009	249	(2)	15,306
Income (loss) before income taxes	2,365	788	(235)		2,918
Income tax expense (benefit)	545	165	(129)		581
Equity in net income of subsidiaries			2,443	(2,443)	
Net income	\$ 1,820	\$ 623	\$ 2,337	\$ (2,443)	\$ 2,337

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Net Realized Investment Gains (Losses)					
Other-than-temporary impairment losses:					
Total losses	\$ (174)	\$ (127)	\$ (1)	\$	\$ (302)
Portion recognized in accumulated other changes in equity from nonowner sources	32	37			69
Other-than-temporary impairment losses	(142)	(90)	(1)		(233)

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Other net realized investment gains (losses)	66	(1)	(4)	61
Net realized investment losses	\$ (76)	\$ (91)	\$ (5)	\$ (172)

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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At September 30, 2010

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Assets					
Fixed maturities, available for sale, at fair value (including \$210 subject to securities lending) (amortized cost \$61,028)	\$ 44,338	\$ 21,068	\$ 21	\$	\$ 65,427
Equity securities, available for sale, at fair value (cost \$374)	197	249	60		506
Real estate	1	842			843
Short-term securities	1,415	775	2,791		4,981
Other investments	1,935	924	101		2,960
Total investments	47,886	23,858	2,973		74,717
Cash	136	160	2		298
Investment income accrued	514	257			771
Premiums receivable	3,832	1,864			5,696
Reinsurance recoverables	7,927	4,133			12,060
Ceded unearned premiums	752	200			952
Deferred acquisition costs	1,581	259			1,840
Contractholder receivables	4,189	1,328			5,517
Goodwill	2,411	954			3,365
Other intangible assets	334	188			522
Investment in subsidiaries			29,566	(29,566)	
Other assets	1,724	679	60	(47)	2,416
Total assets	\$ 71,286	\$ 33,880	\$ 32,601	\$ (29,613)	\$ 108,154
Liabilities					
Claims and claim adjustment expense reserves	\$ 33,991	\$ 17,982	\$	\$	\$ 51,973
Unearned premium reserves	7,731	3,541			11,272
Contractholder payables	4,189	1,328			5,517
Payables for reinsurance premiums	307	246			553
Deferred tax liability	97		(35)		62

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Debt	1,189	9	5,101	(47)	6,252
Other liabilities	3,826	1,160	244		5,230
Total liabilities	51,330	24,266	5,310	(47)	80,859
Shareholders equity					
Preferred Stock Savings Plan convertible preferred stock (0.2 shares issued and outstanding)			70		70
Common stock (1,748.6 shares authorized; 460.5 shares issued and outstanding)		391	19,980	(391)	19,980
Additional paid-in capital	11,214	6,955		(18,169)	
Retained earnings	6,666	1,410	18,114	(8,072)	18,118
Accumulated other changes in equity from nonowner sources	2,076	858	2,372	(2,934)	2,372
Treasury stock, at cost (267.4 shares)			(13,245)		(13,245)
Total shareholders equity	19,956	9,614	27,291	(29,566)	27,295
Total liabilities and shareholders equity	\$ 71,286	\$ 33,880	\$ 32,601	\$ (29,613)	\$ 108,154

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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At December 31, 2009

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Assets					
Fixed maturities, available for sale, at fair value (including \$90 subject to securities lending) (amortized cost \$63,311)	\$ 44,532	\$ 21,022	\$ 293	\$	\$ 65,847
Equity securities, available for sale, at fair value (cost \$373)	196	198	57		451
Real estate	2	863			865
Short-term securities	2,241	750	1,861		4,852
Other investments	1,826	1,029	95		2,950
Total investments	48,797	23,862	2,306		74,965
Cash	132	122	1		255
Investment income accrued	547	275	3		825
Premiums receivable	3,648	1,823			5,471
Reinsurance recoverables	8,260	4,556			12,816
Ceded unearned premiums	788	128			916
Deferred acquisition costs	1,507	251			1,758
Deferred tax asset	460	173	39		672
Contractholder receivables	4,268	1,529			5,797
Goodwill	2,411	954			3,365
Other intangible assets	356	232			588
Investment in subsidiaries			30,608	(30,608)	
Other assets	1,871	248	59	(46)	2,132
Total assets	\$ 73,045	\$ 34,153	\$ 33,016	\$ (30,654)	\$ 109,560
Liabilities					
Claims and claim adjustment expense reserves	\$ 34,622	\$ 18,505	\$	\$	\$ 53,127
Unearned premium reserves	7,504	3,357			10,861
Contractholder payables	4,268	1,529			5,797
Payables for reinsurance premiums	309	237			546

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Debt	1,192	9	5,372	(46)	6,527
Other liabilities	3,832	1,221	234		5,287
Total liabilities	51,727	24,858	5,606	(46)	82,145
Shareholders equity					
Preferred Stock Savings Plan convertible preferred stock (0.2 shares issued and outstanding)			79		79
Common stock (1,748.6 shares authorized; 520.3 shares issued and outstanding)		391	19,593	(391)	19,593
Additional paid-in capital	11,206	6,960		(18,166)	
Retained earnings	8,852	1,399	16,310	(10,246)	16,315
Accumulated other changes in equity from nonowner sources	1,260	545	1,219	(1,805)	1,219
Treasury stock, at cost (199.6 shares)			(9,791)		(9,791)
Total shareholders equity	21,318	9,295	27,410	(30,608)	27,415
Total liabilities and shareholders equity	\$ 73,045	\$ 34,153	\$ 33,016	\$ (30,654)	\$ 109,560

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

13. CONSOLIDATING FINANCIAL STATEMENTS OF THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES, Continued

CONSOLIDATING STATEMENT OF CASH FLOWS (Unaudited)

For the nine months ended September 30, 2010

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Cash flows from operating activities					
Net income	\$ 1,766	\$ 737	\$ 2,322	\$ (2,503)	\$ 2,322
Net adjustments to reconcile net income to net cash provided by operating activities	191	(548)	2,596	(2,169)	70
Net cash provided by operating activities	1,957	189	4,918	(4,672)	2,392
Cash flows from investing activities					
Proceeds from maturities of fixed maturities	2,507	1,364	10		3,881
Proceeds from sales of investments:					
Fixed maturities	2,045	1,236			3,281
Equity securities	30	127			157
Real estate		10			10
Other investments	213	213			426
Purchases of investments:					
Fixed maturities	(3,212)	(1,947)	(8)		(5,167)
Equity securities	(3)	(26)			(29)
Real estate		(15)			(15)
Other investments	(221)	(152)			(373)
Net sales (purchases) of short-term securities	826	38	(930)		(66)
Securities transactions in course of settlement	23	(263)			(240)
Other	(216)	(4)			(220)
Net cash provided by (used in) investing activities	1,992	581	(928)		1,645
Cash flows from financing activities					
Payment of debt	(4)		(271)		(275)
Dividends paid to shareholders			(512)		(512)

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Issuance of common stock employee share options			267			267
Treasury shares acquired share repurchase authorization			(3,441)			(3,441)
Treasury shares acquired net employee share-based compensation			(40)			(40)
Excess tax benefits from share-based payment arrangements			6			6
Dividends paid to parent company	(3,952)	(721)		4,673		
Capital contributions, loans and other transactions between subsidiaries	11	(12)	2	(1)		
Net cash used in financing activities	(3,945)	(733)	(3,989)	4,672		(3,995)
Effect of exchange rate changes on cash		1				1
Net increase in cash	4	38	1			43
Cash at beginning of year	132	122	1			255
Cash at end of period	\$ 136	\$ 160	\$ 2	\$	\$	298
Supplemental disclosure of cash flow information						
Income taxes paid (received)	\$ 399	\$ 186	\$ (74)	\$	\$	511
Interest paid	\$ 65	\$	\$ 198	\$	\$	263

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited), Continued

13. CONSOLIDATING FINANCIAL STATEMENTS OF THE TRAVELERS COMPANIES, INC. AND SUBSIDIARIES,
Continued

CONSOLIDATING STATEMENT OF CASH FLOWS (Unaudited)

For the nine months ended September 30, 2009

(in millions)	TPC	Other Subsidiaries	Travelers (1)	Eliminations	Consolidated
Cash flows from operating activities					
Net income	\$ 1,820	\$ 623	\$ 2,337	\$ (2,443)	\$ 2,337
Net adjustments to reconcile net income to net cash provided by operating activities	371	424	(103)	175	867
Net cash provided by operating activities	2,191	1,047	2,234	(2,268)	3,204
Cash flows from investing activities					
Proceeds from maturities of fixed maturities	1,997	1,741	31		3,769
Proceeds from sales of investments:					
Fixed maturities	1,016	1,186	4		2,206
Equity securities	6	31			37
Other investments	164	53			217
Purchases of investments:					
Fixed maturities	(3,201)	(3,149)			(6,350)
Equity securities		(22)			(22)
Real estate		(12)			(12)
Other investments	(169)	(93)			(262)
Net sales (purchases) of short-term securities	(824)	(92)	(429)		(1,345)
Securities transactions in course of settlement	495	93			588
Other	(255)	(16)			(271)
Net cash used in investing activities	(771)	(280)	(394)		(1,445)
Cash flows from financing activities					
Payment of debt	(2)		(141)		(143)
Issuance of debt			494		494
Dividends paid to shareholders			(518)		(518)
			76		76

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Issuance of common stock employee share options							
Treasury shares acquired share repurchase authorization			(1,720)				(1,720)
Treasury shares acquired net employee share-based compensation			(29)				(29)
Excess tax benefits from share-based payment arrangements			4				4
Dividends paid to parent company	(1,456)	(814)			2,270		
Capital contributions, loans and other transactions between subsidiaries			2		(2)		
Net cash used in financing activities	(1,458)	(814)	(1,832)		2,268		(1,836)
Effect of exchange rate changes on cash		13					13
Net increase (decrease) in cash	(38)	(34)	8				(64)
Cash at beginning of year	183	167					350
Cash at end of period	\$ 145	\$ 133	\$ 8		\$		\$ 286
Supplemental disclosure of cash flow information							
Income taxes paid (received)	\$ 600	\$ 154	\$ (181)		\$		\$ 573
Interest paid	\$ 65	\$	\$ 183		\$		\$ 248

(1) The Travelers Companies, Inc., excluding its subsidiaries.

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Item 2. 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).

FINANCIAL HIGHLIGHTS

2010 Third Quarter Consolidated Results of Operations

- Net income of \$1.01 billion, or \$2.14 per share basic and \$2.11 per share diluted
- Net earned premiums of \$5.42 billion
- Catastrophe losses of \$117 million pretax (\$77 million after-tax)
- Pretax net favorable prior year reserve development of \$222 million (\$147 million after-tax)
- GAAP combined ratio of 90.6%
- Pretax net investment income of \$735 million (\$597 million after-tax)

2010 Third Quarter Consolidated Financial Condition

- Total investments of \$74.72 billion; fixed maturities and short-term securities comprise 94% of total investments
- Total assets of \$108.15 billion
- Total debt of \$6.25 billion, resulting in a debt-to-total capital ratio of 18.6% (20.5% excluding net unrealized investment gains (losses), net of tax)
- Repurchased 11.8 million common shares for total cost of \$600 million under share repurchase authorization
- Shareholders' equity of \$27.30 billion; book value per common share of \$59.11, up 15% from September 30, 2009
- Holding company liquidity of \$2.82 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.

Table of Contents**Consolidated Results of Operations**

(in millions, except ratio and per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues				
Premiums	\$ 5,422	\$ 5,421	\$ 15,992	\$ 16,075
Net investment income	735	763	2,250	1,963
Fee income	64	72	219	234
Net realized investment gains (losses)	226	29	220	(172)
Other revenues	35	42	99	124
Total revenues	6,482	6,327	18,780	18,224
Claims and expenses				
Claims and claim adjustment expenses	3,213	3,123	10,020	9,648
Amortization of deferred acquisition costs	966	967	2,845	2,864
General and administrative expenses	837	889	2,516	2,510
Interest expense	95	98	290	284
Total claims and expenses	5,111	5,077	15,671	15,306
Income before income taxes	1,371	1,250	3,109	2,918
Income tax expense	366	315	787	581
Net income	\$ 1,005	\$ 935	\$ 2,322	\$ 2,337
Net income per share				
Basic	\$ 2.14	\$ 1.66	\$ 4.73	\$ 4.05
Diluted	\$ 2.11	\$ 1.65	\$ 4.68	\$ 4.02
GAAP combined ratio				
Loss and loss adjustment expense ratio	58.7%	57.0%	61.9%	59.4%
Underwriting expense ratio	31.9	32.7	32.1	31.8
GAAP combined ratio	90.6%	89.7%	94.0%	91.2%
Incremental impact of direct to consumer initiative on GAAP combined ratio				
	0.9%	0.6%	0.7%	0.6%

The Company's discussions of 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 net income per common share are presented on a diluted basis.

Overview

Diluted net income per share of \$2.11 in the third quarter of 2010 increased by 28% over the same period of 2009, due to a 7% increase in reported net income and the favorable impact of common share repurchases over the previous twelve months. Net income of \$1.01 billion in the third quarter of 2010 increased by \$70 million over the same period of 2009, primarily reflecting the impact of an increase in net realized investment gains and a decline in catastrophe losses, partially offset by decreases in net favorable prior year reserve development and net investment income. In addition, net income in the third quarter of 2009 benefited from the favorable re-estimation of the current year loss ratio for the first two quarters of 2009 (primarily in the Business Insurance segment) that was recorded in the third quarter of 2009, which reflected better than expected frequency trends in the first two quarters of 2009. Catastrophe losses in the third quarters of 2010 and 2009 totaled \$117 million and \$158 million, respectively. Net favorable prior year reserve development in the third quarters of 2010 and 2009 totaled \$222 million and \$309 million, respectively.

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Diluted net income per share of \$4.68 in the first nine months of 2010 increased by 16% over the same period of 2009, despite a decrease in reported net income, which also reflected the favorable impact of common share repurchases over the previous twelve months. Net income of \$2.32 billion in the first nine months of 2010 was \$15 million lower than in the same period of 2009, primarily reflecting the impact of an increase in catastrophe losses, largely offset by net realized investment gains (versus net realized investment losses in the first nine months of 2009) and increases in both net investment income and net favorable prior year reserve development. Catastrophe losses in the first nine months of 2010 and 2009 totaled \$1.03 billion and \$441 million, respectively. Net favorable prior year reserve development in the first nine months of 2010 and 2009 totaled \$900 million and \$828 million, respectively. Net income in the first nine months of 2009 also reflected a reduction in income tax expense of \$88 million resulting from the favorable resolution of various prior year tax matters and an \$87 million reduction in the estimate of property windpool assessments related to Hurricane Ike that had been recorded in general and administrative expenses in 2008.

Revenues*Earned Premiums*

Earned premiums in the third quarter of 2010 totaled \$5.42 billion, level with the same 2009 period. In the first nine months of 2010, earned premiums of \$15.99 billion were \$83 million, or less than 1%, lower than the same 2009 period. In the Business Insurance segment, earned premiums in the third quarter and first nine months of 2010 declined 1% and 3%, respectively, from the same periods of 2009. In the Financial, Professional & International Insurance segment, earned premiums in the third quarter and first nine months of 2010 declined 5% and increased 1%, respectively, compared with the same periods of 2009. In the Personal Insurance segment, earned premiums in the third quarter and first nine months of 2010 increased 4% and 3%, respectively, over the same periods of 2009. Factors contributing to the changes in earned premiums in each segment are discussed in more detail in the segment discussions that follow.

Net Investment Income

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

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Average investments (a)	\$ 70,929	\$ 73,515	\$ 71,718	\$ 72,991
Pretax net investment income	735	763	2,250	1,963
After-tax net investment income	597	616	1,824	1,637
Average pretax yield (b)	4.1%	4.2%	4.2%	3.6%
Average after-tax yield (b)	3.4%	3.4%	3.4%	3.0%

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

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

Net investment income of \$735 million in the third quarter of 2010 was \$28 million, or 4%, lower than in the same period of 2009, primarily driven by a decline in investment income from fixed maturity investments. This decline in investment income from the fixed maturity portfolio primarily resulted from lower long-term reinvestment yields available in the market, as well as a lower level of average invested fixed maturity investments. Non-fixed maturity investments generated net investment income of \$65 million in the third quarter of 2010, compared with \$63 million in the third quarter of 2009. In the first nine months of 2010, net investment income of \$2.25 billion was \$287 million, or 15%, higher than in the same period of 2009. Non-fixed maturity investments generated net investment income of \$220 million in the first nine months of 2010, compared with negative net investment income of \$145 million in the same period of 2009. The increase in net investment income from non-fixed maturity investments in 2010 reflected improved investment market conditions. Through the first nine months of 2010, investment income from fixed maturity investments declined \$77 million compared with the same period of 2009. This decline in investment income from the fixed maturity portfolio primarily resulted from lower long-term reinvestment yields available in the market.

Table of Contents*Fee Income*

The National Accounts market in the Business Insurance segment is the primary source of the Company's fee-based business. The \$8 million and \$15 million declines in fee income in the third quarter and first nine months of 2010, respectively, compared with the same periods of 2009 are described in the Business Insurance segment discussion that follows.

Net Realized Investment Gains (Losses)

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

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net Realized Investment Gains (Losses)				
Other-than-temporary impairment losses:				
Total gains (losses)	\$ 8	\$ (43)	\$ 9	\$ (302)
Portion recognized in accumulated other changes in equity from nonowner sources	(14)	24	(29)	69
Other-than-temporary impairment losses	(6)	(19)	(20)	(233)
Other net realized investment gains	232	48	240	61
Net realized investment gains (losses)	\$ 226	\$ 29	\$ 220	\$ (172)

Other-Than-Temporary Impairment Losses on Investments In the third quarter of 2010, impairments included in net income totaled \$6 million. In the prior year quarter, impairments included in net income totaled \$19 million. Impairments in the fixed maturity portfolio in the third quarter of 2009 totaled \$18 million, which included \$7 million of impairments related to structured mortgage securities, \$6 million related to various issuers' deteriorated financial position and \$5 million related to securities with respect to which the Company had the intent to sell. Impairments in the third quarter of 2009 also included \$1 million related to other investments.

Through the first nine months of 2010, impairments included in net income totaled \$20 million. In the first nine months of 2009, impairments included in net income totaled \$233 million. Impairments in the fixed maturity portfolio in the first nine months of 2009 totaled \$148 million, which included \$65 million of impairments related to structured mortgage securities, \$66 million related to various issuers' deteriorated financial position and \$17 million related to fixed maturity investments that the Company had the intent to sell. Equity impairments in the first nine months of 2009 were \$79 million, the majority of which were related to issuers in the financial industry. Impairments in the first nine months of 2009 also included \$6 million related to other investments.

Other Net Realized Investment Gains (Losses) Other net realized investment gains in the third quarter of 2010 totaled \$232 million. In September 2010, the Company sold substantially all of its remaining common stock holdings in Verisk Analytics, Inc. (Verisk) for total proceeds of approximately \$230 million as part of the secondary public offering of Verisk. The Company recorded a pretax realized investment

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gain of \$205 million on this sale in the third quarter of 2010. The 2010 third quarter total also included \$30 million of net realized investment gains related to the Company's holdings of stock purchase warrants of a publicly held company and \$29 million of net realized investment gains related to fixed maturity investments. These gains were partially offset by \$19 million of net realized investment losses related to U.S. Treasury futures contracts which are used to shorten the duration of the Company's fixed maturity portfolio and \$11 million of net realized investment losses related to foreign currency exchange. In the third quarter of 2009, other net realized investment gains totaled \$48 million, which included \$37 million of net realized investment gains related to fixed maturity investments and \$29 million of net realized investment gains related to the Company's holdings of stock purchase warrants of a publicly held company. Also included in the third quarter 2009 total were net realized investment losses of \$11 million related to U.S. Treasury futures contracts and \$6 million of net realized investment losses related to transactions associated with a subsidiary sold in 2008.

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Through the first nine months of 2010, other net realized investment gains totaled \$240 million, which included the Verisk gain described above, as well as \$75 million of net realized investment gains related to fixed maturity investments, \$15 million of net realized investment gains related to equity securities and \$6 million of net realized investment gains related to the Company's holdings of stock purchase warrants of a publicly held company. These net realized investment gains were partially offset by \$52 million of net realized investment losses related to U.S. Treasury futures contracts and \$10 million of net realized investment losses related to foreign currency exchange. Other net realized investment gains for the first nine months of 2009 were \$61 million, which included \$65 million of net realized investment gains related to fixed maturity investments, \$21 million of net realized investment losses related to foreign exchange and \$14 million of net realized investment gains associated with the U.S. Treasury futures contracts discussed above.

Claims and Expenses

Claims and claim adjustment expenses totaled \$3.21 billion in the third quarter of 2010, \$90 million, or 3%, higher than in the third quarter of 2009. The 2010 total included \$222 million of net favorable prior year reserve development and \$117 million of catastrophe losses, whereas the 2009 third quarter total included \$309 million of net favorable prior year reserve development and \$158 million of catastrophe losses. Catastrophe losses in the third quarters of both 2010 and 2009 primarily resulted from several severe wind and hail storms.

In the first nine months of 2010, claims and claim adjustment expenses totaled \$10.02 billion, an increase of \$372 million, or 4%, over the total in the same period of 2009. The 2010 total included \$1.03 billion of catastrophe losses and \$900 million of net favorable prior year reserve development, whereas the comparable 2009 total included \$441 million of catastrophe losses and \$828 million of net favorable prior year reserve development. In addition to the storms described above with respect to the third quarter, catastrophe losses in the first nine months of 2010 also included losses from severe winter storms in the first quarter of the year and severe wind and hail storms in the second quarter of the year.

The Company's three business segments each experienced net favorable prior year reserve development in the third quarter and first nine months of both 2010 and 2009. In the Business Insurance segment, net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$102 million and \$647 million, compared with \$262 million and \$660 million in the respective periods of 2009. In the Financial, Professional & International Insurance segment, net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$97 million and \$203 million, compared with \$25 million and \$48 million in the respective periods of 2009. In the Personal Insurance segment, net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$23 million and \$50 million, compared with \$22 million and \$120 million in the respective periods of 2009. Factors contributing to net favorable prior year reserve development in each segment during these periods are discussed in more detail in the segment discussions that follow.

The amortization of deferred acquisition costs totaled \$966 million and \$2.85 billion in the third quarter and first nine months of 2010, respectively, compared with \$967 million and \$2.86 billion in the respective periods of 2009, consistent with earned premium levels in all periods.

General and administrative expenses totaled \$837 million in the third quarter of 2010, a decrease of \$52 million, or 6%, from the total in the same period of 2009. The decline in expenses in the third quarter of 2010 was concentrated in the Business Insurance segment. In the first nine months of 2010, general and administrative expenses totaled \$2.52 billion, an increase of \$6 million, or less than 1%, over the same period of 2009. The 2009 total included a reduction of \$87 million in the estimate of property windpool assessments related to Hurricane Ike due to a decline in estimated insurance industry losses related to Hurricane Ike. Excluding that adjustment in 2009, general and administrative expenses in the first nine months of 2010 were \$81 million, or 3%, lower than in the same period of 2009, with the decline concentrated in the Business

Insurance segment.

Interest Expense

Interest expense of \$95 million in the third quarter of 2010 was \$3 million lower than in the same period of 2009, reflecting a lower average level of debt outstanding in the third quarter of 2010 due to debt maturities. In the first nine months of 2010, interest expense totaled \$290 million, an increase of \$6 million, or 2%, over interest expense of \$284 million in the same period of 2009, reflecting a higher average level of debt outstanding in the first nine months of 2010.

Table of Contents*GAAP Combined Ratio*

The consolidated GAAP combined ratio of 90.6% in the third quarter of 2010 was 0.9 points higher than the consolidated GAAP combined ratio of 89.7% in the same 2009 period. The consolidated GAAP combined ratio of 94.0% in the first nine months of 2010 was 2.8 points higher than the consolidated GAAP combined ratio of 91.2% in the same 2009 period.

The consolidated loss and loss adjustment expense ratio of 58.7% in the third quarter of 2010 was 1.7 points higher than the loss and loss adjustment expense ratio of 57.0% in the same 2009 period. The 2010 and 2009 third quarter consolidated loss and loss adjustment expense ratios included 4.1 point and 5.7 point benefits from net favorable prior year reserve development, respectively. Catastrophe losses accounted for 2.2 points and 2.9 points of the 2010 and 2009 third quarter loss and loss adjustment expense ratios, respectively. The consolidated loss and loss adjustment expense ratios excluding catastrophe losses and prior year reserve development for the third quarter of 2010 was 0.8 points higher than the 2009 third quarter ratio on the same basis. The consolidated loss and loss adjustment expense ratio reported in the third quarter of 2009 benefited from the favorable re-estimation of the current year loss ratio for the first two quarters of 2009 (primarily in the Business Insurance segment) that was recorded in the third quarter of 2009, which reflected better than expected frequency trends in the first two quarters of 2009. The 2010 third quarter consolidated loss and loss adjustment expense ratio also reflected the impact of loss cost trends continuing to modestly outpace earned rate increases in the Business Insurance segment.

The consolidated loss and loss adjustment expense ratio of 61.9% in the first nine months of 2010 was 2.5 points higher than the loss and loss adjustment expense ratio of 59.4% in the same 2009 period. The 2010 and 2009 consolidated loss and loss adjustment expense ratios included 5.6 point and 5.1 point benefits from net favorable prior year reserve development, respectively. Catastrophe losses accounted for 6.4 points and 2.7 points of the 2010 and 2009 nine-month loss and loss adjustment expense ratios, respectively. Through the first nine months of 2010, the adjusted loss and loss adjustment expense ratio was 0.7 points lower than the adjusted ratio for the same period of 2009. The improvement in the adjusted year-to-date 2010 loss ratio was concentrated in the Personal Insurance and Financial, Professional & International Insurance segments and reflected earned rate increases outpacing loss cost trends. The consolidated loss and loss adjustment expense ratios reported in the third quarter and first nine months of 2009 did not reflect the favorable re-estimation of the 2009 loss and loss adjustment expense ratio (primarily in the Business Insurance segment) that occurred in the fourth quarter of 2009.

The consolidated underwriting expense ratio of 31.9% for the third quarter of 2010 was 0.8 points lower than the third quarter 2009 consolidated underwriting expense ratio of 32.7%, primarily reflecting lower expenses in the Business Insurance segment. Through the first nine months of 2010, the consolidated underwriting expense ratio of 32.1% was 0.3 points higher than the consolidated underwriting expense ratio of 31.8% in the same period of 2009. The year-to-date 2009 consolidated underwriting expense ratio reflected a 0.5 point benefit resulting from the reduction in the estimate of property windpool assessments related to Hurricane Ike. Excluding that factor in 2009, the year-to-date consolidated underwriting expense ratio in 2010 was 0.2 points lower than in 2009, reflecting lower expenses.

Written Premiums

Consolidated gross and net written premiums were as follows:

Gross Written Premiums

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(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Business Insurance	\$ 3,027	\$ 3,029	\$ 9,141	\$ 9,369
Financial, Professional & International Insurance	852	918	2,665	2,735
Personal Insurance	2,125	1,988	5,975	5,663
Total	\$ 6,004	\$ 5,935	\$ 17,781	\$ 17,767

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(in millions)	Net Written Premiums			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Business Insurance	\$ 2,651	\$ 2,611	\$ 8,280	\$ 8,387
Financial, Professional & International Insurance	808	870	2,378	2,347
Personal Insurance	2,003	1,859	5,743	5,414
Total	\$ 5,462	\$ 5,340	\$ 16,401	\$ 16,148

Gross and net written premiums in the third quarter of 2010 increased 1% and 2%, respectively, over the same 2009 period. Increases in net written premiums in the Personal Insurance and Business Insurance segments were partially offset by a decline in the Financial, Professional & International Insurance segment. New business volume in the Business Insurance and Personal Insurance segments in the third quarter of 2010 increased over the same period of 2009, but declined in the Financial, Professional & International Insurance segment. Retention rates remained strong across all business segments. The impact of renewal rate changes on premiums remained positive in the Personal Insurance and Financial, Professional & International Insurance segments, but was slightly negative in the Business Insurance segment.

In the first nine months of 2010, gross written premiums were slightly higher than in the same period of 2009, and net written premiums increased by 2% over the same period of 2009. The difference in changes between gross and net written premiums in the first nine months of 2010 was concentrated in the Financial, Professional & International Insurance segment, largely due to lower reinsurance costs and changes in the structure of the Company's reinsurance during the first quarter that directionally aligned retentions in the Company's International business with its U.S. practices. The impact of new business volume, retention rates and renewal rate changes on net written premiums for the first nine months of 2010 was consistent with that described above for the third quarter.

RESULTS OF OPERATIONS BY SEGMENT

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 currently 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.

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.

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

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

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues				
Earned premiums	\$ 2,736	\$ 2,768	\$ 8,027	\$ 8,295
Net investment income	514	529	1,579	1,335
Fee income	64	72	219	234
Other revenues	10	14	23	32
Total revenues	\$ 3,324	\$ 3,383	\$ 9,848	\$ 9,896
Total claims and expenses	\$ 2,594	\$ 2,473	\$ 7,612	\$ 7,594
Operating income	\$ 543	\$ 668	\$ 1,677	\$ 1,775
Loss and loss adjustment expense ratio	60.5%	53.5%	59.6%	56.3%
Underwriting expense ratio	31.6	33.0	32.2	32.1
GAAP combined ratio	92.1%	86.5%	91.8%	88.4%

Overview

Operating income of \$543 million in the third quarter of 2010 was \$125 million, or 19%, lower than in the same period of 2009, primarily driven by a decline in net favorable prior year reserve development, partially offset by lower catastrophe losses. In addition, operating income in the third quarter of 2009 benefited from the favorable re-estimation of the current year loss ratio for the first two quarters of 2009 that was recorded in the third quarter of 2009, which reflected better than expected frequency trends in the first two quarters of 2009. Net favorable prior year reserve development totaled \$102 million in the third quarter of 2010, compared with \$262 million in the same period of 2009. Catastrophe losses in the third quarter of 2010 totaled \$53 million, compared with \$86 million in the same period of 2009. In the first nine months of 2010, operating income totaled \$1.68 billion, a decrease of \$98 million, or 6%, from the same period of 2009, primarily driven by an increase in catastrophe losses, partially offset by an increase in net investment income. In addition, operating income in the first nine months of 2009 included benefits of \$41 million from the favorable resolution of various prior year tax matters and a \$38 million reduction in the estimate of property windpool assessments related to Hurricane Ike. Catastrophe losses in the first nine months of 2010 totaled \$367 million, compared with \$157 million in the same period of 2009. Net favorable prior year reserve development in the first nine months of 2010 totaled \$647 million, compared with \$660 million in the same period of 2009.

Earned Premiums

Earned premiums of \$2.74 billion in the third quarter of 2010 decreased \$32 million, or 1%, from the same period of 2009. In the first nine months of 2010, earned premiums of \$8.03 billion were 3% lower than in the same period of 2009. The declines in both periods of 2010 were primarily attributable to reduced insured exposures due to lower levels of economic activity.

Net Investment Income

Net investment income in the third quarter of 2010 decreased by \$15 million from the same period of 2009. In the first nine months of 2010, net investment income increased by \$244 million over the same period of 2009. Refer to the *Net Investment Income* section of the *Consolidated Results of Operations* discussion herein for a description of the factors contributing to the changes in the Company's consolidated net investment income compared with the third quarter and first nine months of 2009.

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Fee Income

National Accounts is the primary source of fee income due to its service businesses, which include claim and loss prevention services to large companies that choose to self-insure a portion of their insurance risks, as well as claims and policy management services to workers compensation residual market pools. Fee income in the third quarter and first nine months of 2010 decreased by \$8 million and \$15 million, respectively, compared to the same 2009 periods, primarily reflecting lower serviced premium and claim volume due to the de-population of workers compensation residual market pools, the impact of both lower claim volume and lower loss costs (as fees are based either on the number of claims serviced or as a percentage of losses) driven by workers compensation reforms and overall lower claim frequency. Lower new business volume due to lower levels of economic activity and increased competition also contributed to the lack of growth in fee income in recent quarters.

Claims and Expenses

Claims and claim adjustment expenses in the third quarter of 2010 totaled \$1.68 billion, an increase of \$175 million, or 12%, over the same 2009 period, primarily reflecting a decline in net favorable prior year reserve development. Claims and claim adjustment expenses in the first nine months of 2010 totaled \$4.89 billion, an increase of \$117 million, or 2%, over the same 2009 period, primarily reflecting an increase in catastrophe losses. Net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$102 million and \$647 million, respectively, compared with net favorable prior year reserve development of \$262 million and \$660 million in the respective periods of 2009. Catastrophe losses in the third quarter and first nine months of 2010 totaled \$53 million and \$367 million, respectively, compared with \$86 million and \$157 million in the respective periods of 2009. Catastrophe losses in the third quarter and first nine months of both 2010 and 2009 primarily resulted from several severe wind and hail storms. Catastrophe losses in the first nine months of 2010 also included losses from severe winter storms in the first quarter of the year.

Net favorable prior year reserve development in the third quarter of 2010 was driven by better than expected loss results in the general liability, workers compensation, property and commercial automobile product lines for multiple accident years. The general liability product line improvement was concentrated in excess coverages and reflected a favorable litigation environment. Net favorable prior year reserve development in the workers compensation product line was concentrated in the 2002-2005 accident years and resulted from lower than expected claim frequency and better than expected loss emergence. The property product line improvement primarily occurred in the 2009 accident year as a result of better than expected claim emergence trends in the Industry-Focused Underwriting and Target Risk Underwriting groups. The Company believes that the improvement in the commercial automobile product line, which occurred primarily in the 2009 accident year, resulted from the economic downturn causing fewer vehicles to be on the road and fewer miles being driven, leading to lower than expected frequency and severity of losses. The net favorable prior year reserve development in these product lines was partially offset by a \$140 million increase to asbestos reserves in the third quarter, which is discussed in further detail in the Asbestos Claims and Litigation section herein. Net favorable prior year reserve development in the first nine months of 2010 reflected the same factors described above for the third quarter. In addition, better than expected loss results in this segment in recent years resulted in a favorable re-estimation of reserves for unallocated loss adjustment expenses in the second quarter of 2010. The Company also recorded a \$35 million increase to environmental reserves in the second quarter, which is discussed in further detail in the Environmental Claims and Litigation sections herein.

Net favorable prior year reserve development in the third quarter and the first nine months of 2009 was driven by better than expected loss results primarily concentrated in the general liability, commercial multi-peril, property and commercial automobile product lines for recent accident years. The general liability and commercial multi-peril product lines experienced better than anticipated loss development that was attributable to several factors, including what the Company believes to be improved legal and judicial environments, as well as enhanced risk control, underwriting and claim process initiatives. The property product line improvement primarily occurred in the latter part of the 2008 accident year as a result of better than expected claim emergence trends. The commercial automobile line of business experienced better than

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expected loss development that was attributable to what the Company believes were more favorable legal and judicial environments, claim handling initiatives focused on the automobile line of insurance and improvements in auto safety technology. The net favorable prior year reserve development in these product lines was partially offset by \$185 million and \$70 million increases to asbestos and environmental reserves, respectively, in the first nine months of 2009.

The amortization of deferred acquisition costs totaled \$448 million and \$1.31 billion in the third quarter and first nine months of 2010, respectively, compared with \$448 million and \$1.35 billion in the respective periods of 2009, consistent with earned premium levels in all periods.

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General and administrative expenses in the third quarter of 2010 totaled \$463 million, \$54 million lower than in the same period of 2009. In the first nine months of 2010, general and administrative expenses of \$1.41 billion were \$64 million lower than the total in the same period of 2009. The 2009 year-to-date total included a \$38 million reduction in the estimate of property windpool assessments related to Hurricane Ike. Adjusting for that reduction in 2009, general and administrative expenses in the first nine months of 2010 were \$102 million lower than in the same period of 2009.

GAAP Combined Ratio

The GAAP combined ratio of 92.1% in the third quarter of 2010 was 5.6 points higher than the GAAP combined ratio of 86.5% in the same 2009 period. The GAAP combined ratio of 91.8% in the first nine months of 2010 was 3.4 points higher than the GAAP combined ratio of 88.4% in the same 2009 period.

The loss and loss adjustment expense ratio of 60.5% in the third quarter of 2010 was 7.0 points higher than the third quarter 2009 ratio of 53.5%. Net favorable prior year reserve development provided 3.8 point and 9.5 point benefits to the loss and loss adjustment expense ratio in the third quarters of 2010 and 2009, respectively. Catastrophe losses in the third quarters of 2010 and 2009 accounted for 2.0 points and 3.1 points of the loss and loss adjustment expense ratio, respectively. The 2010 third quarter loss and loss adjustment expense ratio excluding catastrophe losses and prior year reserve development was 2.4 points higher than the 2009 ratio on the same basis. The loss ratio reported in the third quarter of 2009 benefited from the favorable re-estimation of the current year loss ratio for the first two quarters of 2009 that was recorded in the third quarter of 2009, which reflected better than expected frequency trends in the first two quarters of 2009. In addition, the third quarter 2010 loss ratio reflected somewhat reduced underwriting margins related to pricing and loss cost trends. These factors were partially offset by a decline in unallocated loss adjustment expenses related to lower workers' compensation claim volume.

In the first nine months of 2010, the loss and loss adjustment expense ratio of 59.6% was 3.3 points higher than the 2009 ratio of 56.3%. Catastrophe losses in the first nine months of 2010 and 2009 accounted for 4.6 points and 1.9 points of the loss and loss adjustment expense ratio, respectively. Net favorable prior year reserve development provided 8.1 point and 8.0 point benefits to the loss and loss adjustment expense ratio in the first nine months of 2010 and 2009, respectively. The loss and loss adjustment expense ratio in the first nine months of 2010 excluding catastrophe losses and prior year reserve development was 0.7 points higher than the 2009 ratio on the same basis. The loss and loss adjustment expense ratios reported in the third quarter and first nine months of 2009 did not reflect the favorable re-estimation of the 2009 loss and loss adjustment expense ratio that occurred in the fourth quarter of 2009.

The underwriting expense ratio of 31.6% for the third quarter of 2010 was 1.4 points lower than the third quarter 2009 underwriting expense ratio of 33.0%, primarily reflecting lower expenses. In the first nine months of 2010, the underwriting expense ratio of 32.2% was level with the expense ratio in the same 2009 period. The underwriting expense ratio in the first nine months of 2009 included a 0.5 point benefit from the reduction in the estimate of windpool assessments described above. Adjusting for that factor in 2009, the underwriting expense ratio for the first nine months of 2010 was 0.4 points lower than the 2009 underwriting expense ratio. The improvement in the 2010 adjusted year-to-date expense ratio also reflected lower expenses.

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

(in millions)	Gross Written Premiums			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Select Accounts	\$ 683	\$ 677	\$ 2,113	\$ 2,156
Commercial Accounts	722	684	2,086	2,041
National Accounts	253	312	830	1,024
Industry-Focused Underwriting	609	585	1,812	1,832
Target Risk Underwriting	522	533	1,595	1,609
Specialized Distribution	232	232	695	702
Total Business Insurance Core	3,021	3,023	9,131	9,364
Business Insurance Other	6	6	10	5
Total Business Insurance	\$ 3,027	\$ 3,029	\$ 9,141	\$ 9,369

(in millions)	Net Written Premiums			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Select Accounts	\$ 664	\$ 655	\$ 2,082	\$ 2,118
Commercial Accounts	655	609	1,942	1,883
National Accounts	173	197	593	683
Industry-Focused Underwriting	590	564	1,743	1,762
Target Risk Underwriting	342	360	1,223	1,240
Specialized Distribution	222	221	684	690
Total Business Insurance Core	2,646	2,606	8,267	8,376
Business Insurance Other	5	5	13	11
Total Business Insurance	\$ 2,651	\$ 2,611	\$ 8,280	\$ 8,387

In Business Insurance Core, gross written premiums in the third quarter of 2010 were level with the third quarter of 2009, and net written premiums increased by 2% from the third quarter of 2009. In the first nine months of 2010, gross written premiums decreased by 2% from the same period of 2009, and net written premiums decreased 1% from the first nine months of 2009. The difference in rates of decline between gross and net written premiums in both periods of 2010 was concentrated in Residual Markets within National Accounts. A significant portion of gross written premiums for products offered by Residual Markets is ceded to other insurers and residual market pools. As a result, the decline in gross written premiums did not have a proportional impact on net written premiums. The increase in net written premiums in the third quarter of 2010 was concentrated in the Commercial Accounts and Industry-Focused Underwriting groups, partially offset by premium declines in the National Accounts and Target Risk Underwriting groups. The decline in gross and net written premiums in the first nine months of 2010 was driven in large part by lower levels of economic activity in recent quarters that impacted exposure changes at renewal, audit premium adjustments, policy endorsements and mid-term cancellations.

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Select Accounts. Net written premiums of \$664 million in the third quarter of 2010 increased 1% over the same period of 2009, driven by continued strong business retention rates and positive renewal premium changes. In the first nine months of 2010, net written premiums of \$2.08 billion were 2% lower than in the same 2009 period. The year-to-date decline in 2010 was primarily due to a decline in business retention rates and lower levels of new business. Business retention rates in the third quarter of 2010 remained strong and were level with the same 2009 period. Renewal premium changes were positive in the third quarter and first nine months of 2010, reflecting positive renewal rate changes and modest exposure growth. New business volume in 2010 was level with the third quarter of 2009 but declined compared with the first nine months of 2009, driven by lower business volumes from larger accounts where marketplace competition remains high.

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Commercial Accounts. Net written premiums of \$655 million in the third quarter of 2010 increased 8% over the prior year quarter. In the first nine months of 2010, net written premiums of \$1.94 billion were 3% higher than in the same period of 2009. The increases were primarily driven by increased levels of new business in both periods of 2010, combined with continued strong business retention rates. Renewal premium changes in the third quarter of 2010 were slightly negative, reflecting slightly negative renewal rate changes and no exposure growth. Renewal premium changes in the first nine months of 2010 were also slightly negative, reflecting slightly positive renewal rate changes, offset by a modest decline in exposures driven by lower levels of economic activity. Business retention rates in the third quarter and first nine months of 2010 remained strong and were consistent with the prior year periods.

National Accounts. Net written premiums of \$173 million in the third quarter of 2010 decreased 12% from the prior year quarter. In the first nine months of 2010, net written premiums of \$593 million were 13% lower than in the same period of 2009. The declines in 2010 were due to reduced insurance exposures driven by lower levels of economic activity, lower new business volume, less prior year retrospective premium adjustments and the loss of a large account.

Industry-Focused Underwriting. Net written premiums of \$590 million in the third quarter of 2010 increased 5% over the same 2009 period. In the first nine months of 2010, net written premiums of \$1.74 billion declined 1% from the same period of 2009. Premium growth in the third quarter of 2010 was concentrated in the Technology and Oil & Gas business units, driven by strong business retention rates coupled with new business. The decline in year-to-date premium volume was concentrated in the Oil & Gas and Construction business units, reflecting market conditions in these industries.

Target Risk Underwriting. Net written premiums of \$342 million in the third quarter of 2010 were 5% lower than in the prior year quarter. In the first nine months of 2010, net written premiums of \$1.22 billion were 1% lower than in the same period of 2009. The decline in premium volume in both periods of 2010 was concentrated in the National Property business unit, driven by declines in renewal premium changes and new business levels.

Specialized Distribution. Net written premiums of \$222 million in the third quarter of 2010 were level with the same period of 2009. In the first nine months of 2010, net written premiums of \$684 million were 1% lower than in the same period of 2009.

Financial, Professional & International Insurance

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

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

Three Months Ended

Nine Months Ended

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(dollars in millions)	September 30,		September 30,	
	2010	2009	2010	2009
Revenues				
Earned premiums	\$ 820	\$ 861	\$ 2,499	\$ 2,472
Net investment income	110	118	331	329
Other revenues	7	7	20	20
Total revenues	\$ 937	\$ 986	\$ 2,850	\$ 2,821
Total claims and expenses	\$ 657	\$ 766	\$ 2,190	\$ 2,231
Operating income	\$ 212	\$ 167	\$ 470	\$ 448
Loss and loss adjustment expense ratio	42.2%	53.3%	50.8%	54.1%
Underwriting expense ratio	37.4	35.4	36.4	35.8
GAAP combined ratio	79.6%	88.7%	87.2%	89.9%

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Overview

Operating income of \$212 million in the third quarter of 2010 was \$45 million, or 27%, higher than in the prior year quarter, primarily reflecting an increase in net favorable prior year reserve development. In the first nine months of 2010, operating income of \$470 million was \$22 million, or 5%, higher than in the same 2009 period, primarily driven by an increase in net favorable prior year reserve development, largely offset by an increase in catastrophe losses. Net favorable prior year reserve development totaled \$97 million and \$203 million in the third quarter and first nine months of 2010, respectively, compared with \$25 million and \$48 million in the respective periods of 2009. Catastrophe losses in the first nine months of 2010 totaled \$87 million, which primarily resulted from an earthquake in Chile during the first quarter. Catastrophe losses in the same period of 2009 totaled \$6 million.

Earned Premiums

Earned premiums of \$820 million in the third quarter of 2010 declined 5% from the same period of 2009, primarily reflecting the impact of the following factors during the preceding twelve months: intentional underwriting actions taken and competitive market conditions at Lloyd's and in the Professional Liability business unit in the Bond & Financial Products group, and lower volume in the Construction Services business unit due to the continued slowdown in construction spending. In the first nine months of 2010, earned premiums of \$2.50 billion were 1% higher than in the same period of 2009, primarily attributable to lower reinsurance costs associated with prior year reinsurance treaties, the impact of changes in the structure of the Company's reinsurance during the first quarter that modestly increased retentions to directionally align retentions in the Company's International business with its U.S. practices, and the favorable impact of foreign currency exchange rates.

Net Investment Income

Net investment income in the third quarter and first nine months of 2010 decreased by \$8 million and increased by \$2 million, respectively, over the same periods of 2009. Refer to the *Net Investment Income* section of the *Consolidated Results of Operations* discussion herein for a description of the factors contributing to the changes in the Company's consolidated net investment income in the third quarter and first nine months of 2010 compared with the same periods of 2009.

Claims and Expenses

Claims and claim adjustment expenses in the third quarter of 2010 totaled \$350 million, a decrease of \$113 million, or 24%, from the same 2009 period, primarily reflecting an increase in net favorable prior year reserve development and a decline in business volume. Net favorable prior year reserve development totaled \$97 million and \$25 million in the third quarters of 2010 and 2009, respectively. In the Bond & Financial Products group, net favorable prior year reserve development in the third quarter of 2010 was driven by better than expected development in the surety and management liability lines of business due to lower than expected claim activity and loss severity. In the International group, the majority of net favorable prior year reserve development in the third quarter of 2010 occurred in several lines of business in Canada. In addition, several product lines in the United Kingdom and Ireland operations, as well as at the Company's operation at Lloyd's, also experienced net favorable prior year reserve development in the third quarter of 2010. Catastrophe losses in the third quarters of both 2010 and 2009 were not significant.

In the first nine months of 2010, claims and claim adjustment expenses totaled \$1.28 billion, a decrease of \$67 million, or 5%, from the same 2009 period, primarily reflecting an increase in net favorable prior year reserve development, partially offset by an increase in catastrophe losses and the unfavorable impact of foreign currency exchange rates. Catastrophe losses totaled \$87 million in the first nine months of 2010, compared with \$6 million in the same period of 2009. The earthquake in Chile in the first quarter accounted for virtually all catastrophe losses incurred in 2010. Net favorable prior year reserve development in the first nine months of 2010 and 2009 totaled \$203 million and \$48 million, respectively. The 2010 total was driven by the same factors described above for the third quarter, as well as better than expected results for recent accident years for the directors & officers and errors & omissions lines of business.

The amortization of deferred acquisition costs totaled \$154 million and \$460 million in the third quarter and first nine months of 2010, respectively, compared with \$162 million and \$459 million in the respective periods of 2009, consistent with earned premium levels in all periods.

General and administrative expenses in the third quarter and first nine months of 2010 totaled \$153 million and \$450 million, respectively, compared with \$141 million and \$425 million in the respective periods of 2009. The increase in both periods primarily reflected increases in employee-related costs and costs to support business growth.

Table of Contents*GAAP Combined Ratio*

The GAAP combined ratio of 79.6% in the third quarter of 2010 was 9.1 points lower than the GAAP combined ratio of 88.7% in the same 2009 period. The GAAP combined ratio of 87.2% in the first nine months of 2010 was 2.7 points lower than the GAAP combined ratio of 89.9% in the same 2009 period.

The loss and loss adjustment expense ratio of 42.2% in the third quarter of 2010 was 11.1 points lower than the 2009 ratio of 53.3%. The 2010 ratio included an 11.8 point benefit from net favorable prior year reserve development and a 0.3 point benefit from the re-estimation of prior quarter catastrophe losses, whereas the 2009 ratio included a 2.9 point benefit from net favorable prior year reserve development and a 0.5 point negative impact from catastrophe losses. Excluding catastrophe losses and prior year reserve development, the loss and loss adjustment expense ratio for the third quarter of 2010 was 1.4 points lower than the third quarter 2009 ratio on the same basis, reflecting the impact of earned rate increases and lower loss severity.

In the first nine months of 2010, the loss and loss adjustment expense ratio of 50.8% was 3.3 points lower than the ratio of 54.1% in the same period of 2009. The 2010 ratio included an 8.1 point benefit from net favorable prior year reserve development and a 3.4 point impact from catastrophes, whereas the 2009 ratio included a 1.9 point benefit from net favorable prior year reserve development and a 0.2 point impact from catastrophe losses. The loss and loss adjustment expense ratio in the first nine months of 2010 excluding catastrophe losses and prior year reserve development was 0.3 points lower than the 2009 ratio on the same basis.

The underwriting expense ratio of 37.4% in the third quarter of 2010 was 2.0 points higher than in the same period of 2009. The underwriting expense ratio of 36.4% for the first nine months of 2010 was 0.6 points higher than the underwriting expense ratio in the same period of 2009. The increase in the third quarter underwriting expense ratio primarily reflected the impact of reduced earned premium volume. The increase in the year-to-date underwriting expense ratio also reflected increases in employee-related costs and costs to support business growth.

Written Premiums

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

(in millions)	Gross Written Premiums			
	Three Months Ended		Nine Months Ended	
	2010	2009	2010	2009
Bond & Financial Products	\$ 556	\$ 587	\$ 1,613	\$ 1,681
International	296	331	1,052	1,054
Total Financial, Professional & International Insurance	\$ 852	\$ 918	\$ 2,665	\$ 2,735

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(in millions)	Net Written Premiums			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Bond & Financial Products	\$ 547	\$ 574	\$ 1,468	\$ 1,466
International	261	296	910	881
Total Financial, Professional & International Insurance	\$ 808	\$ 870	\$ 2,378	\$ 2,347

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The Financial, Professional & International Insurance segment's gross and net written premiums in the third quarter of 2010 both decreased 7% from the same period of 2009. In the Bond & Financial Products group, the 5% decline in net written premiums compared with the third quarter of 2009 was concentrated in the Construction Services business unit due to the continued slowdown in construction spending. In the International group, the 12% decline in net written premiums compared with the third quarter of 2009 primarily reflected intentional underwriting actions taken at Lloyd's, competitive market conditions and the unfavorable impact of foreign currency exchange rates. Gross and net written premiums in the first nine months of 2010 decreased 3% and increased 1%, respectively, compared with the same period of 2009. Net written premiums for the Bond & Financial Products group through the first nine months of 2010 were level with the same period of 2009, as the impact of a reduction in surety reinsurance costs associated with prior year reinsurance treaties and lower costs on current year reinsurance treaties were offset by lower Construction Services volume due to the continued slowdown in construction spending. In the International group, the growth in net written premiums in the first nine months of 2010 was largely due to changes in the structure of the Company's reinsurance that modestly increased retentions to directionally align retentions in the Company's International business with its U.S. practices, as well as the favorable impact of foreign currency exchange rates. The impact of these changes was partially offset by the impact of intentional underwriting actions taken at the Company's operation at Lloyd's and competitive market conditions.

In the Bond & Financial Products group (excluding the surety line of business, for which the following are not relevant measures), business retention rates in the third quarter of 2010 remained strong and increased over the third quarter of 2009. Through the first nine months of 2010, retention rates were level with the same period of 2009. Renewal premium changes in the third quarter and first nine months of 2010 were slightly negative, primarily reflecting reduced insured exposures due to intentional underwriting actions taken and lower levels of economic activity. New business volume in the third quarter and first nine months of 2010 declined from the same 2009 periods, which reflected increased business opportunities in 2009 due to market disruption and increasingly competitive market conditions in 2010. For the International group (also excluding the surety line of business), business retention rates in the third quarter and first nine months of 2010 declined from the same periods of 2009. New business volume also declined from the same periods of 2009, primarily due to higher volumes in Ireland in the prior year quarter and the intentional underwriting actions in the Company's Lloyd's operation, while renewal premium changes were slightly positive in the third quarter and first nine months of 2010.

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. Personal Insurance writes almost all of its insurance coverage through agents, brokers and other intermediaries, which collectively comprise its Agency book of business.

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

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues				
Earned premiums	\$ 1,866	\$ 1,792	\$ 5,466	\$ 5,308
Net investment income	111	116	340	299
Other revenues	18	20	56	62
Total revenues	\$ 1,995	\$ 1,928	\$ 5,862	\$ 5,669

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Total claims and expenses	\$	1,759	\$	1,729	\$	5,558	\$	5,166
Operating income	\$	168	\$	149	\$	246	\$	391
Loss and loss adjustment expense ratio		63.2%		64.3%		70.5%		66.5%
Underwriting expense ratio		29.9		30.9		30.0		29.5
GAAP combined ratio		93.1%		95.2%		100.5%		96.0%
Incremental impact of direct to consumer initiative on GAAP combined ratio		2.5%		1.9%		2.1%		1.7%

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Overview

Operating income of \$168 million in the third quarter of 2010 was \$19 million, or 13%, higher than operating income in the same period of 2009, primarily reflecting an increase in business volume and the favorable impact of earned rate increases outpacing loss cost trends. Through the first nine months of 2010, operating income of \$246 million was \$145 million, or 37%, lower than in the same 2009 period. The decline in operating income in the first nine months of 2010 primarily reflected an increase in catastrophe losses and a decline in net favorable prior year reserve development, partially offset by an increase in net investment income, an increase in business volume, the favorable impact of earned rate increases outpacing loss cost trends and a reduction in non-catastrophe weather-related losses. In addition, operating income in the first nine months of 2009 included a \$48 million reduction in the estimate of property windpool assessments related to Hurricane Ike that had been recorded in general and administrative expenses in 2008. Catastrophe losses in the third quarter and first nine months of 2010 totaled \$66 million and \$573 million, respectively, compared with \$68 million and \$278 million in the respective periods of 2009. Net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$23 million and \$50 million, respectively, compared with \$22 million and \$120 million in the respective periods of 2009.

Earned Premiums

Earned premiums of \$1.87 billion in the third quarter of 2010 increased \$74 million, or 4%, over earned premiums in the same period of 2009. In the first nine months of 2010, earned premiums of \$5.47 billion were \$158 million, or 3%, higher than in the same 2009 period. The increases reflected continued strong business retention rates, continued renewal premium increases and growth in new business volume during the preceding twelve months.

Net Investment Income

Net investment income in the third quarter and first nine months of 2010 decreased by \$5 million and increased \$41 million, respectively, compared with the same periods of 2009. Refer to the *Net Investment Income* section of the *Consolidated Results of Operations* discussion herein for a description of the factors contributing to the changes in the Company's consolidated net investment income in the third quarter and first nine months of 2010 compared with the same periods of 2009.

Claims and Expenses

Claims and claim adjustment expenses in the third quarter of 2010 totaled \$1.18 billion, an increase of \$28 million, or 2%, over the same period of 2009, primarily reflecting an increase in business volume. Through the first nine months of 2010, claims and claim adjustment expenses totaled \$3.85 billion, an increase of \$322 million, or 9%, over the same period of 2009. The year-to-date total in 2010 reflected an increase in catastrophe losses, a reduction in net favorable prior year reserve development and increased business volume. The year-to-date total in 2010 also reflected a decline in non-catastrophe weather-related losses. Catastrophe losses in the third quarter and first nine months of 2010 totaled \$66 million and \$573 million, respectively, compared with \$68 million and \$278 million in the respective periods of 2009. Catastrophe losses in both 2010 and 2009 resulted from several severe wind and hail storms.

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Net favorable prior year reserve development in the third quarter and first nine months of 2010 totaled \$23 million and \$50 million, respectively, compared with \$22 million and \$120 million in the respective periods of 2009. Net favorable prior year reserve development in both periods of 2010 was concentrated in the Homeowners and Other product line. The third quarter 2009 net favorable prior year reserve development also occurred in the Homeowners and Other product line and primarily reflected favorable loss experience related to Hurricane Ike. Net favorable prior year reserve development in the first nine months of 2009 primarily reflected favorable loss experience related to Hurricanes Ike and Katrina.

The amortization of deferred acquisition costs totaled \$364 million and \$1.07 billion in the third quarter and first nine months of 2010, respectively, compared with \$357 million and \$1.06 billion in the respective periods of 2009, consistent with earned premium levels in all periods.

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General and administrative expenses in the third quarter of 2010 totaled \$215 million, \$5 million lower than in the same period of 2009. In the first nine months of 2010, general and administrative expenses of \$632 million were \$55 million higher than in the same period of 2009. The total for the first nine months of 2009 reflected a \$48 million reduction in the estimate of property windpool assessments related to Hurricane Ike. Adjusting for the impact of windpool assessments in 2009, general and administrative expenses in the first nine months of 2010 increased 1% over the same period of 2009, primarily reflecting growth in business volume and continued costs supporting business growth and product development, including the Company's direct to consumer initiative.

GAAP Combined Ratio

The GAAP combined ratio of 93.1% in the third quarter of 2010 was 2.1 points lower than the GAAP combined ratio of 95.2% in the same 2009 period. The GAAP combined ratio of 100.5% in the first nine months of 2010 was 4.5 points higher than the GAAP combined ratio of 96.0% in the same 2009 period.

The loss and loss adjustment expense ratio of 63.2% in the third quarter of 2010 was 1.1 points lower than the comparable 2009 ratio of 64.3%. Catastrophe losses accounted for 3.6 points of the 2010 third quarter loss and loss adjustment expense ratio, whereas the 2009 third quarter loss and loss adjustment expense ratio included a 3.8 point impact of the cost of catastrophes. The loss and loss adjustment expense ratio for the third quarter of 2010 and 2009 included 1.2 point and 1.3 point benefits, respectively, from net favorable prior year reserve development. The loss and loss adjustment expense ratio excluding catastrophe losses and prior year reserve development for the third quarter of 2010 was 1.0 points lower than the 2009 ratio on the same basis, primarily reflecting the favorable impact of earned rate increases outpacing loss cost trends.

In the first nine months of 2010, the loss and loss adjustment expense ratio of 70.5% was 4.0 points higher than the comparable 2009 ratio of 66.5%. Catastrophe losses accounted for 10.5 points of the loss and loss adjustment expense ratio for the first nine months of 2010, whereas the loss and loss adjustment expense ratio for the first nine months of 2009 included a 5.2 point impact of catastrophe losses. The loss and loss adjustment expense ratio for the first nine months of 2010 and 2009 included 0.9 point and 2.2 point benefits, respectively, from net favorable prior year reserve development. Through the first nine months of 2010, the loss and loss adjustment expense ratio excluding catastrophe losses and prior year reserve development was 2.6 points lower than the 2009 ratio on the same basis, reflecting the favorable impact of earned rate increases outpacing loss cost trends and a reduction in non-catastrophe weather-related losses.

The underwriting expense ratio of 29.9% for the third quarter of 2010 was 1.0 points lower than the third quarter 2009 underwriting expense ratio of 30.9%, primarily reflecting lower expenses. In the first nine months of 2010, the underwriting expense ratio of 30.0% was 0.5 points higher than the underwriting expense ratio of 29.5% in the same 2009 period. The 2009 year-to-date underwriting expense ratio included a 0.9 point benefit from the reduction in the estimate of windpool assessments described above.

Agency Written Premiums

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

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(in millions)	Gross Written Premiums			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Agency Automobile	\$ 958	\$ 905	\$ 2,826	\$ 2,748
Agency Homeowners and Other	1,140	1,067	3,078	2,877
Total Agency Personal Insurance	\$ 2,098	\$ 1,972	\$ 5,904	\$ 5,625

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(in millions)	Net Written Premiums			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Agency Automobile	\$ 952	\$ 898	\$ 2,810	\$ 2,729
Agency Homeowners and Other	1,024	946	2,862	2,647
Total Agency Personal Insurance	\$ 1,976	\$ 1,844	\$ 5,672	\$ 5,376

Gross and net Agency written premiums in the third quarter of 2010 increased 6% and 7%, respectively, over the totals in the same period of 2009. In the first nine months of 2010, gross Agency written premiums increased 5%, and net Agency written premiums increased 6% over the respective totals in the same period of 2009.

In the Agency Automobile line of business, net written premiums in the third quarter and first nine months of 2010 increased 6% and 3%, respectively, over the same periods of 2009. The increases in both periods of 2010 primarily reflected the impact on written premiums of the introduction of twelve-month policy terms in certain markets in 2010. Excluding the impact of the change in policy terms in 2010, Agency Automobile net written premiums increased 1% over the third quarter of 2009 and were level with the first nine months of 2009. Business retention rates remained strong and new business levels increased over the third quarter and first nine months of 2009. Renewal premium changes were positive in both periods of 2010 but declined from the respective periods of 2009.

In the Agency Homeowners and Other line of business, net written premiums in the third quarter and first nine months of 2010 grew 8% over the same periods of 2009. Growth in the third quarter of 2010 was driven by increases in renewal premium changes and business retention rates. New business levels declined slightly from the third quarter of 2009. Through the first nine months of 2010, changes in the timing of certain reinsurance contributed to net written premium growth over the same period of 2009, along with increases in renewal premium changes, business retention rates and new business levels.

The Personal Insurance segment had approximately 7.7 million and 7.4 million policies in force at September 30, 2010 and 2009, respectively.

Interest Expense and Other

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Operating loss	\$ (65)	\$ (70)	\$ (214)	\$ (169)

The \$5 million decrease in operating loss in Interest Expense and Other in the third quarter of 2010 compared with the same period of 2009 primarily reflected a decline in interest expense. The \$45 million increase in operating loss in the first nine months of 2010 compared with the same 2009 period reflected a benefit of \$28 million from the favorable resolution of various prior year tax matters in the first nine months of 2009. In addition, the operating loss in the first nine months of 2010 included a \$12 million increase in tax expense associated with recent federal health care legislation, and an increase in interest expense. After-tax interest expense in the third quarter and first nine months of 2010

totaled \$62 million and \$189 million, respectively, compared with \$64 million and \$185 million in the respective periods of 2009.

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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 new 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. The bankruptcy of many traditional defendants has also caused increased settlement demands against those policyholders who are not in bankruptcy but that remain in the tort system. Currently, in many jurisdictions, those who allege very serious injury and who can present credible medical evidence of their injuries are receiving priority trial settings in the courts, while those who have not shown any credible disease manifestation are having their hearing dates delayed or placed on an inactive docket. This trend of prioritizing claims involving credible evidence of injuries, along with the focus on previously peripheral defendants, contributes to the claims and claim adjustment expense payments experienced by the Company. The Company's asbestos-related claims and claim adjustment expense experience also has been impacted by the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or through the insolvency of other participating insurers.

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

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

In addition to claims against policyholders, proceedings have been launched directly against insurers, including the Company, by individuals challenging insurers' conduct with respect to the handling of past asbestos claims and by individuals seeking damages arising from alleged asbestos-related bodily injuries. 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.

Travelers Property Casualty Corp. (TPC), a wholly-owned subsidiary of the Company, had entered into settlement agreements, which are subject to a number of contingencies, in connection with a number of these direct action claims. These settlement agreements had been approved by the

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court in connection with 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 ruling to the U.S. Court of Appeals for the Second Circuit. On February 15, 2008, the

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Second Circuit issued an opinion vacating on jurisdictional grounds the district court's approval of the bankruptcy court's order that barred the filing of certain direct action claims against TPC in the future. TPC and certain other parties filed Petitions for Writ of Certiorari in the United States Supreme Court seeking review of the Second Circuit's decision. Those petitions were granted and on June 18, 2009, the Supreme Court ruled in favor of the Company, reversing the Second Circuit's decision. However, since the Second Circuit had not ruled on several additional issues principally related to procedural matters and the adequacy of notice provided to certain parties, the Supreme Court remanded the case to the Second Circuit for further proceedings on those specific issues. On March 22, 2010, the Second Circuit issued an opinion in which it found that the notice of the 1986 Orders provided to the remaining objector was insufficient to bar contribution claims by that objector against TPC. On April 5, 2010, TPC filed a Petition for Rehearing and Rehearing *En Banc* with the Second Circuit, requesting further review of its March 22, 2010 opinion, which was denied on May 25, 2010. On August 18, 2010, TPC filed a Petition for Writ of Certiorari in the United States Supreme Court seeking review of the Second Circuit's March 22, 2010 opinion, and a Petition for a Writ of Mandamus seeking an order from the Supreme Court requiring the Second Circuit to comply with the Supreme Court's June 18, 2009 ruling in TPC's favor. The Supreme Court has not yet ruled on the Petitions. The plaintiffs in the Statutory and Hawaii actions and the Common Law Claims actions filed Motions to Compel with the bankruptcy court on September 2, 2010 and September 3, 2010, respectively, arguing that all conditions precedent to the settlements have been met and seeking to require TPC to pay the settlement amounts. On September 30, 2010, TPC filed an Opposition to the plaintiffs' Motions to Compel on the grounds that the conditions precedent to the settlements, principally the requirement that all contribution claims be barred, have not been met in light of the Second Circuit's March 22, 2010 opinion. A hearing on the Motions to Compel is scheduled for October 21, 2010. (For a description of these matters, see note 12 to the consolidated financial statements).

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

In the third quarter of 2010, the Company completed its annual in-depth asbestos claim review and noted the continuation of recent trends, which include:

- continued high level of litigation activity involving individuals alleging serious asbestos-related illness;
- stable payment patterns for a large proportion of policyholders;
- a decrease in the number of large asbestos exposures confronting the Company due to additional settlement activity;
- continued moderate level of asbestos-related bankruptcy activity; and
- the absence of new theories of liability or new classes of defendants.

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

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As in prior years, the annual claim review considered active policyholders and litigation cases for potential product and non-product liability. Compared with the prior year period, the Home Office and Field Office categories, which account for the vast majority of policyholders with active asbestos-related claims, experienced an overall reduction in the number of policyholders who, for the first time, were tendering asbestos claims. However, gross defense and indemnity costs in these categories remained at similar levels to what the Company has experienced in recent years due to the high level of litigation activity in a limited number of jurisdictions where individuals alleging serious asbestos-related injury continue to target previously peripheral defendants.

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

The completion of these reviews and analyses in the third quarter resulted in a net \$140 million increase in the Company's asbestos reserves, driven by increases in the Company's estimate of 1) projected settlement and defense costs related to a broad number of policyholders; 2) costs of litigating asbestos-related coverage matters; and 3) projected payments on assumed reinsurance accounts. This increase included a \$70 million benefit from the reduction in the allowance for uncollectible reinsurance resulting from a recent favorable ruling related to a reinsurance dispute, and an increase in estimated reinsurance recoverables. In the third quarter of 2009, the Company recorded a \$185 million increase in asbestos reserves, primarily driven by a slight increase in the Company's assumption for projected defense costs related to many policyholders. Overall, the company's assessment of the underlying asbestos environment did not change significantly from recent periods.

Net asbestos losses and expenses paid in the first nine months of 2010 were \$240 million, compared with \$184 million in the same period of 2009. Approximately 29% and 21% of total net paid losses in the first nine months of 2010 and 2009, respectively, related to policyholders with whom the Company had entered into settlement agreements limiting the Company's liability. Net asbestos reserves totaled \$2.66 billion at September 30, 2010, compared with \$2.92 billion at September 30, 2009.

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

(at and for the nine months ended September 30, in millions)	2010	2009
Beginning reserves:		
Direct	\$ 3,097	\$ 3,299
Ceded	(339)	(385)
Net	2,758	2,914
Incurred losses and loss expenses:		
Direct	262	185
Ceded	(122)	
Net	140	185
Losses paid:		
Direct	301	233
Ceded	(61)	(49)
Net	240	184
Ending reserves:		
Direct	3,058	3,251
Ceded	(400)	(336)
Net	\$ 2,658	\$ 2,915

See Uncertainty Regarding Adequacy of Asbestos and Environmental Reserves.

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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 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 generally considers the probable liability, available coverage, relevant judicial interpretations and historical value of similar exposures. In addition, the Company considers the many variables presented, such as the nature of the alleged activities of the policyholder at each site; the 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.

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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.

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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 modest upward development in the expected defense and settlement costs for certain of its pending policyholders. As a result, the Company increased its net environmental reserves by \$35 million in the second quarter of 2010. The Company increased its net environmental reserves by \$70 million in the second quarter of 2009, due to a slight increase in the number of policyholders tendering claims for the first time and upward development in the expected defense and settlement costs for certain of its pending policyholders.

Net paid losses in the first nine months of 2010 and 2009 were \$51 million and \$70 million, respectively. At September 30, 2010, approximately 92% of the net environmental reserve (approximately \$347 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 8% of the net environmental reserve (approximately \$30 million), consists of case reserves.

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

(at and for the nine months ended September 30, in millions)	2010	2009
Beginning reserves:		
Direct	\$ 389	\$ 400
Ceded	4	14
Net	393	414
Incurred losses and loss expenses:		
Direct	45	85
Ceded	(10)	(15)
Net	35	70
Losses paid:		
Direct	51	74
Ceded	(4)	(4)
Net	51	70
Ending reserves:		
Direct	383	411
Ceded	(6)	3
Net	\$ 377	\$ 414

UNCERTAINTY REGARDING ADEQUACY OF ASBESTOS AND ENVIRONMENTAL RESERVES

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As a result of the processes and procedures described above, management believes that the reserves carried for asbestos and environmental claims at September 30, 2010 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 disputes pertaining to the amount of available coverage for asbestos and environmental claims in a manner inconsistent with the Company's previous assessment of these claims, the number and outcome of direct actions against the Company, future developments pertaining to the Company's ability to recover reinsurance for asbestos and environmental claims and the unavailability of other insurance sources potentially available to policyholders, whether through exhaustion of policy limits or through the insolvency of other participating insurers. In addition, uncertainties arise

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from the insolvency or bankruptcy of policyholders and other defendants. It is also not possible to predict changes in the legal, regulatory and legislative environment and their impact on the future development of asbestos and environmental claims. This 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 note 12 to the consolidated financial statements).

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 majority of funds available for investment are deployed in a widely diversified portfolio of high quality, liquid taxable U.S. government, tax-exempt U.S. municipal bonds, and taxable corporate and U.S. agency mortgage-backed 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 weighted average credit quality of the Company's fixed maturity portfolio, both including and excluding U.S. Treasury securities, was Aa2 at September 30, 2010 and December 31, 2009. Below investment grade securities represented 2.9% and 2.7% of the total fixed maturity investment portfolio at September 30, 2010 and December 31, 2009, respectively. The average effective duration of fixed maturities and short-term securities was 3.5 (3.8 excluding short-term securities) at September 30, 2010, compared with 3.9 (4.2 excluding short-term securities) at December 31, 2009. The decline in duration primarily resulted from the impact of declining market yields on existing holdings of municipal bonds and mortgage-backed securities (which impact the assumptions related to optional pre-payments and the related estimate of effective duration for callable securities).

The Company's fixed maturity investment portfolio at September 30, 2010 included \$41.43 billion of securities which are obligations of states, municipalities and political subdivisions (collectively referred to as the municipal bond portfolio). Included in the municipal bond portfolio were \$7.15 billion of advance refunded or escrowed-to-maturity bonds. Advance refunded and escrowed-to-maturity bonds are bonds for which an irrevocable trust has been established to fund the remaining payments of principal and interest. Such escrow accounts are verified as to their sufficiency by an external auditor and are almost exclusively comprised of U.S. Treasury securities. The municipal bond portfolio is diversified across the United States, the District of Columbia and Puerto Rico and includes general obligation and revenue bonds issued by states, cities, counties, school districts and similar issuers. Moody's Investors Service has assigned a negative outlook to municipal securities issued by local governments within the United States.

The Company bases its investment decision on the credit characteristics of the municipal security; however, its municipal bond portfolio includes a number of securities that were enhanced by third-party insurance for the payment of principal and interest in the event of an issuer default. Of the insured municipal securities in the Company's investment portfolio at September 30, 2010, approximately 99% were rated at A3 or above, and approximately 90% were rated at Aa3 or above, without the benefit of insurance. The Company believes that a loss of the benefit of insurance would not result in a material adverse impact on the Company's results of operations, financial position or liquidity, due to the underlying credit strength of the issuers of the securities, as well as the Company's ability and intent to hold the securities. The average credit rating of the underlying issuers of these securities was Aa2 at September 30, 2010. The average credit rating of the entire municipal bond portfolio was Aa1 at September 30, 2010 with and without the third-party insurance.

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At September 30, 2010 and December 31, 2009, the Company held commercial mortgage-backed securities (CMBS, including FHA project loans) of \$638 million and \$714 million, respectively. At September 30, 2010, approximately \$204 million of these securities, or the loans backing such securities, contained guarantees by the U.S. government or a government-sponsored enterprise; and \$19 million were comprised of Canadian non-guaranteed securities. The average credit rating of the \$434 million of non-guaranteed securities at September 30, 2010 was Aaa, and 89% of those securities were issued in 2004 and prior years. 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 portfolio's relatively small size and the underlying credit strength of these securities.

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 Company's investment strategy generally favors securities that control this risk within expected interest rate ranges. The Company does invest in other types of CMO tranches if a careful assessment indicates a favorable risk/return tradeoff. The Company does not purchase residual interests in CMOs. Recently, attorneys general in all 50 states launched a joint probe into mortgage lenders and servicers regarding foreclosure practices. In addition, a number of major companies that service mortgages suspended home foreclosures in those states that handle foreclosures through the court system to address allegations of irregularities in foreclosure documents. While the Company does not believe these and related actions will have a material impact on its investment portfolio or its reported net investment income, it is not yet clear how these issues will ultimately be resolved and a substantial and protracted disruption to the foreclosure process could materially impact returns on the Company's CMO portfolio.

At September 30, 2010 and December 31, 2009, the Company held CMOs classified as available for sale with a fair value of \$2.27 billion and \$2.58 billion, respectively (in addition to the CMBS securities of \$638 million and \$714 million, respectively, described above). Approximately 38% and 37% of the Company's CMO holdings were guaranteed by or fully collateralized by securities issued by GNMA, FNMA or FHLMC at September 30, 2010 and December 31, 2009, respectively. In addition, at September 30, 2010 and December 31, 2009, the Company held \$2.27 billion and \$2.63 billion, respectively, of GNMA, FNMA, FHLMC (excluding FHA project loans which are included with CMBS) mortgage-backed pass-through securities classified as available for sale. The average credit rating of all of the above securities was Aa1 at September 30, 2010 and December 31, 2009.

The Company's fixed maturity investment portfolio at September 30, 2010 and December 31, 2009 included asset-backed securities collateralized by sub-prime mortgages and collateralized mortgage obligations backed by alternative documentation mortgages with a collective fair value of \$299 million and \$270 million, respectively (comprising approximately 0.5% and 0.4% of the Company's total fixed maturity investments at September 30, 2010 and December 31, 2009, respectively). The disruption in secondary investment markets for mortgage-backed securities in recent years provided the Company with the opportunity to selectively acquire additional asset-backed securities collateralized by sub-prime mortgages at discounted prices. The Company purchased \$29 million and \$74 million of such securities during the nine months ended September 30, 2010 and the year ended December 31, 2009, respectively. The Company defines sub-prime mortgage-backed securities as investments in which the underlying loans primarily exhibit one or more of the following characteristics: low FICO scores, above-prime interest rates, high loan-to-value ratios or high debt-to-income ratios. Alternative documentation securitizations are those in which the underlying loans primarily meet the government-sponsored entity's requirements for credit score but do not meet the government-sponsored entity's guidelines for documentation, property type, debt and loan-to-value ratios. The average credit rating on these securities and obligations held by the Company was Baa2 and A3 at September 30, 2010 and December 31, 2009, respectively.

The Company's real estate investments include warehouses and office buildings and other commercial land and properties that are directly owned. The carrying value of these investments totaled \$843 million and \$865 million at September 30, 2010 and December 31, 2009, respectively.

The Company's other investments are primarily comprised of private equity limited partnerships, hedge funds, real estate partnerships, joint ventures, mortgage loans, venture capital (through direct ownership and limited partnerships) and trading securities. These asset classes have historically provided a higher return than fixed maturity investments but are subject to more volatility. Net investment income provided by these asset classes totaled \$46 million and \$161 million in the third quarter and first nine months of 2010, respectively, compared with net investment income of \$45 million and negative net investment income of \$203 million in the respective periods of 2009. The losses in 2009 reflected market conditions. The carrying value of the Company's other investments at September 30, 2010 and December 31, 2009 was \$2.96 billion and \$2.95 billion, respectively. In October 2010, the Company sold its non-public warrants in a public company for approximately \$99 million, which approximated the warrants' fair value at September 30, 2010.

Table of Contents**REINSURANCE RECOVERABLES**

For a description of the Company's reinsurance recoverables, refer to Reinsurance Recoverables in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

On August 20, 2010, in a reinsurance dispute in New York state court captioned *United States Fidelity & Guaranty Company v. American Re-Insurance Company, et al.*, the trial court granted summary judgment for the Company, awarding it \$251 million (after taking into account a settlement with one of the defendants), plus pre-judgment interest in the amount of \$166 million. United States Fidelity and Guaranty Company is a subsidiary of the Company. The \$251 million awarded by the court represents the amount owed to the Company under the terms of the reinsurance agreements and is reported as part of reinsurance recoverables in the Company's consolidated balance sheet. The interest awarded by the Court is treated for accounting purposes as a gain contingency in accordance with FASB Topic 450, *Contingencies*, and accordingly has not been recognized in the Company's consolidated financial statements. When the judgment is entered by the court, post-judgment interest will accrue at the rate of 9 percent (without compounding) on the entire award of \$417 million. The summary judgment ruling, including the award of interest, is subject to appeal. The Company intends to vigorously pursue collection of the amounts awarded in the court's ruling.

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

(in millions)	September 30, 2010	December 31, 2009
Gross reinsurance recoverables on paid and unpaid claims and claim adjustment expenses	\$ 7,387	\$ 8,138
Allowance for uncollectible reinsurance	(373)	(523)
Net reinsurance recoverables	7,014	7,615
Structured settlements	3,403	3,456
Mandatory pools and associations	1,643	1,745
Total reinsurance recoverables	\$ 12,060	\$ 12,816

The \$601 million decline in net reinsurance recoverables since December 31, 2009 reflected cash collections and the impact of net favorable prior year reserve development, partially offset by a reduction in the allowance for uncollectible reinsurance. The reduction in the allowance for uncollectible reinsurance was driven by a \$70 million benefit resulting from a recent favorable ruling related to the reinsurance dispute described above. As a result, at September 30, 2010, reinsurance recoverables included the full \$251 million owed to the Company under the terms of the related reinsurance agreement.

Included in reinsurance recoverables are certain amounts related to structured settlements. Structured settlements comprise annuities purchased from various life insurance companies to settle certain personal physical injury claims, of which workers' compensation claims comprise a significant portion. In cases where the Company did not receive a release from the claimant, the structured settlement is included in reinsurance recoverables as the Company retains the contingent liability to the claimant. In the event that the life insurance company fails to make the required annuity payments, the Company would be required to make such payments. In the third quarter of 2010, Old Mutual plc, the parent of a U.S. life insurance company that is one of the largest issuers of structured settlements included in the Company's reinsurance recoverables, agreed to sell its U.S. life insurance business to a hedge fund buyer. The Company currently cannot predict the impact of the transaction on the long-term creditworthiness of the annuity issuer.

OUTLOOK

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

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

The Company expects retention levels (the amount of expiring premium that renews, before the impact of renewal premium changes) will remain strong, generally consistent with recent periods. In the Business Insurance and Financial, Professional & International Insurance segments, the Company expects that renewal premium changes, including the components of rate changes and insured exposures, will not meaningfully change during the remainder of 2010 and into 2011 compared with the first nine months of 2010. In the Personal Insurance segment, the Company expects that Agency Automobile renewal premium changes, while positive, will decrease slightly in the remainder of 2010 and into 2011 from levels in the first nine months of 2010. For its Agency Homeowners' and Other business, the Company expects renewal premium changes in the remainder of 2010 and into 2011 will remain generally consistent with the first nine months of 2010.

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The pricing environment for new business generally has less of an impact on underwriting profitability than renewal rate changes, given the volume of new business relative to renewal business. While property and casualty insurance market conditions are expected to remain competitive in the remainder of 2010 and into 2011 for new business, the Company believes it is well-positioned to capitalize on new business opportunities as agents, brokers and customers seek to place business with high-quality carriers. In addition, the Company announced in 2009 that it launched a new distribution channel that markets personal insurance products directly to consumers, which is expected to generate modest growth in premium volume for Personal Insurance in 2010 and into 2011.

While economic conditions have recently improved and U.S. gross domestic product experienced growth in the latter part of 2009 and early 2010, that trend may not continue, and the U.S. economy may enter into a double dip recession. Further, if growth continues, it may be at a slow rate for an extended period of time. In addition, other economic conditions, such as the commercial and residential real estate environment and employment rates, may continue to be weak. If weak economic conditions persist or deteriorate, low levels of economic activity could impact exposure changes at renewal and our ability to write business at acceptable rates. Additionally, such low levels of economic activity could adversely impact audit premium adjustments, policy endorsements and mid-term cancellations after policies are written. All of the foregoing, in turn, could adversely impact net written premiums in 2010 and into 2011. Since earned premiums lag net written premiums, earned premiums could be adversely impacted in the remainder of 2010 and into 2011.

Underwriting Gain/Loss. The anticipated impact of competitive market conditions and general economic conditions on the Company's earned premiums, as discussed above, coupled with an expected modest increase in loss costs, will likely result in modestly reduced underwriting profitability during the remainder of 2010 and into 2011, as compared with 2009. In addition, the Company's direct to consumer initiative in the Personal Insurance segment, discussed above, while intended to enhance the Company's long-term ability to compete successfully in a consumer-driven marketplace, is expected to remain unprofitable for a number of years as this book of business grows and matures.

In recent periods, the Company has experienced net favorable prior year reserve development, driven by better than expected loss experience in all of the Company's segments for prior loss years. Better than expected loss experience and other favorable circumstances may continue at lower levels compared to recent periods, may not continue or may reverse, causing the Company to recognize lower favorable prior year reserve development, no favorable prior year reserve development or unfavorable prior year reserve development in future periods. The ongoing review of prior year claim and claim adjustment expense reserves, or other changes in current period circumstances, may result in the Company revising current year loss estimates upward or downward in future periods.

Catastrophe losses are inherently unpredictable from year to year, and the Company's results of operations would be adversely impacted by significant catastrophe losses in the remainder of 2010 and into 2011.

Investments. The Company expects to continue to focus its investment strategy on maintaining a high-quality investment portfolio and a relatively low average effective duration. The Company's invested assets at September 30, 2010 totaled \$74.72 billion, of which 94% was invested in fixed maturity and short-term securities, with the remaining 6% invested in equity securities, real estate, private equity limited partnerships, hedge funds and real estate partnerships.

Net investment income is a material contributor to the Company's results of operations. While investment returns are difficult to predict and inherently uncertain, in the remainder of 2010 and into 2011, the Company expects investment returns for its fixed maturity investment portfolio to be slightly lower than in recent periods due to lower reinvestment yields available for maturing long-term fixed maturity investments. Returns from the Company's short-term and non-fixed maturity investment portfolios are expected to remain challenged. Short-term interest rates are expected to remain at or near historically low levels. The Company expects investment income in its non-fixed maturity investment portfolio

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during the remainder of 2010 and into 2011 to be generally consistent with the first nine months of 2010. However, if general economic conditions and/or investment market conditions deteriorate in the remainder of 2010 and into 2011, the Company could also experience a reduction in net investment income and/or significant realized investment losses, including impairments. The Company expects its fixed income assets, including its municipal portfolio, to provide adequate risk-adjusted returns and support its insurance operations over the long-term.

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Capital Position. The Company believes it has a strong capital position and expects to continue its common share repurchase program in the remainder of 2010 as part of its continuing efforts to maximize shareholder value. During the fourth quarter of 2010, the Company expects to repurchase between \$1.1 billion and \$1.6 billion of its common shares under its share repurchase authorization. The actual amount of share repurchases may be materially different and will depend on a variety of factors, including the Company's earnings, corporate and regulatory requirements, share price, catastrophe losses, strategic initiatives and other market conditions.

The Company had a net after-tax unrealized investment gain of \$2.89 billion in its fixed maturity investment portfolio at September 30, 2010. While the Company does not attempt to predict future interest rate movements, a rising interest rate environment would reduce the market value of fixed maturity investments and, therefore, reduce shareholders' equity, and a declining interest rate environment would have the opposite effects.

Many of the statements in this Outlook section are forward-looking statements, which are subject to risks and uncertainties that are often difficult to predict and beyond the Company's control. Actual results could differ materially from those expressed or implied by such forward-looking statements. Further, such forward-looking statements speak only as of the date of this report and the Company undertakes no obligation to update them. See Forward Looking Statements. For a discussion of potential risks and uncertainties that could impact the Company's results of operations or financial position, see Item 1A Risk Factors herein and in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates in this report.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of a company's ability to generate sufficient cash flows to meet the 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.

At September 30, 2010, total cash and short-term invested assets aggregating \$2.82 billion and having a weighted average maturity of 55 days were held at the holding company. The assets held at the holding company are sufficient to meet the holding company's current liquidity requirements and are more than two times the Company's target level. These liquidity requirements primarily include shareholder dividends and debt service. The Company has a shelf registration with the Securities and Exchange Commission which permits it to issue securities from time to time.

On June 10, 2010, the Company entered into a three-year, \$1.0 billion revolving credit agreement with a syndicate of financial institutions, replacing its five-year, \$1.0 billion credit agreement that expired on that date. No borrowings have been made under the credit agreement since its inception. Pursuant to the credit agreement covenants, the Company must maintain a minimum consolidated net worth (generally defined as shareholders' equity plus certain trust preferred and mandatorily convertible securities, reduced for goodwill and other intangible assets). That threshold is adjusted downward by an amount equal to 70% of the aggregate amount of common stock repurchased by the Company after March 31, 2010, up to a maximum deduction of \$1.75 billion. The threshold was \$14.70 billion at September 30, 2010, and will decline to a

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minimum of \$14.35 billion during the term of the credit agreement, subject to the Company repurchasing an additional \$500 million of its common stock. The Company must also maintain a ratio of total debt to the sum of total debt plus consolidated net worth of not greater than 0.40 to 1.00. In addition, the credit agreement contains other customary restrictive covenants as well as certain customary events of default, including with respect to a change in control, which is defined to include the acquisition of 35% or more of the Company's voting stock and certain changes in the composition of the Company's board of directors. At September 30, 2010, the Company was in compliance with these covenants. Generally, the cost of borrowing under this agreement will range from LIBOR plus 100 basis points to LIBOR plus 175 basis points depending on the

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Company's credit ratings. At September 30, 2010, that cost would have been LIBOR plus 125 basis points, had there been any amounts outstanding under the credit agreement. This line of credit also supports the Company's \$800 million commercial paper program, of which \$100 million was outstanding at September 30, 2010. The Company is not reliant on its commercial paper program to meet its operating cash flow needs.

The Company currently utilizes uncollateralized letters of credit issued by major banks with an aggregate limit of approximately \$418 million to provide much of the capital needed to support its obligations at Lloyd's. If uncollateralized letters of credit are not available at a reasonable price or at all in the future, the Company can collateralize these letters of credit or may have to seek alternative means of supporting its obligations at Lloyd's, which could include utilizing holding company funds on hand.

Operating Activities

Net cash flows provided by operating activities in the first nine months of 2010 and 2009 totaled \$2.39 billion and \$3.20 billion, respectively. Cash flows in the first nine months of 2010 reflected a higher level of catastrophe loss payments and lower collected premiums compared with the first nine months of 2009.

Investing Activities

Net cash flows provided by investing activities in the first nine months of 2010 totaled \$1.65 billion, compared with net cash flows used in investing activities in the first nine months of 2009 of \$1.45 billion. Net cash provided by investing activities in the first nine months of 2010, along with cash flows provided by operating activities, was principally deployed in common share repurchases. Fixed maturity securities accounted for the majority of investment purchases, sales and maturities in both years.

The Company's management of the duration of the fixed maturity investment portfolio generally produces a duration that exceeds the estimated duration of the Company's net insurance liabilities. The average effective duration of fixed maturities and short-term securities was 3.5 (3.8 excluding short-term securities) at September 30, 2010, compared with 3.9 (4.2 excluding short-term securities) at December 31, 2009. The decline in duration primarily resulted from the impact of declining market yields on existing holdings of municipal bonds and mortgage-backed securities (which impact the assumptions related to optional pre-payments and the related estimate of effective duration for callable securities).

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 maturity portfolio adequately fund the estimated runoff of the Company's insurance reserves. Although this is not an exact cash flow match in each period, the substantial degree by which the market value of the fixed maturity 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 claim payments without having to sell illiquid assets or access credit facilities.

Financing Activities

Net cash flows used in financing activities in the first nine months of 2010 totaled \$4.00 billion, compared with \$1.84 billion in the same 2009 period. The 2010 total primarily reflected common share repurchases, dividends to shareholders and the repayment of debt, partially offset by the proceeds from employee stock option exercises. On April 15, 2010, the Company's \$250 million, 8.125% senior notes matured and were fully paid. On August 23, 2010, the Company's \$21 million, 7.415% medium-term notes matured and were fully paid. On September 16, 2010, the Company repaid the remaining \$4 million principal balance on its 7.81% private placement senior notes. The 2009 total primarily reflected common share repurchases and dividends to shareholders, partially offset by the proceeds from the issuance of debt and employee stock option exercises.

Dividends paid to shareholders totaled \$512 million and \$518 million in the first nine months of 2010 and 2009, respectively. The declaration and payment of future dividends to holders of the Company's common stock will be at the discretion of the Company's board of directors and will depend upon many factors, including the Company's financial position, earnings, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints and other factors as the board of directors deems relevant. Dividends would be paid by the Company only if declared by its board of directors out of funds legally available, subject to any other restrictions that may be applicable to the Company.

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Since May 2006, the Company's board of directors has approved four common share repurchase authorizations, for a cumulative authorization of up to \$16 billion of shares of the Company's common stock. Under these authorizations, the most recent of which totaled \$6 billion and was approved by the board of directors in October 2009, repurchases may be made from time to time in the open market, pursuant to preset trading plans meeting the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934, in private transactions or otherwise. The authorizations do not have a stated expiration date. The timing and actual number of shares to be repurchased in the future will depend on a variety of factors, including the Company's financial position, earnings, catastrophe losses, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, other investment opportunities (including mergers and acquisitions), market conditions and other factors. During the three months and nine months ended September 30, 2010, the Company repurchased 11.8 million shares and 66.8 million shares, respectively, under its share repurchase authorization for a total cost of approximately \$600 million and \$3.40 billion, respectively. The average cost per share repurchased was \$50.73 and \$50.92, respectively. At September 30, 2010, the Company had \$3.11 billion of capacity remaining under its share repurchase authorization.

The following table summarizes the components of the Company's capital structure at September 30, 2010 and December 31, 2009.

(in millions)	September 30, 2010	December 31, 2009
Debt:		
Short-term	\$ 109	\$ 373
Long-term	6,154	6,165
Net unamortized fair value adjustments and debt issuance costs	(11)	(11)
Total debt	6,252	6,527
Preferred shareholders' equity	70	79
Common shareholders' equity:		
Common stock and retained earnings, less treasury stock	24,853	26,117
Accumulated other changes in equity from nonowner sources	2,372	1,219
Total shareholders' equity	27,295	27,415
Total capitalization	\$ 33,547	\$ 33,942

The \$395 million decrease in total capitalization from December 31, 2009 reflected the impact of the \$3.40 billion of common share repurchases made under the Company's share repurchase authorization, shareholder dividends of \$515 million and the repayment of \$275 million of debt, largely offset by net income of \$2.32 billion in the first nine months of 2010 and the \$1.15 billion increase in accumulated other changes in equity from nonowner sources.

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

(dollars in millions)	September 30, 2010	December 31, 2009
Total capitalization excluding net unrealized gain on investments	\$ 30,557	\$ 32,081
Net unrealized gain on investments, net of taxes	2,990	1,861
Total capitalization	\$ 33,547	\$ 33,942
Debt-to-total capital ratio	18.6%	19.2%
Debt-to-total capital ratio excluding net unrealized gain on investments	20.5%	20.3%

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The debt-to-total capital ratio excluding net unrealized gain on investments is calculated by dividing (a) debt by (b) total capitalization excluding net unrealized investment gains and losses, net of taxes. Net unrealized investment gains and losses can be significantly impacted by both discretionary and other economic factors and are not necessarily indicative of operating trends. Accordingly, in the opinion of the Company's management, the debt-to-capital ratio calculated on this basis provides another useful metric to understand the Company's financial leverage position. The Company's debt-to-total capital ratio of 20.5% at September 30, 2010 calculated on this basis was within the Company's target range.

Catastrophe Reinsurance Coverage

The Company utilizes several catastrophe reinsurance treaties with unaffiliated reinsurers and a catastrophe bond program to help manage its exposure to losses resulting from catastrophes.

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

The following table summarizes the Company's coverage under its General Catastrophe Treaty, effective for the period July 1, 2010 through June 30, 2011:

Layer of Loss	Reinsurance Coverage In-Force
\$0 - \$1.0 billion	Loss 100% retained by the Company, except for certain losses covered by the Earthquake Excess-of-Loss Treaty as described below
\$1.0 billion - \$1.5 billion	20.0% (\$100 million) of loss covered by treaty; 80.0% (\$400 million) of loss retained by Company
\$1.5 billion - \$2.25 billion	56.7% (\$425 million) of loss covered by treaty; 43.3% (\$325 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. On December 18, 2009, Longpoint Re II, Ltd. (Longpoint Re II), a newly formed independent Cayman Islands insurance company, successfully completed an offering to unrelated investors of \$500 million aggregate principal amount of catastrophe bonds. In connection with the offering, the Company and Longpoint Re II entered into two reinsurance agreements (covering a three-year and four-year period, respectively), each providing up to \$250 million of reinsurance to the Company from losses resulting from certain hurricane events in the northeastern United States.

Under the terms of these reinsurance agreements, the Company is obligated to pay annual reinsurance premiums to Longpoint Re II for the reinsurance coverage. The reinsurance agreements entered into by the Company with Longpoint Re II utilize 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. (owned by Verisk Analytics, Inc.). The reinsurance agreements entered into with Longpoint Re II as part of the catastrophe bond program meet the requirements to be accounted for as reinsurance in

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accordance with the guidance for reinsurance contracts. Amounts payable to the Company under the reinsurance agreements will be determined by the index-based losses, which are designed to approximate the Company's actual losses from any covered event. The amount of actual losses and index losses from any covered event may differ. The principal amount of the catastrophe bonds will be reduced by any amounts paid to the Company under the reinsurance agreements.

The index-based losses attachment point and maximum limit are reset annually to maintain modeled probabilities of attachment and expected loss on the respective catastrophe bonds equal to the initial modeled probabilities of attachment and expected loss. With regard to the Longpoint Re II program, the two reinsurance agreements entered into on December 18, 2009 provide protection for covered events occurring before or on December 18, 2012 and December 18, 2013, respectively. The Company will be entitled to begin recovering amounts under the two reinsurance agreements if the index-based losses in the covered area for a single occurrence reach an initial attachment amount of \$2.250 billion. The full \$250 million coverage amount of each agreement is available on a proportional basis until index-based losses reach a maximum \$2.850 billion limit. The Company has not incurred any losses that have resulted in a recovery under the Longpoint Re II agreements since their inception.

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

At the time the agreements were entered into, the Company determined that Longpoint Re II was a variable interest entity (VIE), but concluded that it did not have a variable interest in the entity. Accordingly, the Company does not consolidate Longpoint Re II in its consolidated financial statements. Refer to the Catastrophe Reinsurance section of the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for further discussion of the Company's evaluation and conclusion with regard to Longpoint Re II's status as a VIE.

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 \$600 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, 2010 through June 30, 2011. Losses from a covered event (occurring over several days) anywhere in the United States, Canada, the Caribbean and Mexico may be used to satisfy the retention. Recoveries under the catastrophe bond programs (if any) would be first applied to reduce losses subject to this treaty.

Earthquake Excess-of-Loss Reinsurance Treaty. The Company's earthquake treaty provides for up to \$150 million of coverage, subject to a \$125 million retention, for earthquake losses incurred under policies written by the National Property business unit in the Company's Business Insurance segment for the period July 1, 2010 through June 30, 2011.

International Reinsurance Treaties. 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.

CRITICAL ACCOUNTING ESTIMATES

For a description of the Company's critical accounting estimates, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The Company considers its most significant accounting estimates to be those applied to claims and claim adjustment expense reserves and related reinsurance recoverables, investment valuation and impairments, and goodwill impairments. Except as discussed below, there have been no material changes to the Company's critical accounting estimates since December 31, 2009.

Table of Contents**Claims and Claim Adjustment Expense Reserves**

The table below displays the Company's gross claims and claim adjustment expense reserves by product line. A portion of the Company's gross claims and claim adjustment expense reserves (totaling \$3.44 billion at September 30, 2010) are for asbestos and environmental claims and related litigation. While the ongoing review of asbestos and environmental claims and associated liabilities considers the inconsistencies of court decisions as to coverage, plaintiffs' expanded theories of liability and the risks inherent in complex litigation and other uncertainties, in the opinion of the Company's management, it is possible that the outcome of the continued uncertainties regarding these claims could result in liability in future periods that differs from current reserves by an amount that could be material to the Company's future operating results. See the preceding discussion of Asbestos Claims and Litigation and Environmental Claims and Litigation.

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

(in millions)	September 30, 2010			December 31, 2009		
	Case	IBNR	Total	Case	IBNR	Total
General liability	\$ 5,929	\$ 10,747	\$ 16,676	\$ 6,368	\$ 11,542	\$ 17,910
Property	933	687	1,620	1,211	771	1,982
Commercial multi-peril	1,892	1,793	3,685	1,878	1,762	3,640
Commercial automobile	2,260	1,089	3,349	2,262	1,294	3,556
Workers compensation	9,411	7,104	16,515	9,355	7,122	16,477
Fidelity and surety	581	1,194	1,775	661	1,091	1,752
Personal automobile	1,437	939	2,376	1,457	994	2,451
Homeowners and personal other	665	853	1,518	633	717	1,350
International and other	2,380	2,009	4,389	2,003	1,933	3,936
Property-casualty	25,488	26,415	51,903	25,828	27,226	53,054
Accident and health	62	8	70	64	9	73
Claims and claim adjustment expense reserves	\$ 25,550	\$ 26,423	\$ 51,973	\$ 25,892	\$ 27,235	\$ 53,127

The \$1.15 billion decline in gross claims and claim adjustment expense reserves since December 31, 2009 reflected ongoing claims and claim adjustment expense activity, including losses incurred and payments, as well as favorable prior year reserve development and payments related to operations in runoff, partially offset by the impact of the high level of catastrophe losses incurred during the first nine months of 2010.

Asbestos and environmental reserves are included in the General liability, Commercial multi-peril and International and other lines in the summary table above. Asbestos and environmental reserves are discussed separately; see Asbestos Claims and Litigation, Environmental Claims and Litigation and Uncertainty Regarding Adequacy of Asbestos and Environmental Reserves.

FUTURE APPLICATION OF ACCOUNTING STANDARDS

See note 1 to the consolidated financial statements for a discussion of recently issued accounting pronouncements.

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FORWARD LOOKING STATEMENTS

This report contains, and management may make, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, may be forward-looking statements. Specifically, earnings guidance, statements about the Company's share repurchase plans and statements about the potential impact of investment markets and other economic conditions on the Company's investment portfolio and underwriting results, among others, are forward looking, and the Company may also make forward-looking statements about, among other things:

- its results of operations and financial condition (including, among other things, premium volume, premium rates, net and operating income, investment income and performance, return on equity, and expected current returns and combined ratios);
- the sufficiency of the Company's asbestos and other reserves (including, among other things, asbestos claim payment patterns);
- the impact of emerging claims issues;
- the cost and availability of reinsurance coverage;
- catastrophe losses;
- the impact of investment, economic and underwriting market conditions; and
- strategic initiatives.

The Company cautions investors that such statements are subject to risks and uncertainties, many of which are difficult to predict and generally beyond the Company's control, that could cause actual results to differ materially from those expressed in, or implied or projected by, the forward-looking information and statements.

Some of the factors that could cause actual results to differ include, but are not limited to, the following:

- catastrophe losses could materially and adversely affect the Company's results of operations, its financial position and/or liquidity, and could adversely impact the Company's ratings, the Company's ability to raise capital and the availability and cost of reinsurance;
- during or following a period of financial market disruption or prolonged economic downturn, the Company's business could be materially and adversely affected;
- the Company's investment portfolio may suffer reduced returns or material losses, including as a result of a challenging economic environment that impacts the credit of municipal or other issuers in its portfolio;
- if actual claims exceed the Company's loss reserves, or if changes in the estimated level of loss reserves are necessary, the Company's financial results could be materially and adversely affected;

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- the Company's business could be harmed because of its potential exposure to asbestos and environmental claims and related litigation;
- the Company is exposed to, and may face adverse developments involving, mass tort claims such as those relating to exposure to potentially harmful products or substances;
- the effects of emerging claim and coverage issues on the Company's business are uncertain;
- the intense competition that the Company faces could harm its ability to maintain or increase its business volumes and profitability;
- the Company may not be able to collect all amounts due to it from reinsurers, and reinsurance coverage may not be available to the Company in the future at commercially reasonable rates or at all;
- the Company is exposed to credit risk in certain of its business operations;
- the Company's businesses are heavily regulated and changes in regulation (including as a result of the adoption of financial services reform legislation) may reduce the Company's profitability and limit its growth;
- a downgrade in the Company's claims-paying and financial strength ratings could adversely impact the Company's business volumes, adversely impact the Company's ability to access the capital markets and increase the Company's borrowing costs;
- the inability of the Company's insurance subsidiaries to pay dividends to the Company's holding company in sufficient amounts would harm the Company's ability to meet its obligations and to pay future shareholder dividends;
- disruptions to the Company's relationships with its independent agents and brokers could adversely affect the Company;

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- the Company's efforts to develop new products (including its direct to consumer initiative in Personal Insurance) or expand in targeted markets may not be successful, may create enhanced risks and may adversely impact results;
- the Company's business success and profitability depend, in part, on effective information technology systems and on continuing to develop and implement improvements in technology;
- if the Company experiences difficulties with technology, data security and/or outsourcing relationships the Company's ability to conduct its business could be negatively impacted;
- acquisitions and integration of acquired businesses may result in operating difficulties and other unintended consequences;
- the Company is subject to a number of risks associated with conducting business outside the United States;
- the Company could be adversely affected if its controls to ensure compliance with guidelines, policies and legal and regulatory standards are not effective;
- the Company's businesses may be adversely affected if it is unable to hire and retain qualified employees;
- loss of or significant restriction on the use of credit scoring in the pricing and underwriting of Personal Insurance products could reduce the Company's future profitability; and
- the operation of the Company's repurchase plans depend on a variety of factors, including the Company's financial position, earnings, capital requirements of the Company's operating subsidiaries, legal requirements, regulatory constraints, catastrophe losses, other investment opportunities (including mergers and acquisitions), market conditions and other factors.

The Company's forward-looking statements speak only as of the date of this report or as of the date they are made, and the Company undertakes no obligation to update forward-looking statements. For a more detailed discussion of these factors, see Item 1A Risk Factors herein and in the Company's most recent annual report on Form 10-K filed with the Securities and Exchange Commission and Management's Discussion and Analysis of Financial Condition and Results of Operations herein and in the Company's most recent annual report on Form 10-K.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the Company's market risk components since December 31, 2009.

Item 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including

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its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2010. Based upon that evaluation and subject to the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2010, the design and operation of the Company's disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

There were no changes in the Company's internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The information required with respect to this item can be found under "Contingencies" in Note 12 to the Company's unaudited condensed consolidated financial statements contained in this quarterly report and is incorporated by reference into this Item 1.

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Item 1A. RISK FACTORS

For a discussion of the Company's potential risks or uncertainties, please see "Risk Factors" in Part I, Item 1A of the Company's 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission. In addition, please see "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Outlook" and "Critical Accounting Estimates" herein and in the 2009 Form 10-K. Other than as may be described below, there have been no material changes to the risk factors disclosed in Part I, Item 1A of the Company's 2009 Annual Report on Form 10-K.

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 governmental regulatory agencies in such jurisdictions.

These regulatory systems are generally designed to protect the interests of policyholders, and not necessarily the interests of insurers, their shareholders and other investors. For example, to protect policyholders whose insurance company becomes financially insolvent, guaranty funds have been established in all fifty states to pay the covered claims of policyholders in the event of an insolvency of an insurer. The funding of guaranty funds is provided through assessments levied against remaining insurers in the marketplace. As a result, the insolvency of one or more insurance companies could result in additional assessments levied against us.

These regulatory systems also address authorization for lines of business, 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 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 a time of financial uncertainty or a prolonged economic downturn, regulators may choose to adopt more restrictive insurance laws and regulations. For example, insurance regulators may choose to restrict the ability of insurance subsidiaries to make payments to their parent companies or reject rate increases due to the economic environment.

Although the U.S. federal government has not historically regulated the insurance business, there have been proposals from time to time, and especially after the financial crisis in 2008 and 2009, to impose federal regulation on the insurance industry. On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Among other things, the Dodd-Frank Act establishes a Federal Insurance Office within the U.S. Treasury. The Federal Insurance Office initially has limited regulatory authority and is empowered to gather data and information regarding the insurance industry and insurers, including conducting a study for submission to the U.S. Congress on how to modernize and improve insurance regulation in the U.S. Further, the Dodd-Frank Act gives the Federal Reserve supervisory authority over a number of financial services companies, including insurance companies, if they are designated by a two-thirds vote of a Financial Stability Oversight Council (the "Council") as systemically important. While we do not believe that we are systemically important, as defined in the Dodd-Frank Act, it is possible that, at some point in the future, the Council may not agree with us. If we were designated as systemically important, the Federal Reserve's supervisory authority could include the ability to impose heightened financial regulation and could impact requirements regarding our capital, liquidity and leverage as well as our business and investment conduct. As a result of the foregoing, the Dodd-Frank Act, or other additional federal regulation that is adopted in the future, could impose significant burdens on us, including

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impacting the ways in which we conduct our business, increasing compliance costs and duplicating state regulation, and could result in a competitive disadvantage.

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

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

Outside of the U.S., the European Union's executive body, the European Commission, is implementing new capital adequacy and risk management regulations called Solvency II that would apply to our businesses across the European Union, particularly in our U.K. businesses, beginning after October 31, 2012. Under Solvency II, it is possible that the U.S. parent of a European Union subsidiary could be subject to certain Solvency II requirements if the regulator determines that the subsidiary's capital position is dependent on the parent company and the U.S. company is not already subject to regulations deemed equivalent to Solvency II. In addition, regulators in countries where we have operations are working with the International Association of Insurance Supervisors (and in the U.S., with the National Association of Insurance Commissioners) to consider changes to insurance company supervision, including solvency requirements and group supervision. While it is not yet known how these actions will impact the Company, such regulations could result in a need for additional capital, increased costs of compliance, increased disclosure and less flexibility in our capital management.

U.S. or non-U.S. 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 of compliance and thus could materially and adversely affect our results of operations and limit our growth.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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

ISSUER PURCHASES OF EQUITY SECURITIES

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	Approximate dollar value of shares that may yet be purchased under the plans or programs
July 1, 2010	July 31, 2010	1,477,036	\$ 50.14	1,475,300	\$ 3,635,504,848
Aug. 1, 2010	Aug. 31, 2010	6,415,990	49.86	6,415,300	3,315,621,896
Sept. 1, 2010	Sept. 30, 2010	3,942,003	52.36	3,938,125	3,109,424,920
Total		11,835,029	\$ 50.73	11,828,725	\$ 3,109,424,920

The Company repurchased 6,304 shares during the three-month period ended September 30, 2010 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. Since May 2006, the Company's board of directors has approved four common share repurchase authorizations, for a cumulative authorization of up to \$16 billion of shares of the Company's common stock.

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Item 5. OTHER INFORMATION

All of the Company's executive officers hold equity in the Company in excess of the required level under the Company's executive stock ownership policy. For a summary of this policy as currently in effect, see "Stock Ownership Guidelines" under "Executive Compensation Compensation Discussion and Analysis" in the Company's proxy statement filed with the SEC on March 17, 2010. From time to time, some of the Company's executives may determine that it is advisable to diversify their investments for personal financial planning reasons, or may seek liquidity for other reasons, and may sell shares of common stock of the Company in the open market, in private transactions or to the Company. To effect such sales, some of the Company's executives have entered into, and may in the future enter into, trading plans designed to comply with the Company's Securities Trading Policy and the provisions of Rule 10b5-1 under the Securities Exchange Act of 1934. The trading plans will not reduce any of the executives' ownership of the Company's shares below the applicable executive stock ownership guidelines. The Company does not undertake any obligation to report Rule 10b5-1 plans that may be adopted by any employee or director of the Company in the future, or to report any modifications or termination of any publicly announced plan.

As of September 30, 2010, Jay S. Fishman, Chairman of the Board and Chief Executive Officer, and Alan D. Schnitzer, Vice Chairman and Chief Legal Officer and Executive Vice President - Financial, Professional & International Insurance, were the only named executive officers (i.e., an executive officer named in the compensation disclosures in the Company's proxy statement) that have entered into Rule 10b5-1 trading plans that remain in effect. The trading plans extend up to approximately four months from the date of this report. Under the Company's stock ownership guidelines, Mr. Fishman has a target ownership level established as the lesser of 150,000 shares or the equivalent value of 500% of base salary, and Mr. Schnitzer has a target ownership level established as the lesser of 30,000 shares or the equivalent value of 300% of base salary (as such amounts are calculated for purposes of the stock ownership guidelines). See "Executive Compensation Compensation Discussion and Analysis - Stock Ownership Guidelines" in the Company's proxy statement filed with the SEC on March 17, 2010.

Item 6. EXHIBITS

See Exhibit Index.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, The Travelers Companies, Inc. has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE TRAVELERS COMPANIES, INC.
(Registrant)

Date: October 21, 2010

By **/S/ MATTHEW S. FURMAN**
Matthew S. Furman
Senior Vice President
(Authorized Signatory)

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Date: October 21, 2010

By /S/ DOUGLAS K. RUSSELL
Douglas K. Russell
Senior Vice President and Corporate Controller
(Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Articles of Incorporation of The Travelers Companies, Inc. (the Company), effective as of May 1, 2007, were filed as Exhibit 3.1 to the Company's quarterly report on Form 10-Q for the fiscal quarter ended June 30, 2007, and are incorporated herein by reference.
3.2	Amended and Restated Bylaws of the Company, effective as of February 18, 2009, were filed as Exhibit 3.2 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008, and are incorporated herein by reference.
10.1	Amended and Restated Time Sharing Agreement, effective August 3, 2010, by and between the Company and Jay S. Fishman.
10.2	Current Director Compensation Program, effective as of August 3, 2010.
12.1	Statement regarding the computation of the ratio of earnings to fixed charges and the ratio of earnings to combined fixed charges and preferred stock dividends.
31.1	Certification of Jay S. Fishman, Chairman and Chief Executive Officer of the Company, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Jay S. Benet, Vice Chairman and Chief Financial Officer of the Company, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Jay S. Fishman, Chairman and Chief Executive Officer of the Company, as required by Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Jay S. Benet, Vice Chairman and Chief Financial Officer of the Company, as required by Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	The following financial information from The Travelers Companies, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 formatted in XBRL: (i) Consolidated Statement of Income for the three months and nine months ended September 30, 2010 and 2009; (ii) Consolidated Balance Sheet at September 30, 2010 and December 31, 2009; (iii) Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2010 and 2009; (iv) Consolidated Statement of Cash Flows for the nine months ended September 30, 2010 and 2009; and (v) Notes to Consolidated Financial Statements.

Filed herewith.

Copies of any of the exhibits referred to above will be furnished to security holders who make written request therefor to The Travelers Companies, Inc., 385 Washington Street, Saint Paul, MN 55102, Attention: Corporate Secretary.

The total amount of securities authorized pursuant to any instrument defining rights of holders of long-term debt of the Company does not exceed 10% of the total assets of the Company and its consolidated subsidiaries. Therefore, the Company is not filing any instruments evidencing long-term debt. However, the Company will furnish copies of any such instrument to the Securities and Exchange Commission upon request.

