Operating and financial review (unaudited) 2014

Zurich Insurance Group
Annual Report 2014

Operating and financial review

The Operating and financial review is the management analysis of the business performance of Zurich Insurance Group Ltd and its subsidiaries (collectively the Group) for the year ended December 31, 2014, compared with 2013.

Contents

The information contained within the Operating and financial review is unaudited and is based on the consolidated results of the Group for the years ended December 31, 2014 and 2013. All amounts are shown in U.S. dollars and rounded to the nearest million unless otherwise stated, with the consequence that the rounded amounts may not add up to the rounded total in all cases. All ratios and variances are calculated using the underlying amounts rather than the rounded amounts. This document should be read in conjunction with the Annual Report 2014 of the Group and, in particular, with its Consolidated financial statements for the year ended December 31, 2014.

In addition to the figures stated in accordance with International Financial Reporting Standards (IFRS), the Group uses business operating profit (BOP), new business measures and other performance indicators to enhance the understanding of its results. Details of these additional measures are set out in the separately published Glossary. These should be viewed as complementary to, and not as substitutes for the IFRS figures. For a reconciliation of BOP to net income attributable to shareholders, see table 27.2 in note 27 of the Consolidated financial statements.

From January 1, 2014, the General Insurance business has managed Middle East and Africa together with Europe to form a single market-facing business called Europe, Middle East & Africa (EMEA). This change had no impact on total General Insurance or the Group. Comparative figures have been re-presented to reflect this change.

The Group has reviewed the definition of net technical expenses within the General Insurance segment resulting in the reclassification of certain income and expenses between the net non-technical result and net technical expenses. As a result, comparative figures for total net technical expenses, net underwriting result, net non-technical result (excl. items not included in BOP), expense ratio and combined ratio have been restated to reflect this change.

Financial highlights

in USD millions, for the years ended December 31, unless otherwise stated	2014	2013	Change[1]
Business operating profit	**4,638**	4,680	(1%)
Net income attributable to shareholders	**3,895**	4,028	(3%)
General Insurance gross written premiums and policy fees	**36,333**	36,438	–
Global Life gross written premiums, policy fees and insurance deposits	**31,883**	27,095	18%
Farmers Management Services management fees and other related revenues	**2,791**	2,810	(1%)
Farmers Re gross written premiums and policy fees	**3,428**	4,045	(15%)
General Insurance business operating profit	**2,894**	2,859	1%
General Insurance combined ratio	**97.3%**	98.0%	0.7 pts
Global Life business operating profit	**1,273**	1,272	–
Global Life new business annual premium equivalent (APE)[2]	**5,203**	4,418	18%
Global Life new business margin, after tax (as % of APE)[2]	**22.1%**	27.0%	(4.9 pts)
Global Life new business value, after tax[2]	**1,022**	1,060	(4%)
Farmers business operating profit	**1,573**	1,516	4%
Farmers Management Services gross management result	**1,335**	1,353	(1%)
Farmers Management Services managed gross earned premium margin	**7.2%**	7.2%	–
Average Group investments	**206,070**	208,431	(1%)
Net investment result on Group investments	**9,209**	7,398	24%
Net investment return on Group investments[3]	**4.5%**	3.5%	1.0 pts
Total return on Group investments[3]	**8.6%**	1.3%	7.3 pts
Shareholders' equity[4]	**34,735**	32,503	7%
Swiss Solvency Test capitalization ratio[5]	**215%**	217%	(2.0 pts)
Diluted earnings per share (in CHF)	**23.84**	25.23	(6%)
Book value per share (in CHF)[4]	**232.65**	196.14	19%
Return on common shareholders' equity (ROE)[6]	**12.8%**	13.3%	(0.6 pts)
Business operating profit (after tax) return on common shareholders' equity (BOPAT ROE)[6]	**11.1%**	11.6%	(0.6 pts)

1 Parentheses around numbers represent an adverse variance.
2 Details of the principles for calculating new business are included in the Embedded value report in the Annual Report 2014. New business value and new business margin are calculated after the effect of non-controlling interests, whereas APE is presented before non-controlling interests.
3 Calculated on average Group investments.
4 As of December 31, 2014 and December 31, 2013, respectively.
5 Ratios as of July 1, 2014 and January 1, 2014, respectively. The Swiss Solvency Test (SST) ratio is calculated based on the Group's internal model, and both the ratio and the internal model are subject to the review and approval of the Group's regulator, the Swiss Financial Market Supervisory Authority (FINMA). The ratio is filed with FINMA bi-annually.
6 Shareholders' equity used to determine ROE and BOPAT ROE is adjusted for net unrealized gains/(losses) on available-for-sale investments and cash flow hedges. In 2013, no such adjustments were made and accordingly figures have been restated.

Operating and financial review *continued*

Performance overview

The Group delivered overall business operating profit of USD 4.6 billion, a decrease of USD 42 million or 1 percent compared with 2013. All three core businesses increased business operating profits by focusing on their primary markets and maintaining their disciplined approach to products, underwriting and pricing. Both General Insurance and Farmers benefited from an improvement in underlying loss experience as well as from a lower level of catastrophe and weather-related losses. Global Life focused on its priority markets, as well as improving management of its in-force business. Overall development of loss reserves established in prior years was lower than in 2013 and impacted both the General Insurance business and Non-Core Businesses.

The Group's capital and solvency positions remain strong, and together with the results for the year, have enabled the Board of Directors to propose a dividend of CHF **XX** per share. Solvency measured on an economic basis as determined under the Swiss Solvency Test decreased slightly by 2 percentage points since January 1, 2014 to 215 percent as of July 1, 2014. Shareholders' equity has increased since December 31, 2013 by USD 2.2 billion to USD 34.7 billion. This was driven by the positive effects of net income and net unrealized gains on investments, partly offset by the currency translation effect of the strong U.S. dollar as of December 31, 2014, and after deducting the total cost of USD 2.8 billion for the dividend paid in April 2014.

Business operating profit decreased by USD 42 million to USD 4.6 billion, or by 1 percent in U.S. dollar terms, but remained flat on a local currency basis.

- **General Insurance** business operating profit increased by USD 34 million to USD 2.9 billion, or by 1 percent in U.S. dollar terms and on a local currency basis, driven by an improved net underwriting result. This was partly offset by higher non-technical expenses as well as a lower investment result. The net underwriting result reflected an improvement in the underlying loss experience and the absence of major catastrophe and weather-related losses, partly offset by lower levels of favorable loss development on reserves established in prior years, as well as the cost of ongoing growth initiatives included in increased technical expenses.
- **Global Life** business operating profit of USD 1.3 billion was broadly flat, increasing by USD 1 million, but increased by 2 percent on a local currency basis, mainly reflecting the weakening of currencies in Latin America against the U.S. dollar, with improvements on a local currency basis arising in most regions. The ongoing focus on fee-based and protection business has resulted in overall improvements in loadings and fees and in the underlying technical margin, excluding the effect of management actions. These improvements were largely offset by the negative effect of a portfolio transfer in North America and an increase in operating costs, mainly driven by investments in Global Life's priority markets and impairment of software intangible assets.
- **Farmers** business operating profit increased by USD 58 million to USD 1.6 billion, or by 4 percent. This was due to improved underwriting results in **Farmers Re**, which benefited from improved results on its assumed reinsurance business from the Farmers Exchanges. The Farmers Exchanges are owned by their policyholders. Farmers Group Inc., a wholly owned subsidiary of the Group, provides certain non-claims administrative and management services to the Farmers Exchanges as attorney-in-fact and receives fees for its services. **Farmers Management Services** business operating profit slightly reduced by USD 7 million to USD 1.4 billion, as lower management fees and other related revenues as well as decreased investment income were partly offset by gains in other income.
- **Other Operating Businesses** reported a business operating loss of USD 960 million, compared with a loss of USD 1.0 billion in 2013. Lower interest expenses on debt and an increase in investment income in Holding and Financing were offset by higher Headquarters costs with 2013 Headquarters costs benefiting from one-off positive effects.
- **Non-Core Businesses** reported a business operating loss of USD 142 million compared with a profit of USD 73 million in 2013, mainly as a result of increased loss reserves for future liabilities established in prior years.

Business volumes for the core business segments, comprising gross written premiums, policy fees, insurance deposits and management fees, increased by USD 4.0 billion to USD 74.4 billion, or by 6 percent in U.S. dollar terms and 7 percent on a local currency basis.

- **General Insurance** gross written premiums and policy fees decreased by USD 106 million to USD 36.3 billion, but increased by 2 percent on a local currency basis led by underlying growth in the Group's priority markets, partly offset by a non-renewal of a fronted portfolio in North America.
- **Global Life** gross written premiums, policy fees and insurance deposits increased by USD 4.8 billion to USD 31.9 billion, or by 18 percent in both U.S. dollar terms and on a local currency basis. Improvements occurred predominantly in Europe, driven by growth in Corporate Life and Pensions and individual savings business within Bank Distribution.
- **Farmers Management Services** management fees and other related revenues decreased by USD 19 million to USD 2.8 billion, or by 1 percent, due to lower premiums earned in the Farmers Exchanges. **Farmers Re** gross written premiums and policy fees decreased by USD 617 million to USD 3.4 billion, or by 15 percent, due to the reductions in reinsurance assumed from the Farmers Exchanges.

The **net investment result on Group investments** of USD 9.2 billion increased by USD 1.8 billion or by 24 percent and represents a net investment return on average Group investments of 4.5 percent compared with 3.5 percent in 2013. **Net investment income**, predominantly included in the core business results, was marginally lower in U.S. dollar terms, but marginally higher on a local currency basis. **Net capital gains on investments and impairments** included in the net investment result increased by USD 1.8 billion to USD 3.0 billion. The increase primarily resulted from re-balancing activities due to the deployment of additional risk capital, as well as an increase in the valuation of debt securities booked at fair value through profit or loss and a gain compared with a loss in 2013 from the valuation of derivative financial instruments used for hedging underlying business or investment risks. Total return on average Group investments improved to 8.6 percent from 1.3 percent in 2013, benefiting from the increase in the net investment result, as well as from an increase of USD 8.5 billion in gross unrealized gains not flowing through net income compared with losses of USD 4.7 billion in 2013.

Overall, the net effect of currency fluctuations on the results in 2014 was relatively small with the British pound and the Swiss franc on average stronger against the U.S. dollar compared with 2013 broadly offset by the weakening of Latin American currencies, partly reflecting high inflation rates in that region. Exchange rates as of December 31, 2014 were weaker against the U.S. dollar, which resulted in a reduction in most balance sheet positions.

Net income attributable to shareholders decreased by USD 133 million to USD 3.9 billion primarily due to several non-recurring costs relating to the restructuring or disposal of business operations as well as an increase in income tax expense attributable to shareholders, which more than offset the increase in net capital gains on investments. The **shareholders' effective tax rate** increased to 27.3 percent for the year ended December 31, 2014 compared with 24.9 percent for 2013. The increase of 2.4 percentage points reflects changes in the relative levels of profit by country and several one-off costs, including the loss related to the sale of the Group's retail business in Russia, which do not attract tax relief.

ROE decreased by 0.6 percentage points to 12.8 percent, mainly due to the reduction in net income attributable to shareholders. **BOPAT ROE** decreased by 0.6 percentage points to 11.1 percent, as a result of the decrease in business operating profit and the increase in the shareholders' effective tax rate. **Diluted earnings per share** decreased by 6 percent to CHF 23.84 compared with CHF 25.23 in 2013.

Operating and financial review *continued*

General Insurance

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees	36,333	36,438	–
Net earned premiums and policy fees	30,023	29,769	1%
Insurance benefits and losses, net of reinsurance	20,048	20,321	(1%)
Net underwriting result	812	605	34%
Net investment result	2,288	2,384	(4%)
Net non-technical result (excl. items not included in BOP)	(112)	(57)	(95%)
Non-controlling interests	95	72	31%
Business operating profit	**2,894**	**2,859**	**1%**
Loss ratio	66.8%	68.3%	1.5 pts
Expense ratio	30.5%	29.7%	(0.8 pts)
Combined ratio	**97.3%**	**98.0%**	**0.7 pts**

in USD millions, for the years ended December 31	Business operating profit (BOP)		Combined ratio	
	2014	2013	2014	2013
Global Corporate	767	879	96.2%	94.3%
North America Commercial	923	972	96.5%	97.0%
Europe, Middle East & Africa (EMEA)	1,154	956	96.0%	98.1%
International Markets	40	169	104.6%	102.3%
GI Global Functions including Group Reinsurance	8	(116)	nm	nm
Total	**2,894**	**2,859**	**97.3%**	**98.0%**

Business operating profit increased by USD 34 million to USD 2.9 billion, or by 1 percent in U.S. dollar terms and on a local currency basis. This was driven by an improvement in the net underwriting result of USD 207 million to USD 812 million, partly offset by higher non-technical expenses, as well as a lower net investment result from lower hedge fund gains in North America and lower yields in EMEA. The net non-technical result in 2013 included the one-off benefit from the sale of own-use real estate in Taiwan.

Gross written premiums and policy fees decreased by USD 106 million to USD 36.3 billion. On a local currency basis gross written premiums increased by 2 percent. Global Corporate and International Markets achieved growth, on a local currency basis. Growth in Global Corporate resulted from favorable new business production across all regions as well as rate increases. In International Markets, gross written premiums increased on a local currency basis mainly in Latin America, driven by inflation as well as new distribution agreements in Brazil. In North America Commercial, gross written premiums decreased due to the non-renewal of a fronted portfolio. Adjusting for the non-renewal, North America Commercial increased by 2 percent compared with 2013. EMEA was broadly flat. The rate environment remained positive in all regions with overall rates increasing by 2 percent.

The **net underwriting result** increased by USD 207 million to USD 812 million, reflected in the 0.7 percentage points improvement in the combined ratio to 97.3 percent. The loss ratio improved by 1.5 percentage points reflecting improved underlying loss experience across most of the businesses, as well as lower levels of catastrophe and weather-related losses compared with 2013. These improvements were partly offset by lower levels of favorable development of loss reserves established in prior years. The expense ratio deteriorated by 0.8 percentage points compared with 2013. This arose from higher commissions due to changes in both product and geographic mix for which higher levels of commissions apply, and higher expenses reflecting investments in growth initiatives.

Global Corporate

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees	9,434	9,264	2%
Net underwriting result	241	345	(30%)
Business operating profit	**767**	**879**	**(13%)**
Loss ratio	74.4%	73.6%	(0.8 pts)
Expense ratio	21.8%	20.8%	(1.1 pts)
Combined ratio	**96.2%**	**94.3%**	**(1.9 pts)**

Business operating profit decreased by USD 111 million to USD 767 million mainly due to a lower underwriting result. An increase in the net investment result, due to hedge fund gains in Europe, was offset by an increase in non-technical expenses arising from higher foreign exchange losses on transactions.

Gross written premiums and policy fees increased by USD 170 million, or by 2 percent to USD 9.4 billion and by 3 percent on a local currency basis. New business production across all regions as well as rate increases in North America and Europe, Middle East and Africa contributed to the growth. The rate environment remained positive in all major lines of business except property where rates declined slightly. Overall rates increased by 2 percent.

The **net underwriting result** decreased by USD 104 million to USD 241 million, reflected in the deterioration of 1.9 percentage points in the combined ratio to 96.2 percent. The deterioration in the loss ratio of 0.8 percentage points was mainly due to adverse development of loss reserves established in prior years, partly offset by an improvement in underlying losses and lower catastrophe and weather-related events. The expense ratio deteriorated by 1.1 percentage points as a result of investments in growth initiatives, as well as higher management expenses.

Operating and financial review *continued*

North America Commercial

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees	10,056	10,215	(2%)
Net underwriting result	270	231	17%
Business operating profit	**923**	**972**	**(5%)**
Loss ratio	66.4%	68.0%	1.7 pts
Expense ratio	30.1%	28.9%	(1.2 pts)
Combined ratio	**96.5%**	**97.0%**	**0.5 pts**

Business operating profit decreased by USD 48 million to USD 923 million, or by 5 percent. Improvements in the net underwriting result were more than offset by a reduction in the net investment result mainly due to lower hedge fund gains.

Gross written premiums and policy fees decreased by USD 158 million or by 2 percent to USD 10.1 billion. Underlying growth was 2 percent after adjusting for a fronted portfolio that was not renewed. Premium growth was apparent in motor, workers compensation and liability lines of business as execution of targeted growth initiatives continues to remain in focus. The rate environment remained positive in all major lines of business with overall rates increasing by 2 percent.

The **net underwriting result** increased by USD 39 million to USD 270 million, reflected in the improvement of 0.5 percentage points in the combined ratio to 96.5 percent. The underlying loss ratio improved compared with 2013 reflecting the favorable impact of sustained rate increases, as well as benefiting from claims and underwriting initiatives. The net underwriting result also benefited from a release of reserves established in prior years compared with unfavorable development in 2013, as well as lower catastrophe and weather-related losses. The expense ratio deteriorated by 1.2 percentage points, mainly as a result of investments in growth initiatives and higher management expenses, as well as an increase in commissions due to growth in lines of business with higher than average commissions.

Europe, Middle East & Africa

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees	12,626	12,526	1%
Net underwriting result	490	229	nm
Business operating profit	**1,154**	**956**	**21%**
Loss ratio	64.9%	67.6%	2.8 pts
Expense ratio	31.1%	30.5%	(0.6 pts)
Combined ratio	**96.0%**	**98.1%**	**2.1 pts**

Business operating profit increased by USD 198 million to USD 1.2 billion, or by 21 percent in U.S. dollar terms and 18 percent on a local currency basis, as a result of the improvement in the net underwriting result. This was partly offset by lower net investment income.

Gross written premiums and policy fees increased by USD 100 million to USD 12.6 billion, or by 1 percent in U.S. dollar terms, but remained flat on a local currency basis. On a local currency basis, there was solid growth in the UK, Germany and in the personal lines business in Switzerland. This positive impact was offset by decreased premiums written in markets where the focus has been on improving profitability and the impact of the decision to exit the Russian retail market. Premiums also decreased in Italy as the overall personal motor market continued to decline. Overall rates increased by 2 percent in 2014.

The **net underwriting result** increased by USD 261 million to USD 490 million, reflected in the improvement in the combined ratio of 2.1 percentage points to 96.0 percent. The improvement in the loss ratio of 2.8 percentage points reflected further improvements in underlying losses, particularly in Germany and the UK as a result of the sustained focus on profitability. The net underwriting result also benefited from reduced weather-related losses compared with 2013, when there were significant losses from the floods in Europe. These improvements were partly offset by lower levels of favorable development of reserves established in prior years. The expense ratio deteriorated by 0.6 percentage points reflecting increased expenses following investments in growth partly offset by the benefit from a one-off pension adjustment in Switzerland.

Operating and financial review *continued*

International Markets

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees[1]	4,460	4,973	(10%)
Net underwriting result	(175)	(88)	(98%)
Business operating profit	**40**	**169**	**(76%)**
Loss ratio	61.7%	59.9%	(1.7 pts)
Expense ratio	42.9%	42.4%	(0.6 pts)
Combined ratio	**104.6%**	**102.3%**	**(2.3 pts)**

[1] From January 2014, gross written premiums and policy fees relating to Latin American corporate business have been included in Global Corporate. 2013 includes USD 314 million relating to this business

Business operating profit decreased by USD 128 million to USD 40 million, or by 76 percent in U.S. dollar terms and 55 percent on a local currency basis. The decrease resulted from a deterioration in the underwriting result and a less favorable non-technical result. The non-technical result in 2013 benefited from the sale of own-use real estate in Taiwan.

Gross written premiums and policy fees decreased by USD 513 million to USD 4.4 billion, or by 10 percent in U.S. dollar terms, but increased by 3 percent on a local currency basis. On a local currency basis, gross written premiums grew in Latin America by 5 percent due to inflation in Argentina and Venezuela and new distribution agreements in Brazil. This increase was partly offset by a change in the reporting of the Latin American corporate business and the impact of underwriting actions in the personal motor portfolio in Brazil. Asia-Pacific premiums increased by 2 percent on a local currency basis, reflecting growth in Japan, Hong Kong and Malaysia partly offset by lower premiums in Australia. Overall International Markets achieved average rate increases of 4 percent.

The **net underwriting result** deteriorated by USD 86 million, reflected in the 2.3 percentage points deterioration in the combined ratio to 104.6 percent. The loss ratio deteriorated by 1.7 percentage points mainly as a result of the adverse development of reserves established in prior years and higher catastrophe and weather-related losses mainly due to Hurricane Odile in Mexico. These negative effects were partly offset by an improvement in the underlying loss ratio. The expense ratio deteriorated by 0.6 percentage points due to an increase in commissions and higher expenses including costs as a result of the new distribution agreements in Brazil.

Global Life

in USD millions, for the years ended December 31	2014	2013	Change
Insurance deposits	17,289	13,180	31%
Gross written premiums and policy fees	14,594	13,916	5%
Net investment income on Group investments	3,815	3,895	(2%)
Insurance benefits and losses, net of reinsurance	(10,685)	(9,167)	(17%)
Business operating profit	**1,273**	**1,272**	**–**
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts (net reserves)[1]	221,926	226,166	(2%)
Assets under management[1, 2]	265,507	267,202	(1%)
Net policyholder flows[3]	5,470	(2,694)	nm

[1] As of December 31, 2014 and December 31, 2013, respectively.
[2] Assets under management comprise Group and unit-linked investments that are included in the Global Life balance sheet plus assets that are managed by third parties, on which fees are earned.
[3] Net policyholder flows are defined as the sum of gross written premiums and policy fees and deposits, less policyholder benefits. In 2013, net policyholder flows did not include inflows for certain short-duration contracts. Adjusting for this effect, net policyholder flows for 2013 would have been a net outflow of USD 688 million instead of USD 2.7 billion. See table 8.5 in the Consolidated financial statements.

New business – highlights[1]

in USD millions, for the years ended December 31	2014	2013	Change
New business annual premium equivalent (APE)	**5,203**	**4,418**	**18%**
New business margin, after tax	**22.1%**	**27.0%**	**(4.9 pts)**
New business value, after tax	**1,022**	**1,060**	**(4%)**

[1] New business value is calculated on embedded value principles after the effect of non-controlling interests, whereas APE is shown gross of non-controlling interests. New business margin is calculated using net business value as a percentage of APE based on figures net of non-controlling interests for both metrics. See Embedded value report included in the 2014 Annual Report for details of these principles.

Source of earnings[1]

in USD millions, for the years ended December 31	2014	2013	Change
Loadings and fees	4,336	4,181	4%
Investment margin	541	557	(3%)
Technical margin	1,159	1,199	(3%)
Operating and funding costs	(1,901)	(1,733)	(10%)
Acquisition costs	(3,309)	(3,234)	(2%)
Impact of deferrals	447	301	48%
Business operating profit	**1,273**	**1,272**	**–**

[1] Each line represents Zurich's interest after deducting non-controlling interests, amounting in total to USD 239 million (in 2013 USD 233 million) in business operating profit.

Operating and financial review *continued*

Business operating profit was broadly flat in U.S. dollar terms increasing by USD 1 million to USD 1.3 billion, but increased 2 percent on a local currency basis reflecting the weakening of currencies in Latin America against the U.S. dollar. Improvements on a local currency basis in most regions were offset by the negative effects in North America of both the transfer of an annuity portfolio to Non-Core Businesses associated with Global Life's in-force management strategy and impairments of software intangible assets.

Ongoing focus on fee-based and protection business has resulted in improvements in loadings and fees and in the underlying technical margin. Loadings and fees increased by USD 154 million. The majority of the increase was driven by higher volumes in North America and Zurich Santander and higher fees in Asia-Pacific and Middle East (APME), predominantly driven by an increase in unit-linked assets under management. The investment margin decreased by USD 16 million, but with the positive effect of increased investment yields in Latin America, albeit reduced by the effects of foreign currency translation, offset by the impact of persistently low yields in other regions. The underlying technical margin improved by USD 56 million largely driven by North America, Zurich Santander and Europe. This improvement was more than offset by one-off impacts of USD 56 million from the reassessment of reserves prior to the transfer of an annuity portfolio in North America and USD 40 million from a change in the law in Germany affecting policyholders' participations in the technical margin.

Operating and funding costs increased by USD 168 million, including the effect of investments in Global Life's priority markets, impairment of software intangible assets and policyholder tax impacts. Acquisition costs increased by USD 75 million, reflecting higher volumes of business primarily in Europe and North America. In addition, a change in the expense allocation methodology between operating and acquisition costs resulted in an increase in operating costs and a decrease in acquisition costs by USD 30 million compared with 2013. The impact of deferrals improved the result by USD 145 million mainly due to the negative effect of one-off items in 2013.

Insurance deposits increased by USD 4.1 billion to USD 17.3 billion, or by 31 percent in U.S. dollar terms and 30 percent on a local currency basis. Europe experienced strong growth predominantly driven by higher sales of Corporate Life and Pensions products in the UK and Ireland. This growth was partly offset by the reduction in insurance deposits included in Bank Distribution following the withdrawal from new business for certain private banking products in Luxembourg and the UK.

Gross written premiums and policy fees increased by USD 678 million to USD 14.6 billion, or by 5 percent in U.S. dollar terms and 7 percent on a local currency basis. Growth in Europe, predominantly driven by sales of individual savings products in Spain and Germany, was partly offset by a reduction in Latin America, where 2013 included the effect of a large corporate contract in Chile.

Net reserves decreased by 2 percent in U.S. dollar terms, but increased 8 percent on a local currency basis compared with 2013, primarily reflecting favorable market movements on the underlying assets and positive net inflows, partly offset by the effect of the weakening of currencies against the U.S. dollar. **Assets under management** decreased by 1 percent in the U.S. dollar terms, but increased 10 percent on a local currency basis compared with 2013 driven by favorable market movements and positive net inflows, partly offset by the effect of the weakening of currencies against the U.S. dollar. **Net policyholder flows** were positive with a net inflow of USD 5.5 billion, with North America, Latin America and Europe all experiencing improved net inflows. This compared with a net outflow of USD 2.7 billion in 2013, which was mainly due to net outflows from private banking products in the UK.

NBV, APE, NBM and BOP by region

in USD millions, for the years ended December 31	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[1]		New business margin, after tax (as % of APE) (NBM)[1]		Business operating profit (BOP)	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
North America	120	117	208	162	57.8%	72.4%	141	173
Latin America	170	234	1,160	1,178	23.0%	30.5%	222	245
of which:								
Zurich Santander	*113*	*137*	*846*	*821*	*26.1%*	*32.6%*	*203*	*182*
Europe	482	434	3,197	2,376	15.8%	18.8%	841	778
United Kingdom	*205*	*167*	*1,510*	*1,019*	*13.6%*	*16.4%*	*189*	*169*
Germany	*42*	*42*	*428*	*363*	*9.9%*	*12.0%*	*210*	*185*
Switzerland	*72*	*60*	*253*	*225*	*28.5%*	*26.7%*	*241*	*241*
Ireland	*52*	*68*	*452*	*420*	*11.6%*	*16.1%*	*61*	*51*
Spain	*89*	*62*	*325*	*155*	*49.8%*	*67.1%*	*53*	*42*
Italy	*14*	*30*	*190*	*166*	*7.2%*	*17.9%*	*46*	*52*
Rest of Europe	*7*	*5*	*39*	*29*	*18.8%*	*18.3%*	*40*	*37*
APME	191	176	566	530	33.8%	33.4%	131	83
Other	59	99	72	173	83.0%	57.4%	(63)	(7)
Total	**1,022**	**1,060**	**5,203**	**4,418**	**22.1%**	**27.0%**	**1,273**	**1,272**

NBV and APE by pillar

in USD millions, for the years ended December 31	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[1]		New business margin, after tax (as % of APE)[1]	
	2014	2013	**2014**	2013	**2014**	2013
Bank Distribution	282	301	1,741	1,584	24.0%	27.1%
Other Retail	437	491	1,554	1,441	28.2%	34.3%
Corporate Life and Pensions	303	269	1,908	1,394	15.9%	19.3%
Total	**1,022**	**1,060**	**5,203**	**4,418**	**22.1%**	**27.0%**

[1] New business value is calculated on embedded value principles after the effect of non-controlling interests while APE is shown gross of non-controlling interests. New business margin is calculated using net business value as a percentage of APE based on figures net of non-controlling interests for both metrics. See Embedded value report included in the 2014 Annual Report for details of these principles.

Global Life continued to benefit from its acquisitions and investment in organic growth in priority markets, leveraging global bank distribution and corporate life relationships as well as maintaining focus on protection and unit-linked products.

New business value decreased by USD 38 million to USD 1.0 billion, or by 4 percent in U.S. dollar terms and 2 percent on a local currency basis. Changes to the expense allocation methodology, to lapse assumptions in North America and Zurich Santander and to the yield curve methodology in Chile introduced in 2014 all contributed to the overall decrease compared with 2013. These effects were partly offset by increases from higher volumes of sales in North America, Europe and APME.

APE increased by USD 785 million to USD 5.2 billion, or by 18 percent in U.S. dollar terms and 19 percent on a local currency basis. North America, Europe and APME all increased, partly offset by decreases in Other, following withdrawal from certain private banking products in Luxembourg.

New business margin decreased by 4.9 percentage points to 22.1 percent compared with 2013, with decreases occurring in North America, Latin America and Europe. Assumption and methodology changes contributed half of the decrease in new business margin. In North America and Europe margins were also impacted by higher volumes of lower margin business. In addition, a reduction in swap rates negatively affected new business margin particularly in continental European countries.

Operating and financial review *continued*

In North America, IFA/Brokers continued to gain momentum leading to growth in APE of 48 percent and an increase in new business value of 79 percent. Overall, this resulted in a lower, but still very strong, new business margin of 57.8 percent.

In Latin America, APE decreased by 1 percent in U.S. dollar terms, largely driven by the weakening of currencies in Latin America against the U.S. dollar, which also affected new business value. In addition, new business value was impacted by assumption changes, particularly in Zurich Santander, and a change in the expense allocation methodology.

In Europe, the overall increase of USD 48 million in new business value was primarily driven by the UK, Spain and Switzerland. In the UK, new business value improved by USD 38 million, benefiting from continued strong growth of lower margin Corporate Life and Pensions business, driving the overall reduction in new business margin. In Spain, increases in new business value continued to be driven by protection business, while APE growth was largely due to an increase in sales of individual savings products, resulting overall in a lower new business margin. In Switzerland, the increase in new business value resulted from both volume and margin improvements.

In APME, the increase in new business value occurred predominantly in Australia, which experienced both volume and margin improvements in protection business.

In Other, the decrease in new business value was driven by unusual volumes of Corporate Life and Pensions business in 2013, as well as the withdrawal in 2014 from certain private banking products in Luxembourg which resulted in the increase in new business margin.

In Bank Distribution, new business value decreased by USD 19 million to USD 282 million, or by 6 percent in U.S. dollar terms and 1 percent on a local currency basis. Strong volume growth in Zurich Santander and Spain was more than offset by the impact on new business value in Zurich Santander from changed assumptions and the weakening of currencies in Latin America against the U.S. dollar.

In Other Retail, new business value overall decreased by USD 54 million to USD 437 million, or by 11 percent in U.S. dollar terms and 10 percent on a local currency basis. The decrease arose mainly in Latin America, impacted by lower volumes, and Europe, which experienced lower margins, compared with 2013.

In Corporate Life and Pensions, new business value increased by USD 34 million to USD 303 million, or by 13 percent in U.S. dollar terms and 10 percent on a local currency basis, benefiting from higher volumes particularly in Europe, partly offset by a decrease in Other.

Farmers

Farmers business operating profit increased by USD 58 million to USD 1.6 billion compared with 2013. This was due to an improved net underwriting result in Farmers Re partly offset by slightly reduced management fees and other related revenues in Farmers Management Services.

Farmers Management Services

The Farmers Exchanges are owned by their policyholders. Farmers Group Inc., a wholly owned subsidiary of the Group, provides certain non-claims administrative and management services to the Farmers Exchanges as attorney-in-fact and receives fees for its services.

in USD millions, for the years ended December 31	**2014**	2013	Change
Management fees and other related revenues	2,791	2,810	(1%)
Management and other related expenses	(1,455)	(1,457)	–
Gross management result	1,335	1,353	(1%)
Other net income	48	38	27%
Business operating profit	**1,383**	**1,390**	**(1%)**
Managed gross earned premium margin	7.2%	7.2%	–

Business operating profit decreased by USD 7 million to USD 1.4 billion primarily due to slightly reduced management fees and other related revenues.

Management fees and other related revenues of USD 2.8 billion decreased by USD 19 million, or by 1 percent, reflecting lower premiums earned in the Farmers Exchanges. **Management and other related expenses** of USD 1.5 billion remained broadly flat. **Other net income** of USD 48 million increased by USD 10 million with lower investment income more than offset by the difference between positive miscellaneous income and expense items in 2014 compared with negative miscellaneous income and expense items in 2013.

The **managed gross earned premium margin** of 7.2 percent remained unchanged.

Operating and financial review *continued*

Farmers Re

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums and policy fees	3,428	4,045	(15%)
Net underwriting result	66	(9)	nm
Business operating profit	**190**	**125**	**52%**
Loss ratio	67.0%	68.9%	1.9 pts
Expense ratio	31.3%	31.3%	0.0 pts
Combined ratio	**98.3%**	**100.2%**	**1.9 pts**

Business operating profit increased by USD 65 million to USD 190 million, primarily due to an improvement in the net underwriting result.

Gross written premiums and policy fees decreased by USD 617 million, or by 15 percent, to USD 3.4 billion as a result of lower participation in reinsurance agreements with the Farmers Exchanges. The changes in the reinsurance agreements comprised a reduction in the All Lines quota share reinsurance agreement from 18.5 percent to 18.0 percent, effective December 31, 2013 and a further reduction from 18.0 percent to 10.0 percent effective December 31, 2014, subject to the approval of the California Department of Insurance. Participation in the Auto Physical Damage quota share reinsurance agreement was reduced from USD 925 million of ceded premium in 2013 to USD 900 million in 2014.

The **net underwriting result** improved by USD 75 million to USD 66 million as a result of lower catastrophe and underlying losses assumed from the Farmers Exchanges reflected in the 1.9 percentage points reduction in the **loss ratio**. The **expense ratio**, based on ceded reinsurance commission rates payable to Farmers Exchanges, was unchanged.

Farmers Exchanges

Financial information about the Farmers Exchanges, which are owned by their policyholders, is proprietary to the Farmers Exchanges, but is provided to support an understanding of the performance of Farmers Group, Inc. and Farmers Re. Farmers Group, Inc., a wholly owned subsidiary of the Group, provides certain non-claims administrative and management services to the Farmers Exchanges as attorney-in-fact and receives fees for its services.

in USD millions, for the years ended December 31	2014	2013	Change
Gross written premiums	18,635	18,643	–
Gross earned premiums	18,545	18,757	(1%)

Gross written premiums in the Farmers Exchanges remained broadly flat in 2014 following the 2 percent decline in 2013. In 2014, increases in Business Insurance sold through exclusive agents, non-standard Auto, Homeowners, and Specialty were offset by decreases in Business Insurance sold through independent agents, Farmers Auto and Direct Auto.

Gross earned premiums in the Farmers Exchanges decreased by USD 211 million to USD 18.5 billion, or by 1 percent, reflecting the effect of continuing pricing and underwriting actions to improve profitability flowing through gross earned premiums.

Other Operating Businesses

in USD millions, for the years ended December 31	2014	2013	Change
Business operating profit:			
Holding and Financing	(678)	(843)	20%
Headquarters	(282)	(196)	(44%)
Total business operating profit	**(960)**	**(1,039)**	**8%**

Holding and Financing business operating loss decreased by USD 165 million to USD 678 million, primarily driven by lower interest expenses on debt refinanced in 2013 and 2014, higher investment income due to an increased invested asset portfolio and favorable foreign exchange impacts.

Headquarters reported a business operating loss of USD 282 million compared with a loss of USD 196 million in 2013. The increased costs were driven by several non-recurring items in both 2014 and 2013, including lower long-term performance related remuneration costs in 2013.

Non-Core Businesses

in USD millions, for the years ended December 31	2014	2013	Change
Business operating profit:			
Centrally managed businesses	(124)	27	nm
Other run-off	(18)	46	nm
Total business operating profit	**(142)**	**73**	**nm**

Centrally managed businesses, which comprise run-off portfolios managed with the intention of proactively reducing risk and releasing capital, reported a business operating loss of USD 124 million. The deterioration of USD 151 million arose primarily from an increase of reserves relating to long-tail general insurance business in run-off.

Other run-off, which largely comprises U.S. life insurance and annuity portfolios, reported a business operating loss of USD 18 million. The deterioration of USD 64 million arose primarily from the effect of increases in loss reserves held for future liabilities established in prior years.

Disclaimer & Cautionary Statement

Certain statements in this document are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans or objectives of Zurich Insurance Group Ltd or the Zurich Insurance Group (the Group). Forward-looking statements include statements regarding the Group's targeted profit, return on equity targets, expenses, pricing conditions, dividend policy and underwriting and claims results, as well as statements regarding the Group's understanding of general economic, financial and insurance market conditions and expected developments. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results and plans and objectives of Zurich Insurance Group Ltd or the Group to differ materially from those expressed or implied in the forward-looking statements (or from past results). Factors such as (i) general economic conditions and competitive factors, particularly in key markets; (ii) the risk of a global economic downturn; (iii) performance of financial markets; (iv) levels of interest rates and currency exchange rates; (v) frequency, severity and development of insured claims events; (vi) mortality and morbidity experience; (vii) policy renewal and lapse rates; and (viii) changes in laws and regulations and in the policies of regulators may have a direct bearing on the results of operations of Zurich Insurance Group Ltd and its Group and on whether the targets will be achieved. Zurich Insurance Group Ltd undertakes no obligation to publicly update or revise any of these forward-looking statements, whether to reflect new information, future events or circumstances or otherwise.

All references to "Farmers Exchanges" mean Farmers Insurance Exchange, Fire Insurance Exchange, Truck Insurance Exchange and their subsidiaries and affiliates. The three Exchanges are California domiciled interinsurance exchanges owned by their policyholders with governance oversight by their Boards of Governors. Farmers Group, Inc. and its subsidiaries are appointed as the attorneys-in-fact for the Farmers Exchanges and in that capacity provide certain non-claims administrative and management services to the Farmers Exchanges. Neither Farmers Group, Inc., nor its parent companies, Zurich Insurance Company Ltd and Zurich Insurance Group Ltd, have any ownership interest in the Farmers Exchanges. Financial information about the Farmers Exchanges is proprietary to the Farmers Exchanges, but is provided to support an understanding of the performance of Farmers Group, Inc. and Farmers Reinsurance Company.

It should be noted that past performance is not a guide to future performance.

Persons requiring advice should consult an independent advisor.

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