Group Financial Review

Group Highlights

Zurich Financial Services Group (the Group) recorded net income of USD 2,587 million for the year ended December 31, 2004, an increase of 29% compared with USD 2,009 million in 2003. Business operating profit improved by 36% over 2003 to USD 3,143 million for 2004. This result was built on the strong underlying performance of our core businesses and the stabilized development of our Centre operations.

General Insurance showed significant improvements in both business operating profit and net income across all key regions except for North America Corporate, which strengthened loss reserves for development in business written during the soft market years of 1997 through 2001. In addition, General Insurance, which had enjoyed a two-year period of benign catastrophe experience, was impacted by the four hurricanes in the US and the Caribbean and the tragic tsunami in Asia. Life Insurance continued its turnaround with an improved underlying performance, primarily in Europe, after consideration of divested businesses. This improvement is demonstrated in the increase of the new business profit margin to 11.4%. Farmers Management Services increased substantially its contribution to business operating profit and net income. Other Businesses also contributed strong results based on the management actions taken in 2003. The results across all segments were supported by the improved investment return and lower effective tax rate.

Diluted earnings per share rose 18% to CHF 22.18 compared with CHF 18.86 in 2003. For 2004, the return on equity based on net income was 13.3%, an increase of 1.2 percentage points over 2003. Our after-tax business operating profit return on equity was 11.5%, an increase of 1.7 percentage points compared with the 2003 year return.

Performance highlights

Performance highlights
in USD millions, for the years ended December 31

	2004	2003	Change
Gross written premiums and policy fees	**49,304**	48,805	1%
Net investment income	**9,114**	8,395	9%
Net capital gains on investments and impairments	**4,934**	5,180	(5%)
Business operating profit	**3,143**	2,316	36%
Net income	**2,587**	2,009	29%
General Insurance combined ratio	**101.6%**	97.9%	(3.7 pts)
Life Insurance new business profit margin (as % of APE)	**11.4%**	9.0%	2.4 pts
Return on equity	**13.3%**	12.1%	1.2 pts
Business operating profit (after tax) return on equity	**11.5%**	9.8%	1.7 pts
Diluted earnings per share (in CHF)	**22.18**	18.86	18%

Results for 2003 in this Group Financial Review are restated for the implementation of a new accounting standard. Business operating profit figures for 2003 have been restated to conform with the current year presentation. Details are set out in the sections "Basis of Current and Future Presentation and Comparability" and "Investment Performance."

Performance Overview

Gross written premiums

Gross written premiums of USD 49.3 billion in 2004 showed an increase of 1% while in local currency there was a decrease of 4%. In General Insurance, premiums remained level after adjusting for the effects of exchange rate movements and the effects of the sale of certain general insurance businesses. Premiums in Life Insurance increased by 3% after eliminating the effects of the redesign of the group pension business model in Switzerland, the sale of certain life operations and the effects of exchange rate movements.

Business operating profit

Business operating profit increased by USD 827 million, or 36%, over 2003 to USD 3,143 million in 2004 driven by the improved performance in Life Insurance and Other Businesses and the continued consistent profit contribution by Farmers Management Services, partially offset by a lower result in General Insurance. The total expected claims costs, net of reinsurance and before tax, arising from the four hurricanes and the tsunami were USD 700 million and USD 90 million, respectively.

- **General Insurance** business operating profit decreased by USD 766 million to USD 1.4 billion, as a result of the USD 2.1 billion net strengthening of reserves related to prior accident years. In addition, General Insurance incurred losses of USD 680 million related to the hurricanes and USD 82 million related to the December tsunami. These factors have been partially compensated by improved underwriting results in the current year.
- **Life Insurance** increased business operating profit by USD 207 million to USD 1.1 billion. This improved performance reflects the successful launching of profitable new products as well as reduced operating expenses, particularly in Europe. We are progressively changing the business model to position this segment in order to sustain future profitable growth.

- **Farmers Management Services** increased business operating profit by USD 107 million to USD 1.1 billion. This continued improvement is driven by the increase in management fee income, which in turn is based on higher premiums in the Farmers Exchanges, which we manage but do not own. Farmers Management Services has also continued its focus on expense controls.
- **Other Businesses** recorded business operating profit of USD 137 million, an improvement of USD 1.1 billion from the business operating loss in 2003. Centre significantly improved its results following the restructuring actions taken in the prior year and the successful commutations in the current year. The wind-down of Zurich Capital Markets continued in 2004 and also contributed to the improved result in this segment.
- **Corporate Center,** which supports the Group through funding and governance oversight, reduced its net costs improving business operating profit by USD 184 million, based on stable gross headquarter expenses, as well as an improved recovery for services rendered to other segments.
- **Net investment income on Group investments** was USD 7.4 billion, which contributes to the business operating profit for each segment. This net investment income excludes income earned for unit-linked products of USD 1.7 billion, which is managed on behalf of the policyholders of these products.
- The **after-tax business operating profit return on equity** improved by 1.7 percentage points to 11.5% in 2004, compared with 9.8% in 2003.

Net income

Net income improved by USD 578 million, or 29%, to USD 2,587 million in 2004 compared with net income of USD 2,009 million in 2003. In addition to the factors mentioned above, net income was affected by the following:

- **Net capital gains on investments and impairments of Group investments** increased by USD 137 million to USD 948 million. This movement was primarily due to lower impairments as compared with the prior year.
- The underlying **investment return** on our Group Investments in 2004 was 5.9% compared with 4.9% in 2003; the investment result is analyzed in the "Investment Performance" section.
- The Group lowered its **effective income tax rate** by 12.5 percentage points to 28.9%. This improvement is primarily due to the avoidance of large losses in low tax jurisdictions as incurred in the prior year.

Our **return on equity** improved by 1.2 percentage points to 13.3% for 2004 compared with the 2003 return of 12.1%.

Diluted earnings per share, reflecting the increase in net income, improved by 18% to CHF 22.18 in 2004 compared with CHF 18.86 in 2003.

Balance sheet highlights

Balance sheet highlights

in USD millions, as of December 31	**2004**	2003	Change
Group investments	**191,100**	175,967	9%
Investments for unit-linked products	**60,059**	49,780	21%
Total investments	**251,159**	225,747	11%
Gross insurance reserves	**185,071**	172,230	7%
Gross reserves for unit-linked products	**61,091**	51,188	19%
Total gross insurance reserves	**246,162**	223,418	10%
Total financial debt and shareholders' equity	**28,052**	23,709	18%

- **Group investments** increased by USD 15.1 billion due to a positive operating cash flow, higher market valuations and the effects of foreign currency translation, partially offset by the divestment of certain operations in 2004, the redesign of the group pension business model in Switzerland and the restructuring of Zurich Capital Markets.
- **Gross insurance reserves** increased by USD 12.8 billion, or 7%, in 2004. General Insurance reserves increased by USD 9.3 billion to USD 69.3 billion following growth in gross written premiums, net reserve strengthening and exchange rate movement partially offset by the sale of General Insurance businesses during 2004. Gross Life Insurance reserves, excluding reserves for unit-linked products, increased by USD 6.2 billion to USD 103.0 billion after the effects of the redesign of the group pension business model in Switzerland as well as divestments of life businesses during 2004. Other Businesses reserves decreased by USD 3.6 billion.
- **Total financial debt and shareholders' equity** increased by USD 4.3 billion to USD 28.1 billion. USD 3.2 billion arose from the increase in shareholders' equity mainly as a result of our profit in the year and favorable currency translation effects. A further USD 1.1 billion was attributable to the issuance of a 10-year senior debt of EUR 1 billion (USD 1.3 billion at December 31, 2004) partially offset by the repayment of a zero coupon bond of CHF 539 million (USD 427 million) on its maturity.
- The increase in both **investments and reserves for unit-linked products** reflects exchange rate and market movements and continued sales of these products.

Reinsurance

The Group completed a review of various reinsurance arrangements whereby certain risks were ceded by local business units of the Group to third-party reinsurers, who in turn partly or fully retroceded such risks to other business units of the Group. The scope of the review was to determine the impact, if any, for financial or regulatory reporting. The review included in-force arrangements as well as arrangements that had existed previously but had been commuted or otherwise terminated. As a result of this review, the Group determined, with the concurrence of its external auditors, that it was not necessary to restate the comparative financial statements.

The Group nevertheless determined that certain changes should be made to the manner in which such transactions were accounted for as a result of the way these arrangements developed over time. Accordingly, the Group recorded a charge before tax of approximately USD 140 million in 2004 in order to align the accounting treatment of the transactions with Group accounting policy.

If these transactions were accounted for on the basis now viewed as appropriate in the years the transactions were initially recorded, the Group estimates that its consolidated net income before income taxes and minority interests would have been approximately USD 165 million higher in 2003. Due to reductions in net operating results that would have been incurred in prior years, the Group estimates that the related impact on its consolidated shareholders' equity as of December 31, 2003 would have been a reduction of approximately USD 190 million, and a reduction of approximately USD 330 million as of December 31, 2002. These estimates are based on assumptions and judgments that the Group believes are reasonable.

The Group has reported these transactions to appropriate regulatory bodies and is cooperating with all regulatory inquiries. In addition, the Group has strengthened processes in order to address the accounting for and reporting of reinsurance arrangements appropriately on an ongoing basis.

Measuring Business Performance

Business operating profit

We manage our business units on their underlying performance using the measure of business operating profit. Business operating profit eliminates the impact of financial market volatility and other non-operational variables enabling us to assess the underlying insurance performance of each business.

Business operating profit reflects adjustments for taxes, net capital gains on investments and impairments (except for the capital markets and banking operations included in Other Businesses), policyholders' share of investment results for the life business, non-operational foreign exchange movements, and significant items arising from special circumstances including gains and losses on divestments of businesses. Non-operational foreign exchange movements arise from intercompany foreign currency hedging and the corporate financing of subsidiaries which are not a reflection of local operating activities and are, therefore, not included in the calculation of business operating profit. Business operating profit is not a substitute for net income as determined in accordance with International Financial Reporting Standards (IFRS).

Reconciliation of net income to business operating profit

in USD millions, for the years ended December 31	**2004**	2003
Net income	**2,587**	2,009
Adjusted for:		
Net capital (gains) on investments and impairments, excluding capital markets and banking activities	**(4,771)**	(4,976)
Policyholder allocation of net capital gains on investments, including unit-linked products	**4,493**	4,254
Tax expense, adjusting for life policyholder tax	**813**	1,375
Net (gain) on divestments of businesses	**(88)**	(351)
Restructuring provisions	**55**	5
Implementation of Swiss "legal quote"[1]	**54**	–
Business operating profit	**3,143**	2,316

[1] For details, refer to the section "Basis of Current and Future Presentation and Comparability."

The Group has initiated several restructuring programs in 2004. The most significant of these relates to the transformation of the United Kingdom life operations, where management has decided to implement a new business model. This model has been designed to enable the UK life business to secure sustainable performance in line with Group hurdle rates.

The table below indicates the utilization of and other changes in the restructuring provisions between January 1 and December 31, 2004.

Restructuring provisions in USD millions	**2004**
As of January 1 (opening balance)	**144**
Utilized	**(95)**
Increases, net	**55**
Foreign exchange translation	**9**
As of December 31 (closing balance)	**113**

Embedded value

In addition to business operating profit, we use embedded value to measure and manage our Life Insurance operations on a stand-alone basis. Embedded value is discussed in more detail in the Life Insurance section of the Segmental Financial Analysis.

Key Performance Indicators

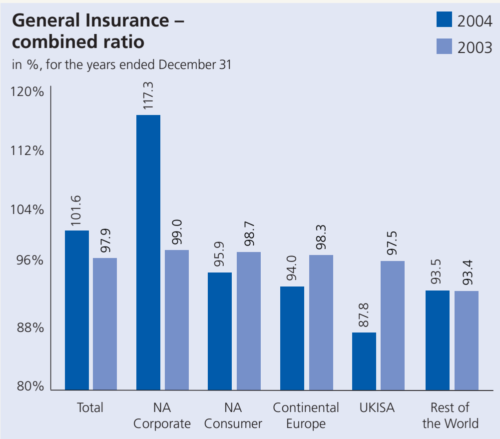
Return on equity

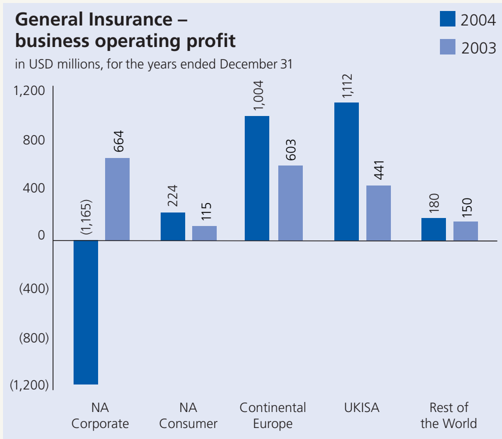
Our stated goal in the medium term is to achieve a blended return on equity of 12% on an after-tax business operating profit basis. A higher return on equity in one segment can compensate for lower returns in others allowing the Group to meet the stated 12% overall target rate. Returns on equity generated by General Insurance, Life Insurance and Farmers Management Services also compensate for certain headquarters expenses, debt expenses and any net operating losses from other operations.

Our return on equity based on net income for 2004 was 13.3%, an increase of 1.2 percentage points over 2003. Our business operating profit after-tax return on equity was 11.5%, an increase of 1.7 percentage points over 2003. This return, while improving, is below our medium term target of 12% due to the impact of the catastrophes and reserve strengthening discussed above.

General Insurance

We consider the combined ratio and business operating profit to be the key performance indicators for our General Insurance operations.



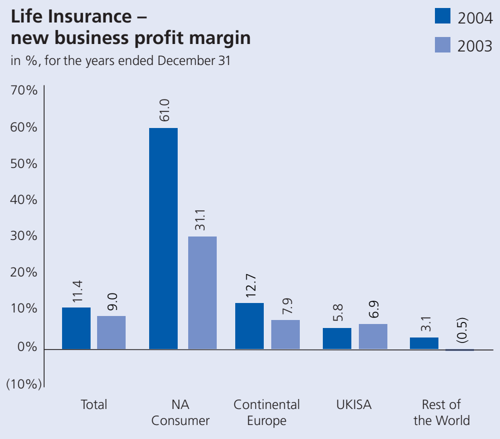


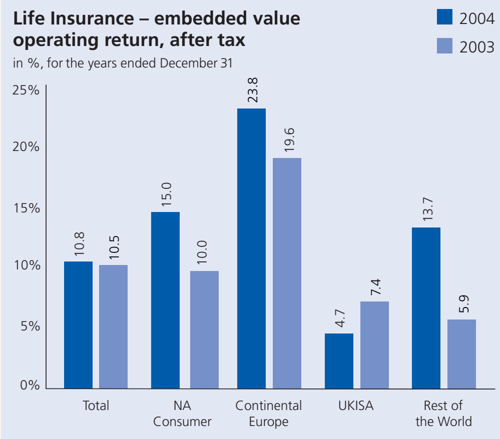
Overall, the combined ratio increased by 3.7 percentage points to 101.6% for 2004 reflecting net underwriting losses of USD 469 million for 2004 compared with a profit of USD 578 million in 2003. The **combined ratio** was impacted by the claims relating to the hurricanes of USD 680 million and to the tsunami of USD 82 million as well as from the strengthening of loss reserves relating to prior years of USD 2.1 billion. The net underwriting result of our North America Consumer, Continental Europe, UKISA and Rest of World regions, together posted an increase of USD 1.1 billion to USD 1.5 billion in 2004. North America Corporate recorded a net underwriting loss of USD 1.8 billion, a decrease of USD 1.9 billion in 2004.

Business operating profit was affected by these same factors and decreased by USD 766 million to USD 1.4 billion in 2004. North America Consumer, Continental Europe, UKISA and Rest of the World regions almost doubled business operating profit from USD 1.3 billion in 2003 to USD 2.5 billion in 2004.

Life Insurance

We consider new business profit margin, embedded value after-tax operating return, and business operating profit to be the key performance indicators for our Life Insurance operations.





New business profit increased by USD 81 million from 192 million to USD 273 million in 2004, which is reflected in the improvement of the **new business profit margin** by 2.4 percentage points from 9.0% to 11.4% in 2004.

Operating return on embedded value after tax and before currency effects was 10.8% for 2004, 0.3 percentage point above last year. The embedded value operating profit after tax was USD 1.4 billion for 2004 compared with USD 928 million in 2003, an improvement of 56%.

Business operating profit for Life Insurance increased by 24% to USD 1.1 billion in 2004 with improvements in Continental Europe, UKISA and Rest of the World partially offset by a small reduction in North America Consumer related to the divestment of life businesses in 2003.

Life Insurance – business operating profit
in USD millions, for the years ended December 31

	2004	2003	Change
North America Consumer	**235**	245	(4%)
Continental Europe	**355**	294	21%
UKISA	**402**	271	48%
Rest of the World	**71**	46	54%
Total	**1,063**	856	24%

Foreign Currency Impact

The Group operates worldwide in multiple currencies. The Group seeks to match its foreign exchange exposures on an economic basis. However, because the Group has chosen the US dollar as its reporting currency, differences arise when local operating currencies are translated into the Group’s reporting currency. The general decline of the US dollar as compared to the Swiss franc, the euro and British pound in 2004 had a positive impact on shareholders’ equity of approximately USD 741 million. Net income in 2004 benefited from these translation effects by approximately USD 176 million.

The tables below show the key financial highlights for the year ended December 31, 2004 translated at the same average exchange rates as applied for the year ended December 31, 2003 to eliminate the foreign currency impact when compared to the prior period. The principal exchange rates are set out in note 2 of the Consolidated Financial Statements.

General Insurance

General Insurance – foreign currency impact on key financial highlights
Variance over the prior period, for the year ended 2004

	% change in local currency	**% change in USD**
Gross written premiums and policy fees	**(1%)**	**4%**
Net investment result	**7%**	**13%**
Insurance benefits and losses	**13%**	**18%**

Life Insurance

Life Insurance – foreign currency impact on key financial highlights Variance over the prior period, for the year ended 2004	% change in local currency	% change in USD
Gross written premiums, policy fees and insurance deposits	**(13%)**	**(4%)**
Insurance deposits	**(12%)**	**(3%)**
Gross written premiums and policy fees	**(13%)**	**(6%)**
Net investment result	**(5%)**	**5%**
Insurance benefits and losses	**(17%)**	**(9%)**

Premium Volume and Management Fees

Group

Overall **gross written premiums and policy fees** rose 1% over 2003 (–4% in local currency) reaching USD 49.3 billion. After taking into account the special factors explained below, premiums have remained flat on a comparable basis.

Net earned premiums and policy fees increased 6% (unchanged in local currency) over 2003, to USD 41.8 billion. After adjusting for the factors explained below, net earned premiums grew by 4%.

General Insurance

General Insurance experienced growth in gross written premiums and policy fees of 4% (–1% in local currency) to USD 37.6 billion in 2004. After adjusting for divestments of businesses as well as exchange rate effects, premiums remained level. On a similar basis, net earned premiums increased by 7% still reflecting the effect of rate increases in previous periods now being earned as revenue as well as higher premium retention reflecting the reduction in our reinsurance program as our balance sheet has strengthened.

Life Insurance

Gross written premiums and policy fees in **Life Insurance** decreased by 6% (–13% in local currency) to USD 11.0 billion in 2004 mainly resulting from the sale of life operations in the second half of 2003, particularly Zurich Life US, Zurich Life UK and certain other European operations, and the redesign of the group pension business model in Switzerland, which has been partially transferred to an external foundation. Excluding these factors, as well as foreign exchange movements, premiums increased by 3%.

Farmers Management Services

In 2004, our **Farmers Management Services** earned USD 2.0 billion in management fees and other related revenue, an increase of 5% over the prior year. This increase is a result of higher gross premiums earned by the Farmers Exchanges, which we manage but do not own, primarily in the Farmers Specialty, Commercial and Fire lines of business.

Investment Performance

Investment result and investments

Total investments as shown in the Consolidated Balance Sheet include Group investments, where the Group bears all or part of the investment risk, and investments for unit-linked products, where policyholders bear the entire investment risk. The investments for unit-linked products and the related investment result have been reclassified following the implementation of SOP 03-01.

Net investment result and investments	Group investments		Investments for unit-linked products		Total	
in USD millions, for the years ended December 31	**2004**	2003	**2004**	2003	**2004**	2003
Net investment income	**7,447**	7,004	**1,667**	1,391	**9,114**	8,395
Net capital gains on investments and impairments	**948**	811	**3,986**	4,369	**4,934**	5,180
Net investment result	**8,395**	7,815	**5,653**	5,760	**14,048**	13,575
in USD millions, as of December 31	**2004**	2003	**2004**	2003	**2004**	2003
Investments	**191,100**	175,967	**60,059**	49,780	**251,159**	225,747

We manage our diversified Group investment portfolio to optimize benefits for both shareholders and policyholders while ensuring compliance with local regulatory and business requirements under the guidance of our Asset/Liability Management and Investment Committee. Investments for unit-linked products are managed in accordance with the investment objectives of each unit-linked fund.

Investment performance

Investment performance of Group investments
in USD millions, for the years ended December 31

	2004	2003	Change
Net investment income	**7,447**	7,004	6%
Net capital gains on investments and impairments	**948**	811	17%
Net investment result	**8,395**	7,815	7%
Movements in unrealized gains on investments included in shareholders' equity	**2,059**	151	nm
Average investments	**183,534**	169,877	8%
Total investment return[1]	**5.9%**	4.9%	1.0 pts

[1] Before investment expenses.

Net investment income for Group investments increased by 6% to USD 7.4 billion from USD 7.0 billion in 2003. This improvement was a result of higher short-term interest rates in the US and UK, the lengthening of bond portfolio durations, partially offset by lower income due to the reduction in the asset base caused by the redesign of the group pension business model in Switzerland.

Net capital gains on investments and impairments for Group investments increased from USD 811 million in 2003 to USD 948 million in 2004. In both 2004 and 2003 we incurred impairments on investments, primarily equities, of USD 175 million and USD 1.1 billion, respectively. The reduction in the year reflects the improvements in equity markets. The reduction in impairments was offset by lower net realized capital gains in 2004, particularly in debt and equity securities. A substantial portion of the net capital gains on investments and impairments relate to our Life Insurance segment. After taking into account the portion attributable to future policyholder benefit reserves, net capital gains on investments and impairments which flowed through to net income were USD 441 million and USD 926 million in 2004 and 2003, respectively.

The total investment return for Group investments was 5.9% compared with 4.9% in 2003. This return includes investment income, net capital gains on investments in the consolidated operating statement and movements in unrealized gains recorded in shareholders' equity. The total investment result was USD 10.5 billion, after investment expenses of USD 289 million compared with USD 8.0 billion after investment expenses of USD 330 million in 2003.

Group investments breakdown

Equity securities include common stock and equity unit-trusts for which the Group bears the investment risk. At year end 2004, we had reduced our holding in this category of equity securities to 4.9% of our investment portfolio, down from 6.4% as of December 31, 2003.

Breakdown of Group investments
in USD millions, as of December 31

	2004	% of total	2003	% of total
Debt securities	**124,298**	**65.1%**	113,002	64.2%
Equity securities	**16,939**	**8.8%**	19,491	11.1%
Common stock, including equity unit-trusts	***9,424***	***4.9%***	*11,319*	*6.4%*
Unit-trusts (debt securities, real estate, short-term investments)	***2,710***	***1.4%***	*2,270*	*1.4%*
Common stock portfolios backing the participating with-profit policyholder contracts	***2,032***	***1.0%***	*1,599*	*0.9%*
Trading equity portfolios in capital markets and banking activities	***2,773***	***1.5%***	*4,303*	*2.4%*
Real estate held for investment	**7,193**	**3.8%**	7,462	4.2%
Mortgage loans	**10,251**	**5.4%**	11,283	6.4%
Policyholders' collateral and other loans	**14,902**	**7.8%**	7,479	4.3%
Other Group investments	**3,764**	**1.9%**	3,714	2.2%
Cash and cash equivalents	**13,753**	**7.2%**	13,536	7.6%
Total	**191,100**	**100%**	175,967	100%

Divestments

During 2004, the Group continued to divest businesses in markets where we did not have a significant presence or which were no longer part of our business strategy. We completed several transactions during the year that generated cash proceeds of USD 2.5 billion compared with USD 2.7 billion in the prior year.

The transaction that generated most of the cash proceeds was the transfer of certain derivative transactions, credit facilities and related assets of Zurich Capital Markets to BNP Paribas. Other significant transactions during 2004 include the sale of Turegum Insurance Company and the life and general insurance operations in Belgium and Luxembourg.

Aggregate net gains on divestments in 2004, including post-completion adjustments such as deferred consideration for certain transactions closed in 2003, were USD 88 million.

Reserves for Losses and Loss Adjustment Expenses

Development of reserves for losses and loss adjustment expenses in USD millions	**2004**	2003	Change
As of January 1 (opening balance)			
Gross reserves for losses and loss adjustment expenses	**51,068**	45,306	13%
Reinsurance recoverable	**(14,055)**	(14,940)	(6%)
Net reserves for losses and loss adjustment expenses	**37,013**	30,366	22%
Net losses and loss adjustment expenses incurred			
Current period	**21,506**	19,254	12%
Prior years	**1,964**	1,874	5%
Total	**23,470**	21,128	11%
Total net losses and loss adjustment expenses paid	**(17,515)**	(16,516)	6%
Divestments of companies and businesses	**(743)**	(291)	155%
Foreign currency translation effects	**1,249**	2,326	(46%)
As of December 31 (closing balance)			
Net reserves for losses and loss adjustment expenses	**43,474**	37,013	17%
Reinsurance recoverable	**14,339**	14,055	2%
Gross reserves for losses and loss adjustment expenses	**57,813**	51,068	13%

We establish reserves for losses and loss adjustment expenses for estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. Reserving is a complex process dealing with uncertainty and requiring the use of informed estimates and judgments. Any changes in estimates are reflected in the results of operations in the period in which estimates are changed.

Of the total USD 43.5 billion **net reserves for losses and loss adjustment expenses,** USD 41.1 billion related to General Insurance and USD 2.2 billion to Other Businesses as of December 31, 2004.

In 2004, we refined our reserving process through a program of continuous and progressive review of different lines of business. In aggregate, we have strengthened reserves because of adverse prior year development by USD 2.0 billion which compares with USD 1.9 billion in 2003. Strengthening of USD 2.6 billion in North America Corporate was mitigated by reserve redundancies of approximately USD 600 million arising across all our other regions including our Centre operations. These net reserve redundancies arise from both claims settlements below the reserved amounts as well as from reassessment of reserving requirements for claims payable in the future.

The prior-year adverse reserve development recorded in 2003 was primarily in North America Corporate, USD 1.0 billion, and in Centre, USD 540 million.

Capitalization and Indebtedness

in USD millions, as of December 31	**2004**	2003	Change
Collateralized loans	**4,135**	4,701	(12%)
Debt related to capital markets and banking activities	**3,880**	5,961	(35%)
Obligation to repurchase securities	**5,009**	3,742	34%
Total operational debt	**13,024**	14,404	(10%)
Senior debt	**3,355**	2,360	42%
Subordinated debt	**2,516**	2,415	4%
Total financial debt	**5,871**	4,775	23%
Total minority interests	**846**	969	(13%)
Total shareholders' equity	**22,181**	18,934	17%
Total financial debt and shareholders' equity	**28,052**	23,709	18%

Indebtedness

Operational debt

As of December 31, 2004 **total operational debt** was USD 13.0 billion, a decrease of USD 1.4 billion since December 31, 2003. As of December 31, 2004, we had USD 4.1 billion of collateralized loans, which were secured by mortgage loans of the same amount given as collateral to the counterparties compared with USD 4.7 billion as of December 31, 2003. Debt relating to capital markets and banking activities decreased by USD 2.1 billion following the transfer of certain derivative transactions, credit facilities and related assets of Zurich Capital Markets (ZCM) to BNP Paribas in accordance with an agreement signed in 2003 as part of the wind-down of ZCM activities. This decrease was partially offset by an increase of USD 1.3 billion in our obligation to repurchase securities to USD 5.0 billion, resulting from increased short-term activities in the Repo market in the normal course of business as part of our investment and liquidity management.

Financial debt

The increase in **total financial debt** of USD 1.1 billion, or 23%, arose mainly from the issuance of EUR 1 billion (USD 1.3 billion) of 10-year senior debt by Zurich Finance (USA), under the "Euro Medium Term Note Programme" for Zurich Insurance Company, partially offset by the repayment on maturity by the Zurich International (Bermuda) Ltd of its zero coupon bond of CHF 539 million (USD 427 million) in July 2003.

Credit facility

On April 21, 2004, a new USD 3 billion syndicated revolving credit facility was signed to replace the USD 1.5 billion facility, which would have matured on May 28, 2004. The new syndicated credit facility consists of two equal tranches maturing in 2007 and 2009. Zurich Group Holding, together with Zurich Insurance Company and Farmers Group, Inc, are guarantors of the new facility, which allows for drawings of up to USD 1.25 billion, USD 1.5 billion and USD 250 million, respectively, for themselves and a number of defined subsidiary borrowers. No borrowings were outstanding as of December 31, 2004 under the new facility. Farmers Group, Inc. cancelled an existing USD 250 million credit facility in April 2004, which would have expired in September 2004.

Minority interests

The reduction in **minority interests** of USD 123 million, or 13%, resulted primarily from ZCM which no longer has any minority shareholder interests in its business.

Shareholders' equity
in USD millions, for the year ended December 31, 2004

Balance as of December 31, 2003, as previously reported	19,384
Implementation of new accounting standard (SOP 03-01)	(450)
Balance as of December 31, 2003, restated	18,934
Change in net unrealized gains on investments excluding translation adjustments	386
Transfer arising from initial application of the "legal quote" legislation in Switzerland	(226)
Translation adjustments	741
Nominal value reduction of common stock	(288)
Share-based payment transactions	19
Treasury stock transactions	66
Net income	2,587
Dividends on preferred securities	(38)
Balance as of December 31, 2004	**22,181**

Shareholders' equity

Shareholders' equity increased by USD 3.2 billion to USD 22.2 billion as of December 31, 2004. The increase from our net income after tax of USD 2.6 billion in 2004 and favorable currency translation effects were partially offset by the nominal value reduction of common stock and the initial application of the legislation for the mandatory participation in profits for policyholders in Switzerland ("legal quote").

Solvency

Regulated entities of the Group are required to submit returns to their local regulators, usually on an annual basis but in some countries more frequently. These returns show the compliance of the reporting entity with local solvency requirements and include information on eligible funds and admissible assets.

On a consolidated basis, Zurich Financial Services, with headquarters in Zurich, Switzerland, is subject to supervision by the Federal Office of Private Insurance ("FOPI"). Regulatory supervision of the Group for its insurance activities and its remaining banking and other regulated financial services activities, including supervision over consolidated solvency and capital adequacy at a Group level are coordinated between FOPI and the Swiss Federal Banking Commission (based on the Decree on the Consolidated Supervision of the Zurich Financial Services Group of April 23, 2001).

Cash Flows

Summary of cash flows in USD millions, for the years ended December 31	**2004**	2003
Cash flows from operating activities		
Net income	**2,587**	2,009
Adjustments for:		
Net capital (gains) on investments and impairments	**(4,934)**	(5,180)
Net (gain) on divestments of businesses	**(88)**	(351)
Equity in income of investments in associates	**(86)**	(90)
Depreciation and amortization	**695**	793
Other non-cash items	**21**	905
Changes in operational assets and liabilities	**10,135**	15,094
Net cash provided by operating activities	**8,330**	13,180
Net cash used in investing activities	**(7,333)**	(6,413)
Net cash used by financing activities	**(398)**	(1,932)
Effect of exchange rate changes on cash and cash equivalents	**683**	809
Change in cash and cash equivalents	**1,282**	5,644
Cash and cash equivalents as of January 1 (opening balance)	**15,677**	10,033
Cash and cash equivalents as of December 31	**16,959**	15,677

Our cash flow from operating activities consists of cash flow arising from our insurance businesses, after payments to reinsurers (net premiums, policy fees and deposits received less net claims after recoveries from reinsurers, benefit payments, policy surrenders and operating expenses) and investment income received (dividends, interest and rents) less interest paid and tax payments.

Farmers Management Services receives management fees as well as investment income and pays operating expenses and taxes. Surplus operating cash flows, plus the proceeds from the sale and maturity of investments as well as divestments, are reinvested through our investing activities. Our investment funds may be used to fund operating cash flow deficits.

Our financing activities result from our corporate funding and borrowing arrangements, capital raising and repayment and payments to shareholders.

Cash and cash equivalents increased in 2004 by USD 1.3 billion compared with USD 5.6 billion in 2003. Cash flow provided by operating activities reduced to USD 8.3 billion in 2004 from USD 13.2 billion in 2003. Transfers to investment activities and financing repayments were together USD 7.7 billion in 2004 compared with USD 8.3 billion in 2003.

Basis of Current and Future Presentation and Comparability

Changes to accounting policies 2004

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 03-01 ("SOP 03-01"), Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts. SOP 03-01 has resulted in three significant changes in the treatment of certain life contracts, which have been adopted retrospectively, in accordance with IAS 8:

i) Recognition of additional liabilities for guaranteed minimum death benefits, guaranteed retirement income benefits and benefits in respect of annuitization options on an accrual basis, primarily for life policies in the United States. The recognition of guarantee liabilities resulted in a write-down of deferred policy acquisition costs, due to a reduction in future estimated gross profits supporting these reserves.
ii) Clarification of the distinction between universal life insurance and investment products, resulting in certain products in the life business in the United Kingdom now being treated as insurance. The classification as insurance consequently resulted in the retrospective accrual of additional insurance reserves.
iii) "Investments held on account and at risk of life insurance policyholders", which are not bankruptcy protected from other creditors, and "Insurance reserves for life insurance where the investment risk is carried by policyholders" were reclassified to total investments and insurance reserves in the amount of approximately USD 50 billion. This change also resulted in the inclusion in the consolidated operating statements of additional investment result arising from the reclassified investments and a substantially corresponding charge in "Policyholder dividends and participation in profits." As a result, there is no material net impact on the Group's operating results.

In 2004, we have made the following restatement for the implementation of SOP 03-01 as published in the Half Year Report 2004.

Adjustments to net income for the year ended December 31, 2003
in USD millions

Net income as published for 2003	2,120
Implementation of a new accounting standard in 2004	(111)
Net income, restated	**2,009**

Adjustments to business operating profit for the year ended December 31, 2003
in USD millions

Business operating profit as published for 2003	2,265
Implementation of a new accounting standard in 2004	(53)
Policyholder allocations	104
Business operating profit, restated	**2,316**

Swiss legal quote

In Switzerland, the "legal quote" legislation was adopted on April 1, 2004. It relates to the regulated pension business in Switzerland and provides for mandatory participation in profits by policyholders. A minimum dividend rate of 90% of the calculated gross surplus must be allocated to policyholders as the surplus arises, where previously such allocations occurred when bonuses were declared.

The Group accounted for the initial application of this legislation in the Consolidated Financial Statements as of June 30, 2004, by transferring net unrealized gains on investments included in shareholders' equity of USD 226 million to insurance reserves as "Policyholders' contract deposits and other funds". In addition, the Group recorded a pre-tax charge of USD 54 million during 2004.

Implementation of new and amended accounting standards in 2005

The Group has been reporting under standards issued by the International Accounting Standards Board (IASB) since 1998. As set out in note 1 to the Consolidated Financial Statements, we refer to accounting principles generally accepted in the United States (US GAAP) for guidance in particular on accounting for insurance.

In January 2005, a significant number of new and amended standards will become effective including the International Financial Reporting Standard on "Insurance Contracts" (IFRS 4). We continue to evaluate the impact on our financial statements and are closely monitoring developments as practical interpretations of IFRS 4 and other changes emerge. The principal change to our financial statements will result from the re-classification of certain life insurance products from insurance to investment and the consequent change in measurement and accounting treatment as investment products. As IFRS 4 does not define the accounting treatment of insurance products, we will continue to refer to US GAAP.

This and other changes will result in the restatement of shareholders' equity, which could be significant, and net income as well as reclassifications in both the consolidated balance sheets and consolidated operating statements. However, we do not expect the changes will have any significant effect on the solvency positions of our businesses, which are generally determined based on regulatory requirements and accounting policies in each country in which we operate.

We continue to monitor developments in the interpretation of the changes to be implemented in 2005 and will determine our position for reporting for the first three months of 2005. We are also working with the accounting professionals and our peer group of insurance companies in Europe through the CFO Forum to assist the IASB in developing a comprehensive standard for the accounting of insurance products.

Financial Reporting

Primary segments:
In 2005, the Group will continue to report segment information using the same primary segments as for 2004. The segments are: General Insurance, Life Insurance, Farmers Management Services, Other Businesses and Corporate Center.

Secondary segments:
In 2005 the Group's secondary format for segment information will continue to be geographic. The geographical segments will be North America, Europe, International Businesses and Centrally Managed Businesses.

Customer segments:
For 2004 General Insurance reporting a further breakdown of the segment into its customer segments (Global Corporate, Commercial and Personal) is provided as part of the Financial Supplement which is published on our Web site www.zurich.com. For 2005 General Insurance reporting our financial review will include information for these customer segments.

Quarterly Consolidated Financial Information

Summary of 2004 quarterly consolidated financial information

in USD millions, for the three months ended	**12/31/04**	09/30/04	06/30/04	03/31/04[1]
Gross written premiums and policy fees	**11,720**	11,172	12,140	14,272
Net earned premiums and policy fees	**10,968**	10,189	10,118	10,529
Net investment results	**5,442**	3,073	2,524	3,009
Other revenues	**1,205**	881	907	833
Total revenues	**17,615**	14,143	13,549	14,371
Insurance benefits and losses	**9,614**	8,611	7,973	8,302
Other expenses	**7,070**	4,918	4,414	4,990
Total benefits, losses and expenses	**16,684**	13,529	12,387	13,292
Net income before income taxes and minority interests	**931**	614	1,162	1,079
Net income	**685**	454	718	730
Business operating profit	**614**	581	978	970

[1] Restated for the introduction of SOP 03-01 in the half year 2004.

Summary of 2003 quarterly consolidated financial information

in USD millions, for the three months ended	12/31/03	09/30/03	06/30/03	03/31/03
Gross written premiums and policy fees	11,895	10,939	12,585	13,386
Net earned premiums and policy fees	10,630	9,166	10,223	9,578
Net investment results	4,743	3,377	6,182	(727)
Other revenues	955	1,264	932	885
Total revenues	16,328	13,807	17,337	9,736
Insurance benefits and losses	8,573	8,065	8,764	7,857
Other expenses	6,636	4,761	7,369	1,572
Total benefits, losses and expenses	15,209	12,826	16,133	9,429
Net income before income taxes and minority interests	1,119	981	1,204	307
Net income	599	658	634	118
Business operating profit	785	205	564	762