Notes to the consolidated financial statements

The Board of Directors of Zurich Financial Services has authorized these consolidated financial statements for issue on February 16, 2005. These Financial Statements will be submitted to the Annual General Meeting of Shareholders to be held on April 19, 2005 for approval.

1. Basis of presentation

Zurich Financial Services and its subsidiaries (collectively the "Group") are an insurance-based financial services provider with an international network that focuses on chosen markets. Key markets are the United States, the United Kingdom and Continental Europe comprising primarily Germany, Switzerland, Italy and Spain. Core businesses are General and Life Insurance. The Group also distributes non-insurance products, such as mutual funds, mortgages and other financial services products, from selected third-party providers.

The holding company, Zurich Financial Services, is incorporated in Zurich, Switzerland. The Group operates through subsidiaries and branch offices. The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law. IFRS does not contain guidelines governing the accounting treatment of certain transactions including those that are specific to insurance products. When a specific topic is not addressed by the standards, the IFRS Framework permits reference to another comprehensive body of accounting principles. In these cases, the Group typically refers to accounting principles generally accepted in the United States (US GAAP) for guidance.

Certain amounts recorded in the consolidated financial statements reflect estimates and assumptions made by management about insurance liability reserves, investment valuations, interest rates and other factors. Significant estimates are discussed in the notes. Actual results may differ from the estimates made.

A new accounting standard, discussed in note 3, resulted in restatement of 2003 consolidated financial statements. In addition, certain reclassifications have been made to prior year amounts and segment disclosures to conform to the current year presentation. These reclassifications have no effect on the previously reported net income.

Segment information

The Group is managed on a matrix basis, reflecting both line of business and geography. Accordingly, segment information is presented in two formats. The primary format is based on the operating businesses of the Group and how they are strategically managed to offer different products and services to specific customer groups. The Group's primary segments are defined as follows:

General Insurance: General Insurance operations write substantially all lines of property and casualty business.

Life Insurance: Life Insurance operations offer a broad line of life insurance, annuity and investment-type policies to individuals and groups.

Farmers Management Services: Farmers Group, Inc. and its subsidiaries ("FGI") provide non-claims related management services to the Farmers Exchanges. The Farmers Exchanges operate in the US property and casualty insurance industry and consist of the Farmers Insurance Exchange, Fire Insurance Exchange, Truck Insurance Exchange (each an "Exchange" and collectively, the "Exchanges"), their respective subsidiaries, Farmers Texas County Mutual ("FTCM"), Foremost County Mutual Insurance Company and Foremost Lloyds of Texas. The Farmers Exchanges are owned by the policyholders of the Exchanges, FTCM and Foremost County Mutual Insurance Company as well as the underwriters of Foremost Lloyds of Texas. Accordingly, the Group has no ownership interest in the Farmers Exchanges. FGI receives a fee for the management services provided which is based primarily on a percentage of the gross earned premiums of the Farmers Exchanges.

Other Businesses: Other Businesses is the combination of the activities described below. In general, such activities are not considered to be core businesses, and certain of these business operations were discontinued, divested or put in run-off in 2004 and 2003.

Capital markets and banking activities consist primarily of Zurich Capital Markets which has a portfolio of hedge fund-based investment vehicles, asset-based financing and credit structures, instruments to manage investment risk, customized strategies to structure or manage financial assets, and administrative services for hedge funds and hedge fund investors.

Centre operations: Centre's portfolio of business consists of property and casualty reinsurance, credit enhancement and life & health business.

Centrally managed insurance operations: In 2004, the Group made some changes to the way it manages its business. As a result, the Group manages certain general and life insurance operations on a central basis from its Corporate Center. Therefore, these operations have been included within the Other Businesses segment, and total assets and liabilities of USD 20 billion have been moved from the Life segment to the Other Businesses segment. Further, the risks and rewards of the transferred businesses differ from those contained within the Life segment. In addition, Reinsurance-run-off, which is also centrally managed, reflects the results of the run-off of liabilities that were retained and that were not transferred to Converium, the Group's former reinsurance subsidiary, which was divested in 2001.

Corporate Center: Corporate Center includes our Group holding and financing companies, Corporate Center operations and alternative investments. This segment also includes some Group internal reinsurance operations that are not attributable to a specific segment but are managed on a global basis.

The Group's secondary format for segment information is geographic:

North America Corporate

North America Consumer

Continental Europe

UKISA includes United Kingdom, Ireland and Southern African operations.

Rest of the World

Centrally Managed Businesses

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Group accounts for inter-segment revenues and transfers as if the transactions were with third parties at current market prices, with the exception of realized capital gains, which are eliminated.

2. Summary of significant accounting policies

(a) Consolidation principles

The Group's consolidated financial statements include the assets, liabilities, equity, revenues, expenses and cash flows of Zurich Financial Services and its subsidiaries. A subsidiary is an entity in which Zurich Financial Services owns, directly or indirectly, more than 50% of the outstanding voting rights, or which it otherwise has the power to control. The results of subsidiaries acquired are included in the consolidated financial statements from the date of acquisition. The results of subsidiaries that have been sold during the year are included up to the date control has ceased. All significant intercompany balances, profits and transactions are eliminated.

Associates and partnerships where the Group has the ability to exercise significant influence, as well as joint ventures where there is joint control, are accounted for using the equity method. Significant influence is presumed to exist when the Group owns, directly or indirectly, between 20% and 50% of the outstanding voting rights.

(b) Revenue recognition

Premiums: Premiums from the sale of general insurance products are recorded when written and are accreted to earnings on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are recognized over the period of risk in proportion to the amount of insurance protection provided. The unearned premium reserve represents the portion of the premiums written relating to the unexpired terms of coverage.

Premiums from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognized as revenue when due from the policyholder. Benefits and expenses are provided against such revenue to recognize profits over the estimated life of the policies. Moreover, for single premium and limited pay contracts, premiums are recorded as income when due with any excess profit deferred and recognized in income in a constant relationship to the insurance in-force or, for annuities, the amount of expected benefit payments.

Amounts collected as premiums from investment type contracts such as universal life, unit-linked and unitized with-profits contracts, are reported as deposits. Revenue from these contracts consists of policy fees for the cost of insurance, administration and surrenders during the period. Front-end fees are recognized over the estimated life of the contracts. Policy benefits and claims that are charged to expenses include benefit claims incurred in the period in excess of related policyholder contract deposits and interest credited to policyholder deposits.

Other revenue: Fee revenue for the provision of non-claims related management services to the Farmers Exchanges is calculated primarily as a percentage of gross premiums earned by the Farmers Exchanges.

Farmers Group Inc. and its subsidiaries ("FGI") provide the following non-claims related management services to the Farmers Exchanges: risk selection, preparation and mailing of policy forms and invoices, premium collection, management of the investment portfolios and certain other administrative and managerial functions. The Farmers Exchanges are responsible for their own claims functions, including the settlement and payment of claims and claims adjustment expenses. They are also responsible for the payment of agent commissions and bonuses and the payment of their premium and income taxes.

Revenues from investment management and distribution fees are based on contractual fee arrangements applied to assets under management and recognized as earned when the service has been provided.

Transfer agent fees are based on a cost per account and transaction-based fees. For mutual funds, a component of the transfer agent fee can be contractual fee arrangements applied to assets under management. Transfer agent fees are recognized when services have been provided per the contract. Commission revenue is recognized on the trade date when the performance obligation is complete and the fees are payable.

Additionally, revenue can be earned from performance fees, which are based upon the achievement of performance levels in excess of pre-determined contractual benchmarks. Performance fees are recognized when it is probable that they will be received and the amount can be estimated reliably.

(c) Deferred policy acquisition costs

The costs of acquiring new business, including commissions, underwriting and policy issue expenses, which vary with and are directly related to the production of new business, are deferred. Deferred policy acquisition costs are subject to recoverability testing at the time of policy issue and at the end of each accounting period. Future investment income is taken into account in assessing recoverability.

Deferred policy acquisition costs for participating traditional life insurance contracts are amortized over the expected life of the contracts as a constant percentage of estimated gross margins. Estimated gross margins include anticipated premiums and investment results less benefits and administration expenses, changes in the net level premium reserve and expected policyholder dividends, as appropriate. Estimated gross margins are re-estimated regularly with the impact of deviations of actual result from estimated experience on the amortization of deferred acquisition costs reflected in earnings.

Deferred policy acquisition costs for other traditional life insurance and annuity policies are amortized over the expected life of the contracts as a constant percentage of expected premiums. Expected premiums are estimated at the date of policy issue and are consistently applied throughout the life of the contract unless premium deficiency occurs.

Deferred policy acquisition costs for investment type contracts such as universal life, unit-linked and unitized with-profits contracts are amortized over the expected life of the contracts based on a constant percentage of the present value of estimated gross profits expected to be realized over the life of the contract. Estimated gross profits include expected amounts to be assessed for mortality, administration, investment and surrender, less benefit claims in excess of policyholder balances, administrative expenses and interest credited. Estimated gross profits are revised regularly and the interest rate used to compute the present value of revised estimates of expected gross profits is the latest revised rate applied to the remaining benefit period. Deviations of actual results from estimated experience are reflected in earnings.

The impact on the deferred policy acquisition cost asset of the change in unrealized gains or losses on investments is recognized through an offset to unrealized gains or losses at the balance sheet date.

Unamortized deferred policy acquisition costs associated with internally replaced contracts that are, in substance, contract modifications, continue to be deferred and amortized. Costs associated with internally replaced contracts that are, in substance, new contracts, are written off.

(d) Insurance losses and reserves

Losses: Losses and loss adjustment expenses are charged to income as incurred. Unpaid losses and loss adjustment expense reserves represent the accumulation of estimates for ultimate losses and include provisions for losses incurred but not yet reported (IBNR). The reserves represent 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, requiring the use of informed estimates and judgments. The Group does not discount its loss reserves, other than for settled claims with fixed payment terms. Any changes in estimates are reflected in results of operations in the period in which estimates are changed.

Future life policyholders' benefits and policyholders' contract deposits: These represent the estimated future policyholder benefit liability for traditional life insurance policies and certain unit-linked investment contracts, respectively.

For participating traditional life insurance policies, future policy benefit liabilities are calculated using a net level premium method on the basis of actuarial assumptions equal to guaranteed mortality and interest rates.

Future life policyholders' benefits for other traditional life insurance policies are calculated using a net level premium valuation method based on actuarial assumptions as to mortality, persistency, expenses and investment return including a margin for adverse deviation. The assumptions are established at policy issue and remain unchanged except where premium deficiency occurs.

Future life policyholders' benefits include the value of accumulated declared bonuses or dividends that have been vested to policyholders.

Policyholders' contract deposits represent the accumulation of premium received less charges plus declared dividends.

The policyholders' share of unrealized gains or losses, which may be paid in the future in respect of assets, is included in future life policyholders' benefits.

Reserves for unit-linked products are recorded as equal to the consideration received plus accumulated investment yield less any fees charged or dividends paid to the policyholder.

"Investments held on account and at risk of life insurance policyholders" and "Insurance reserves for life insurance where the investment risk is carried by policyholders": These represent trading portfolios maintained to meet specific investment objectives of policyholders who bear the investment risk and which are bankruptcy protected from other creditors. Investment income and investment gains and losses accrue directly to policyholders. The assets and liabilities are carried at fair value. Deposits, withdrawals, net investment income, and realized and unrealized capital gains and losses are included in this position and are not reflected in the consolidated operating statement. The costs of insurance, policy administration, investment management, surrender charges and certain policyholder taxes assessed against the policyholders' account balances are included within policy fee revenue.

For products containing guarantees in respect of minimum death benefits ("GMDB"), retirement income benefits ("GRIB") and annuitization options ("GAO"), additional liabilities are recorded in proportion with the receipt of the contracted revenues.

(e) Reinsurance

The Group's insurance subsidiaries cede insurance premiums and risk in the normal course of business in order to limit the potential for losses arising from longer exposures. Reinsurance does not relieve the originating insurer of its liability. Certain Group insurance companies assume reinsurance business incidental to their normal business, as well as from the Farmers Exchanges. Centre ceased to write new contracts in 2003, but has honored its obligations and commitments with respect to existing contracts. Reinsurance assets include balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses, ceded unearned premiums and ceded future life policy benefits. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded gross in the consolidated balance sheet unless a right of offset exists.

Reinsurance contracts are assessed to ensure that underwriting risk, defined as the reasonable possibility of significant loss, and timing risk, defined as the reasonable possibility of a significant variation in the timing of cash flows, are transferred by the ceding company to the reinsurer. Those contracts that do not transfer both risks, referred to in total as insurance risk, are accounted for using the deposit method. A deposit asset or liability is recognized based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the ceding company. Deposits for contracts that transfer only significant underwriting risk are subsequently measured based on the unexpired portion of coverage until a loss is incurred, after which the present value of expected future cash flows under the contract is added to the remaining unexpired portion of coverage. Changes in the deposit amount are recorded in the operating statement as an incurred loss. Interest on deposits that transfer only timing risk, or no risk at all, are accounted for using the interest method. Future cash flows are estimated to calculate the effective yield, and revenue and expense are recorded as interest income or expense.

(f) Investments

Financial assets are classified either as "held-to-maturity", "trading", "available-for-sale", or "loans originated by the Group". Held-to-maturity financial assets are debt securities which the Group has the ability and positive intent to hold to maturity. Trading financial assets are debt and equity securities which the Group buys with the intention to resell in the near term. The remaining debt and equity securities are classified as available-for-sale. Loans originated by the Group, such as mortgage loans, policyholders' collateral and other loans, include loans where money is provided directly to the borrower, other than those that are originated with the intent to be sold in the short term, which are recorded in the trading category.

Financial assets are initially recorded at cost, net of transaction costs directly attributable to the acquisition. Held-to-maturity financial assets are subsequently carried at amortized cost using the effective interest rate method. Trading financial assets are subsequently carried at fair value, with changes in fair value recognized in the current period income. Available-for-sale financial assets are subsequently carried at fair value, with unrealized changes in fair value recorded in shareholders' equity net of deferred income taxes, certain life policyholder liabilities, certain life deferred acquisition costs and minority interests. Loans originated by the Group are subsequently carried at amortized cost using the effective interest rate method, less allowances for doubtful accounts.

The realized gain or loss on divestment is based on the difference between the proceeds received and the carrying value of the investment plus any unrealized gains or losses of the investment recorded in shareholders' equity using the specific identification method. When available-for-sale financial assets are sold, impaired or otherwise disposed of, the cumulative gains and losses previously recognized in shareholders' equity are included in the current period income. The amortization of premium and accretion of discount on available-for-sale and held-to-maturity investments in debt securities is computed using the effective interest method and is recognized in current period income. Dividends on equity securities are recorded as revenue on the ex-dividend date, the date that the dividends become payable to the holders of record. Interest income on financial assets is recognized when earned.

Investments backing UK with-profits life insurance policies and certain Australian life insurance liabilities are held as trading assets and carried at fair value. Movements in the carrying value of these assets are charged to current period income to match the offsetting amounts attributable to policyholders.

Financial assets are assessed for impairment on a regular basis. A financial asset is impaired if its carrying value exceeds the estimated recoverable amount and there is objective evidence of impairment to the financial asset. For an impaired financial asset impairment is recorded by reducing its carrying value through a charge to current period income. If an available-for-sale financial asset is determined to be impaired, the cumulative unrealized loss previously recognized in shareholders' equity is removed from shareholders' equity and recognized in the current period income.

For quoted available-for-sale financial assets the decision to make an impairment provision is based on review of the issuer's current financial position and future prospects and an assessment of the probability that the current market price will recover to former levels within the foreseeable future. The recoverable amount is determined by reference to the market price. For non-quoted available-for-sale financial assets the Group takes into consideration the issuer's current financial position and future prospects in determining whether an impairment provision is required. The recoverable amount is determined by applying recognized valuation techniques. When a decline in the fair value of an available-for-sale asset has been recognized directly in shareholders' equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized directly in shareholders' equity is removed from equity and recognized in current period income even though the asset has not been de-recognized. The amount of the cumulative loss that is removed from shareholders' equity and recognized in current period income is the difference between acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that asset instrument previously recognized in income.

For held-to-maturity financial assets and loans originated by the Group the impairment is considered to have taken place if it is probable that the Group will not be able to collect principal and interest due according to the contractual terms of the instrument. When impairment is determined to have occurred, the carrying amount of the held-to-maturity financial assets is decreased through a charge to current period income. The amount of the impairment loss is the difference between the asset's carrying value and the present value of expected future cash flows discounted at the security's original effective interest rate.

Real estate held for investment purposes is initially recorded at cost, with transaction costs included in the initial measurement. It is subsequently measured at fair value with changes in fair value recognized in current period income. No depreciation is recorded for real estate held for investment. The gain or loss on disposal of real estate held for investment is based on the difference between the proceeds received and the carrying value of the investment.

Short-term investments: Carrying amounts approximate fair values.

Cash amounts represent cash on hand and demand deposits. Cash equivalents are short-term, highly liquid investments with original maturities of 90 days or less.

(g) Derivative financial instruments

Derivative financial instruments are carried at fair value on the balance sheet as assets or liabilities. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying. Inputs used in pricing models are generally market observable or can be derived from market observable data. Derivative financial instruments with positive fair values are recorded as derivative trading assets. Derivative financial instruments with negative fair values are recorded as derivative trading liabilities. Apart from derivative financial instruments designated as qualifying cash flow hedging instruments (see below), changes in fair value are recognized in current period income.

Derivative financial instruments include swaps, futures, forwards and option contracts, all of which derive their value mainly from underlying interest rates, foreign exchange rates, commodity values or equity instruments. A derivative contract may be traded on an exchange or over-the-counter ("OTC"). Exchange-traded derivatives are standardized and include futures and certain option contracts. OTC derivative contracts are individually negotiated between contracting parties and include forwards, caps, floors and swaps. Derivative financial instruments are subject to various risks similar to those related to the underlying financial instruments, including market, credit and liquidity risk.

In addition to the derivative financial instruments described above, the Group enters into contracts that are not considered derivative financial instruments in their entirety but that include embedded derivative features. Such embedded derivatives are assessed at inception of the contract and, depending on their characteristics, are accounted for as separate derivative financial instruments pursuant to IAS 39.

Derivative financial instruments used for hedging: For the purpose of hedge accounting, hedges are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognized asset or liability, or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

To qualify for hedge accounting, the hedging relationship must meet several strict conditions on documentation, probability of occurrence, hedge effectiveness and reliability of measurement. If these conditions are not met, then the relationship does not qualify for hedge accounting. In this case the hedging instrument and the hedged item are reported independently as if there was no hedging relationship. In particular, derivative financial instruments are reported at fair value, with changes in fair value charged to current period income.

In relation to fair value hedges which meet the conditions for special hedge accounting, gains or losses from re-measuring the hedging instrument at fair value are recognized immediately in the operating statement. Gains or losses on the hedged item attributable to the hedged risk are adjusted against the carrying amount of the hedged item and recognized in the operating statement. Where the adjustment is to the carrying amount of a hedged interest-bearing financial instrument carried at amortized cost, the adjustment is amortized to current period income such that it is fully amortized by maturity.

In relation to cash flow hedges which meet the conditions for special hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized directly in shareholders' equity and the ineffective portion is recognized in current period income. When the hedged firm commitment results in the recognition of an asset or a liability, then, at the time the asset or liability is recognized, the associated gains or losses that had previously been recognized in shareholders' equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For other cash flow hedges, the gains or losses that are recognized in shareholders' equity are transferred to the operating statement in the same period in which the item hedged affects the net profit and loss, for example when the future sale actually occurs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, cumulative gains or losses on the hedging instrument recognized in shareholders' equity are kept in shareholders' equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognized in shareholders' equity is transferred to current period income.

(h) Securities lending

Certain entities within the Group participate in securities lending arrangements whereby specific securities are loaned to other institutions, primarily major brokerage firms, for short periods of time. Under the terms of the securities lending agreements, the loaned securities remain under the Group's control and thus do not get de-recognized.

(i) Obligation to repurchase securities

Sales of securities under agreements to repurchase are accounted for as collateralized borrowing transactions and are recorded at their contracted repurchase amount plus accrued interest at the balance sheet date. The Group minimizes the credit risk that counterparties to transactions might be unable to fulfill their contractual obligations by monitoring customer credit exposure and collateral value and generally requiring additional collateral to be deposited with the Group when deemed necessary.

(j) Debt issued

Debt issued by the Group is initially measured at cost, which is the fair value of the consideration received, net of transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method to amortise cost at inception to the redemption value over the life of the debt.

(k) Interest expense

Interest expense is recognized when incurred on an amortized cost basis.

(l) Intangible assets

Goodwill: Acquisitions of subsidiaries and associates are accounted for under the purchase method, whereby the purchase price is allocated to the fair value of assets and liabilities acquired at the date of acquisition with any residual amount allocated to goodwill. Goodwill is amortized using the straight-line method over its estimated economic life. Goodwill arising on strategic acquisitions of the Group to obtain long duration insurance contracts, customer relationships and distribution networks is amortized over a maximum period of 20 years. For all other acquisitions, goodwill is generally amortized over five years. The recoverability of the carrying value of the goodwill is reviewed periodically. If the carrying value of goodwill exceeds the recoverable amount, the carrying value is reduced through a charge to current period earnings.

Present value of profits of acquired insurance contracts is amortized over the expected life of the policies acquired, based on a constant percentage of the present value of estimated gross profits (margins) expected to be realized, or over the premium recognition period, as appropriate.

Other intangibles are carried at cost less accumulated amortization and consist primarily of acquired brand names and software costs that meet the recognition criteria for capitalization. The costs of these assets are amortized using the straight-line method over the following estimated economic lives: brand names 20 years; software three to five years.

Attorney-in-fact relationships: At the date of the acquisition of Farmers Group, Inc. and its subsidiaries ("FGI") in 1988, a portion of the purchase price was assigned to the attorney-in-fact relationships. The asset representing the attorney-in-fact relationships represents the ability of FGI to generate future revenues based on the Group's relationship with the Farmers Exchanges. This carrying value is amortized on a straight-line basis over 40 years. In determining the period of amortization, the Group considered the organizational structure of inter-insurance exchanges, under which subscribers exchange contracts with each other and appoint an attorney-in-fact to provide certain management services. In addition, the Group considered the historical attorney-in-fact relationship between FGI and the Farmers Exchanges. To the extent that there is a change in this relationship, the Group would re-evaluate the value of this intangible asset.

(m) Income taxes

The Group provides current tax expense according to the tax laws of each jurisdiction in which it operates. Income taxes are recognized using the asset and liability method. Deferred income taxes are recorded for temporary differences, which are based on the difference between financial statement carrying amounts and income tax bases of assets and liabilities using enacted income tax rates and laws. Losses for tax purposes are treated as deferred tax assets to the extent it is probable that the losses can offset future taxable income and is allowed by the applicable local tax laws and regulations.

Current and deferred tax assets and liabilities are offset when the income taxes are levied by the same taxation authority and when there is a legally enforceable right to offset them.

Taxes payable by either the holding company or its subsidiaries on distribution to the holding company of the undistributed profits of subsidiaries are recognized as deferred income taxes unless a distribution of those profits is not intended or would not give rise to a tax liability.

Taxes paid by UK life insurance businesses are based on investment income less allowable expenses. To the extent that these taxes exceed the amount that would have been payable in respect of the shareholders' share of taxable profits, it is normal practice for UK life businesses to recover this tax from policyholders. While in the Group's case the relevant company has the contractual right to charge policyholders for the taxes attributable to their share of investment income less expenses, the obligation to pay the tax authority rests with the company and therefore, the full amount of tax including that charged to policyholders is accounted for as an income tax. Income tax expense therefore includes an element attributable to policyholders. In addition, deferred tax on unrealized gains on "Investments held on account and at risk of life insurance policyholders" related to certain UK unit-linked policies is included as income tax expense and an accrual for future policy fees to recover the tax charge is included in gross written premiums and policy fee revenue.

(n) Employee benefits

The operating companies in the Group provide employee retirement benefits through both defined benefit plans providing specified benefits and defined contribution plans. The assets of these plans are generally held separately from the Group's general assets in trustee-administered funds. Defined benefit plan obligations and contributions are determined annually by qualified actuaries using the projected unit credit method. The Group's expense related to these plans is accrued over the employees' service periods based upon the actuarially determined cost for the period. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans. Contributions to the defined contribution pension plans are charged to the operating statement as they become due.

Other defined post-employment benefits, such as medical care and life insurance, are also provided for certain employees and are primarily funded internally. The cost of such benefits is accrued over the service period of the employee based upon the actuarially determined cost for the period.

(o) Share-based payment transactions

Expenses for share-based payment transactions are recognized during the vesting period in the operating statement. These expenses recognize the fair value of the shares or options granted. A corresponding amount is reflected in additional paid-in capital.

(p) Fixed assets

Real estate (buildings) held for own use and other fixed assets are carried at cost less accumulated depreciation and any necessary write-downs due to impairment. The costs of these assets are depreciated principally on a straight-line basis over the following estimated useful economic lives: buildings 25 to 50 years; furniture and fixtures five to ten years; and computer equipment three to five years. Real estate (land) is carried at cost less any necessary write-downs. Maintenance and repair costs are charged to income as incurred. Costs of systems purchased from outside vendors and developed internally are deferred and amortized over expected useful lives up to five years. Gains and losses on disposal of fixed assets and real estate held for own use are determined based on their respective carrying amounts.

(q) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the operating statement on a straight-line basis over the lease term.

(r) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

(s) Treasury stock

Treasury stock is deducted from equity at its nominal value of CHF 6.50 and CHF 9 per share as of December 31, 2004 and 2003, respectively. Differences between this amount and the amount paid for acquiring, or received for disposing of treasury shares, are recorded as an adjustment to additional paid-in capital in shareholders' equity.

(t) Foreign currency translation and transactions

Foreign currency translation: In view of the international nature of the Group there are many individual entities with different functional currencies. Therefore, a common presentation currency is required. Due to the Group's economic exposure to the US dollar (USD), the presentation currency of the Group has been determined to be the USD. Assets and liabilities of Group companies with functional currencies other than USD are translated at the end-of-period exchange rates, while operating statements are translated at average exchange rates for the period. The resulting translation differences are recorded directly in shareholders' equity as cumulative translation adjustments.

Foreign currency transactions: Foreign currency monetary items are translated at end-of-period exchange rates, non-monetary items which are carried at historical cost denominated in a foreign currency are translated at historical rates. Revenues and expenses are translated using the exchange rate at the date of the transaction or a weighted average rate. The resulting exchange differences are recorded in the consolidated operating statement.

The table below summarizes the principal exchange rates that have been used for translation purposes. Net gains and (losses) on foreign currency transactions included in the consolidated operating statements were USD 153 million and USD (125) million for the years ended December 31, 2004 and 2003, respectively.

Table 2
Principal exchange rates
USD per foreign currency unit

	Balance sheets as of		Operating statements and cash flows for the years ended	
	12/31/04	12/31/03	**12/31/04**	12/31/03
Euro	**1.3555**	1.2594	**1.2440**	1.1333
Swiss franc	**0.8769**	0.8072	**0.8063**	0.7446
British pound sterling	**1.9183**	1.7858	**1.8329**	1.6363

3. Implementation of new accounting standards and adjustments

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.

The impact of the new standard is summarized in the tables below.

Table 3.1
Summary of restatement of key consolidated operating statement items due to implementation of a new accounting standard
in USD millions, for the year ended December 31, 2003

	As previously reported	Restatement adjustment	Restated 2003
Revenues			
Net investment income	7,004	1,391	8,395
Net capital gains on investments and impairments	811	4,369	5,180
Benefits, losses and expenses			
Policyholder dividends and participation in profits, net of reinsurance	(423)	(5,622)	(6,045)
Net income before income taxes and minority interests	3,746	(135)	3,611
Income tax expense	(1,520)	24	(1,496)
Net income	2,120	(111)	2,009

Table 3.2
Summary of restatement of key consolidated balance sheet items due to implementation of a new accounting standard
in USD millions, as of December 31, 2003

	As previously reported	Restatement adjustment	Restated 2003
Assets			
Debt securities	113,002	6,030	119,032
Equity securities	15,188	37,134	52,322
Other investments	28,947	4,475	33,422
Cash and cash equivalents	13,536	2,141	15,677
Total investments	175,967	49,780	225,747
Investments held on account and at risk of life insurance policyholders	71,936	(49,956)	21,980
Deferred policy acquisition costs	12,023	(239)	11,784
Total assets	317,876	(234)	317,642
Liabilities			
Insurance reserves, gross	171,864	51,554	223,418
Insurance reserves for life insurance where the investment risk is carried by policyholders	73,233	(51,170)	22,063
Total liabilities	297,523	216	297,739
Shareholders' equity			
Cumulative translation adjustment	181	(29)	152
Retained earnings	6,120	(421)	5,699
Total shareholders' equity	19,384	(450)	18,934

Table 3.3
Summary of restatement of key consolidated statement of cash flows items due to implementation of a new accounting standard
in USD millions, for the year ended December 31, 2003

	As previously reported	Restatement adjustment	Restated 2003
Cash flows from operating activities			
Net income	2,120	(111)	2,009
Net capital (gains) on investments and impairments	(811)	(4,369)	(5,180)
Insurance reserves, gross	6,452	9,115	15,567
Net cash provided by operating activities	8,546	4,634	13,180
Cash flows from investing activities			
Sales and maturities:			
Debt securities	80,584	7,839	88,423
Equity securities	31,800	14,248	46,048
Purchases:			
Debt securities	(93,694)	(7,616)	(101,310)
Equity securities	(21,227)	(17,715)	(38,942)
Net cash used in investing activities	(2,815)	(3,598)	(6,413)
Change in cash and cash equivalents	5,092	552	5,644
Cash and cash equivalents as of January 1 (opening balance)	8,444	1,589	10,033
Cash and cash equivalents as of December 31	13,536	2,141	15,677

The SOP 03-01 restatement adjustments have been recorded primarily in the Life Insurance segment, with the exception of the write-down of deferred policy acquisition costs which relate to business recorded in the Other Businesses segment.

In 2004, amounts for the Group's internal reinsurance transactions have been allocated to the specific regions that wrote the underlying business, whereas in 2003 those results were recorded in the Centrally Managed Businesses region. The 2003 amounts have been reclassified to conform to this presentation.

Forthcoming changes in accounting policy

For 2005 reporting, the Group will adopt new and amended accounting standards.

The International Accounting Standards Board (IASB) issued IFRS 4 "Insurance Contracts" on March 31, 2004. The publication of this standard provides, for the first time, guidance on accounting for insurance contracts. This standard applies to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRS standards. In accordance with the transitional provisions of the standard the Group will adopt IFRS 4 as of January 1, 2005. The most significant change as a result of the adoption of the standard is the re-classification of certain contracts as financial instruments and hence application of IAS 39 to these contracts. The adoption of IFRS 4 does not provide comprehensive guidance on the accounting treatment for insurance contracts and as such the Group will continue to apply US GAAP in certain circumstances where IFRS is silent.

The IASB issued IFRS 3 "Business Combinations" on March 31, 2004. In accordance with the transitional provisions of the standard, the Group has applied this standard to business combinations for which the agreement date is on or after March 31, 2004. The remaining requirements of IFRS 3 will be adopted as of January 1, 2005. The most significant changes required by this standard are:
- All business combinations within its scope are to be accounted for using the purchase method, previously IAS 22 permitted business combinations to be accounted for using the pooling of interests method in certain circumstances.
- The acquiree's identifiable assets, liabilities and contingent liabilities are to be recognized as part of allocating the cost of the combination to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree is stated at the minority's proportion of the net fair values of those items.
- Goodwill acquired in a business combination is to be measured after initial recognition at cost less any accumulated impairment losses. Therefore, the goodwill is not amortized and instead must be tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired.

IAS 36 "Impairment of Assets" and IAS 38 "Intangible Assets" were revised in March 2004 by the IASB as part of the Business Combinations Project. Consistent with the Group's adoption of IFRS 3, the revised standards will be adopted as of January 1, 2005.

The IASB issued IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" on March 31, 2004. The standard adopts the classification "held for sale", introduces the concept of a disposal group, and specifies that assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell. It also replaces IAS 35 regarding the accounting treatment for discontinued operations. In accordance with the transitional provisions of IFRS 5 the standard will be adopted by the Group as of January 1, 2005. The most significant impact for the Group may be the re-classification of some of its assets as "held for sale."

IAS 39 "Financial Instruments: Recognition and Measurement" was revised in December 2003 as part of the IASB's project to improve IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39. A further amendment was made in March 2004. This change related to Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk. IAS 39 "Financial Instruments: Recognition and Measurement" should be applied for annual periods beginning on or after January 1, 2005. The most significant changes are as follows:

- The standard clarifies that the evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for all derecognition transactions
- The standard permits an entity to designate any financial asset or financial liability on initial recognition as one to be measured at fair value, with changes in fair value recognized in profit or loss. To impose discipline on this categorization, an entity is precluded from reclassifying financial instruments into or out of this category
- The standard provides additional guidance about how to determine fair values using valuation techniques
- The standard clarifies that an impairment loss is recognized only when it has been incurred. It also provides additional guidance on what events provide objective evidence of impairment for investments in equity instruments
- Hedges of firm commitments are to be treated as fair value hedges rather than cash flow hedges. However, the standard clarifies that a hedge of the foreign currency risk of a firm commitment can be treated as either a cash flow hedge or a fair value hedge.

The Group has not yet quantified the impact these changes will have on the Group's financial position or results.

4. Changes in the scope of consolidation

During the years ended December 31, 2004 and 2003, the Group completed divestments of several businesses and recognized post-completion adjustments. The total net gain on all divestments made during the year before tax was USD 88 million and USD 351 million, and the after-tax net gain on divestments was USD 71 million and USD 334 million for 2004 and 2003, respectively. Total cash consideration received was USD 2,488 million in 2004 and USD 2,737 million in 2003.

Table 4

Net gain on significant divestments only

in USD millions, for the years ended December 31

	2004	2003
Consideration received	**2,488**	2,664
Less: net assets divested	**(2,356)**	(2,242)
Costs related to divestments	**(44)**	(79)
Net gain on divestments before tax	**88**	343
Net assets divested		
Cash and cash equivalents	**435**	339
Other assets	**6,090**	20,808
Insurance liabilities	**(4,014)**	(9,558)
Other liabilities	**(155)**	(9,347)
Net assets divested	**2,356**	2,242

The Group's most significant transactions affecting the scope of consolidation during the years ended December 31, 2004 and 2003 were as described below.

Changes in 2004

In Belgium and Luxembourg, the Group completed the sale to P&V Assurances of its life insurance operations (both consumer and commercial), its workers' compensation portfolio and its general insurance operations in the consumer and small commercial segments, recognizing a loss of USD 30 million before tax.

The Group completed several other divestments with a net gain of USD 23 million before tax. These included the sale of its interests in Thai Zurich Insurance Company, life insurance policies written by the Group's Taiwanese branch, Turegum Insurance Company, the real-estate investment company Zürich Atrium B.V., Zurich Insurance (Singapore) Pte. Ltd, Zürich Krankenversicherung AG (Deutschland) as well as its stake in Globale Krankenversicherungs-AG, Zurich Life Philippines and McMillan Shakespeare Australia Pty Limited.

The companies and businesses divested in 2004 contributed, before their sale, a net loss of USD 19 million to the Group's 2004 results compared to a net income of USD 19 million in 2003.

During 2004, the Group has also recognized several post-completion adjustments for divestments closed in 2003. The total aggregate post completion gain was USD 95 million. The most significant impacts were from the finalization of the sale of Threadneedle Asset Management Holdings Ltd., Rüd, Blass & Cie AG and the transfer of certain derivative transactions, credit facilities and related assets of Zurich Capital Markets to BNP Paribas.

Changes in 2003

The Group completed the sale of certain operations of Zurich France to Assicurazioni Generali SpA, recognizing a loss of USD 28 million before tax. The transaction included the life insurance operations (including Eagle Star business) and parts of consumer and commercial lines of the general insurance operations.

On October 31, 2003, the Group completed the sale of Zurich Life Assurance Company (Zurich Life), one of the UK Life businesses, to Swiss Re, recognizing a gain of USD 128 million before tax.

On September 30, 2003, the Group completed the sale of Threadneedle Asset Management Holdings Ltd. to American Express Financial Corporation, recognizing a gain on divestment of USD 325 million before tax.

The Group completed the sale of Zurich Life, part of its US life and annuity operations, to Bank One Corporation on September 3, 2003, recognizing a loss on divestment of USD 165 million before tax. Kemper Investors Life Insurance Company was not part of the sale and is retained by the Group.

On September 1, 2003, the Group completed the sale of parts of its Dutch operations to SNS Reaal Groep N.V., recognizing a gain on divestment of USD 114 million before tax. SNS Reaal acquired all of the Group's life insurance operations as well as general insurance operations in the consumer and small business segments in the Netherlands.

On March 31, 2003, the Group completed the sale of Rüd, Blass & Cie AG, Bankgeschäft to Deutsche Bank (Suisse) SA. For this transaction, a significant portion of the sales proceeds could not be recognized at the time of sale, as it was contingent on the development of assets under management over a period of 15 months subsequent to the closing. Finalization was completed in 2004.

In 2003, the companies and businesses divested contributed USD 131 million to the Group's net income.

As of December 31, 2003, Zurich Capital Markets ("ZCM") consolidated Zurich Premier Series Ltd. ("Premier"), an investment company. ZCM's equity interest in the investment company increased from 32% to 59% during the year with the majority interest acquired on December 31, 2003. As a result of the consolidation of Premier, "trading equity portfolios in capital markets and banking activities" and "other liabilities" increased by USD 638 million.

5. Management fees

Table 5
Management fees

in USD millions, for the years ended December 31	**2004**	2003
Farmers management fees and other related revenue	**1,985**	1,885
Asset management fees	**45**	177
Total	**2,030**	2,062

Farmers Group, Inc. and its subsidiaries ("FGI") are contractually permitted to receive a management fee of up to 20% (25% in the case of the Fire Insurance Exchange) of the gross premiums earned by the Farmers Exchanges. In order to enable the Farmers Exchanges to maintain appropriate capital and surplus while offering competitive insurance rates, FGI has historically charged a lower management fee than the maximum allowed. The range of fees has varied by line of business over time and from year to year. During the past five years, aggregate management fees have averaged between 12% and 13% of gross premiums earned by the Farmers Exchanges. The gross earned premiums of the Farmers Exchanges were USD 14,020 million in 2004 (USD 13,654 million in 2003).

Asset management fees were primarily earned by Threadneedle Asset Management Holdings Ltd., which was divested on September 30, 2003.

6. Investments

A summary of net investment income and net capital gains and losses and impairments is given below.

Table 6.1
Investment result

in USD millions, for the years ended December 31	**Net investment income**		**Net capital gains/(losses) and impairments[1]**		**Investment result**	
	2004	2003	**2004**	2003	**2004**	2003
Debt securities	**5,446**	5,318	**1,414**	1,489	**6,860**	6,807
Equity securities	**1,334**	1,245	**2,724**	3,744	**4,058**	4,989
Investments in associates	**86**	90	**(36)**	(9)	**50**	81
Other investments:						
Investments held by investment companies	**14**	11	**140**	113	**154**	124
Real estate held for investment	**840**	799	**471**	135	**1,311**	934
Mortgage loans, policyholders' collateral and other loans	**1,075**	785	**187**	74	**1,262**	859
Short-term investments	**129**	105	**3**	1	**132**	106
Other[2]	**231**	162	**23**	(370)	**254**	(208)
Cash and cash equivalents	**355**	210	**8**	3	**363**	213
Investment result, gross	**9,510**	8,725	**4,934**	5,180	**14,444**	13,905
Investment expenses[3]	**(396)**	(330)	**–**	–	**(396)**	(330)
Investment result, net	**9,114**	8,395	**4,934**	5,180	**14,048**	13,575

[1] Impairments on total investments amounted to USD 175 million in 2004 and USD 1,067 million in 2003.
[2] Including net capital gains/(losses) on derivative financial instruments of USD (5) million in 2004 and USD (419) million in 2003.
[3] Including rental operating expense for real estate held for investment of USD 182 million in 2004 and USD 118 million in 2003.

The details of the investment balances as of December 31, 2004 and 2003 are given in the tables below.

Table 6.2
Breakdown of investments
as of December 31

	2004 USD millions	2004 % of total	2003 USD millions	2003 % of total
Debt securities:				
Available-for-sale	**107,882**	**42.9%**	100,086	44.4%
Held-to-maturity	**5,855**	**2.3%**	3,886	1.7%
Trading	**16,775**	**6.7%**	15,060	6.7%
Total debt securities	**130,512**	**51.9%**	119,032	52.8%
Equity securities (including trading equity portfolios in capital markets and banking activities):				
Available-for-sale	**12,064**	**4.8%**	13,525	6.0%
Trading	**49,449**	**19.6%**	43,100	19.1%
of which: – *Trading equity portfolios in capital markets and banking activities*	***2,773***	***1.1%***	*4,303*	*1.9%*
– *Investments for unit-linked products*	***44,574***	***17.7%***	*37,134*	*16.4%*
Total equity securities	**61,513**	**24.4%**	56,625	25.1%
Investments in associates	**645**	**0.3%**	991	0.4%
Other investments:				
Investments held by investment companies	**1,728**	**0.7%**	1,576	0.7%
Real estate held for investment	**12,541**	**5.0%**	11,101	4.9%
Mortgage loans	**10,251**	**4.1%**	11,283	5.0%
Policyholders' collateral and other loans	**14,902**	**5.9%**	7,479	3.3%
Short-term investments	**1,943**	**0.8%**	1,834	0.8%
Other	**165**	**0.1%**	149	0.1%
Total other investments	**41,530**	**16.6%**	33,422	14.8%
Cash and cash equivalents	**16,959**	**6.8%**	15,677	6.9%
Total	**251,159**	**100.0%**	225,747	100.0%

Short-term investments include investments that have an original maturity of less than one year.

Cash and investments with a carrying value of USD 7,781 million and USD 7,466 million were deposited with regulatory authorities as of December 31, 2004 and 2003, respectively. As of December 31, 2004 and 2003, respectively, debt securities with a carrying value of USD 5,009 million and USD 3,742 million have been sold to financial institutions under short-term sale and repurchase agreements. These securities continue to be recognized as investments in the balance sheets and an obligation to repurchase them is included in liabilities in the balance sheets at that date. On December 31, 2004 and 2003, the volume of securities loaned out by the Group under securities lending programs was USD 16.2 billion and USD 7.4 billion, respectively.

Table 6.3
Debt securities maturity schedule
in USD millions, as of December 31

	Amortized cost Held-to-maturity 2004	Amortized cost Held-to-maturity 2003	Estimated fair value Available-for-sale 2004	Estimated fair value Available-for-sale 2003
Less than one year	**181**	106	**9,498**	4,386
One year through five years	**1,195**	287	**32,759**	30,903
Five years through ten years	**948**	249	**30,601**	31,877
Over ten years	**3,531**	3,244	**20,799**	20,882
Subtotal	**5,855**	3,886	**93,657**	88,048
Mortgage and asset-backed securities	**–**	–	**14,225**	12,038
Total	**5,855**	3,886	**107,882**	100,086

The amortized cost and estimated fair values of debt securities held-to-maturity and available-for-sale are shown by contractual maturity. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or pre-pay certain obligations with or without call or pre-payment penalties.

Table 6.4
Equity securities (including trading equity portfolios in capital markets and banking activities)
as of December 31

	2004 USD millions	2004 % of total investments	2003 USD millions	2003 % of total investments
Common stocks, including equity unit-trusts	**51,396**	**20.4%**	46,435	20.5%
Unit-trusts (debt securities, real estate, short-term investments)	**5,270**	**2.1%**	4,192	1.9%
Common stock portfolios backing the participating with-profit policyholder contracts	**2,074**	**0.8%**	1,695	0.8%
Trading equity portfolios in capital markets and banking activities	**2,773**	**1.1%**	4,303	1.9%
Total	**61,513**	**24.4%**	56,625	25.1%

Table 6.5
Available-for-sale securities
in USD millions, as of December 31

	Cost or amortized cost		Gross unrealized gains		Gross unrealized losses		Estimated fair value	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003
Debt securities – available-for-sale								
Swiss federal and cantonal governments	**8,898**	8,170	**455**	404	**(12)**	(12)	**9,341**	8,562
United Kingdom government	**9,287**	9,009	**457**	358	**(29)**	(94)	**9,715**	9,273
United States government	**8,694**	10,165	**196**	207	**(189)**	(90)	**8,701**	10,282
Other governments	**27,787**	26,788	**992**	687	**(55)**	(296)	**28,724**	27,179
Corporate securities	**35,608**	31,149	**1,627**	1,573	**(72)**	(268)	**37,163**	32,454
Mortgage and asset-backed securities	**13,954**	11,668	**334**	469	**(62)**	(99)	**14,226**	12,038
Redeemable preferred stocks	**11**	294	**1**	4	**–**	–	**12**	298
Total debt securities – available-for-sale	**104,239**	97,243	**4,062**	3,702	**(419)**	(859)	**107,882**	100,086
Equity securities – available-for-sale								
Common stock	**7,090**	9,946	**1,135**	1,081	**(705)**	(1,561)	**7,520**	9,466
Unit-trust	**4,426**	4,034	**119**	81	**(271)**	(309)	**4,274**	3,806
Non-redeemable preferred stock	**237**	253	**49**	17	**(16)**	(17)	**270**	253
Total equity securities – available-for-sale	**11,753**	14,233	**1,303**	1,179	**(992)**	(1,887)	**12,064**	13,525

Table 6.6
Realized capital gains/(losses) and impairments on available-for-sale debt and equity securities
in USD millions, for the years ended December 31

	Debt securities		Equity securities		Total	
	2004	2003	**2004**	2003	**2004**	2003
Gross realized capital gains – available-for-sale	**765**	1,891	**626**	1,405	**1,391**	3,296
Gross realized capital losses – available-for-sale	**(173)**	(304)	**(753)**	(1,402)	**(926)**	(1,706)
Impairments – available-for-sale	**(25)**	(48)	**(123)**	(989)	**(148)**	(1,037)
Total	**567**	1,539	**(250)**	(986)	**317**	553

Table 6.7
Net capital gains/(losses) on trading debt and equity securities
in USD millions, for the years ended December 31

	Debt securities		Equity securities		Total	
	2004	2003	**2004**	2003	**2004**	2003
Net capital gains/(losses) on trading debt and equity securities	**847**	(50)	**2,974**	4,730	**3,821**	4,680

Table 6.8
Investments in associates
in USD millions

	Carrying value		Share in profit/(loss)		Ownership interest	
	2004	2003	**2004**	2003	**2004**	2003
Capital Z Financial Services Fund II LP, United States	**379**	371	**66**	59	**29.43%**	29.41%
The Guarantee Company of North America, Canada	**88**	82	**2**	2	**32.08%**	32.08%
PSP Swiss Property AG, Switzerland[1]	**–**	269	**11**	19	**12.40%**	22.34%
Other	**178**	269	**7**	10	**n/m**	n/m
Total	**645**	991	**86**	90	**n/m**	n/m

[1] Since May 13, 2004, PSP Swiss Property AG, Switzerland has no longer been classified as an investment in associates, as the Group's ownership interest declined below 20%.

Table 6.9
Real estate held for investment

in USD millions	2004	2003
Carrying value as of January 1 (opening balance)	**11,101**	10,572
Additions and capital improvements	**1,115**	231
Disposals	**(636)**	(1,051)
Market value revaluation	**436**	13
Transfer (to)/from assets held for own use	**(27)**	310
Foreign currency translation effects	**552**	1,026
Carrying value as of December 31 (closing balance)	**12,541**	11,101

Real estate held for investment consists of investments in commercial, residential and mixed-use properties primarily located in Switzerland, Germany and the United Kingdom.

Table 6.10
Unrealized gains / (losses) on investments included in shareholders' equity

in USD millions, as of December 31	2004	2003
Debt securities – available-for-sale	**3,643**	2,843
Equity securities – available-for-sale	**311**	(708)
Other	**83**	(157)
Less amount of net unrealized (gains)/losses on investments attributable to:		
Life policyholder dividends and other policyholder liabilities	**(2,248)**	(638)
Life deferred acquisition costs	**(176)**	(119)
Deferred income taxes	**(513)**	(353)
Minority interests	**(25)**	(6)
Total	**1,075**	862

7. Investments held on account and at risk of life insurance policyholders and insurance reserves for life insurance where the investment risk is carried by policyholders

Table 7
Investments held on account and at risk of life insurance policyholders and insurance reserves for life insurance where the investment risk is carried by policyholders

in USD millions, as of December 31	2004	2003
Debt securities	**150**	235
Equity securities	**23,149**	21,175
Collateral and other loans	**4**	6
Other investments	**797**	453
Cash and cash equivalents	**89**	111
Total investments held on account and at risk of life insurance policyholders	**24,189**	21,980
Total insurance reserves for life insurance where the investment risk is carried by policyholders	**24,261**	22,063

In certain countries, "Insurance reserves for life insurance where the investment risk is carried by policyholders" include amounts due to policyholders as well as deferred front-end fees and, thus, the reserves are carried at a higher amount than the total "Investments held on account and at risk of life insurance policyholders".

The implementation of SOP 03-01, as discussed in note 3, resulted in a reclassification of the assets and reserves for products sold in certain countries, predominantly the UK, to their respective investment categories and insurance reserves as they do not meet the criteria for classification as "separate accounts". The effects are disclosed in note 3. The remaining balances represent products that consist primarily of variable life insurance and annuity products for which the policyholder directly bears the investment risk of the related assets.

8. Fair value of financial instruments and other investments

The methods and assumptions used by the Group in estimating the fair value of the financial instruments and other investments are discussed below.

- Debt and equity securities: Fair values are based on quoted market prices when available. If quoted market prices are not available, then fair values are estimated on the basis of pricing models, discounted cash flow or other recognized valuation techniques.
- Investments in associates are accounted for using the equity method. Accordingly, these participations are carried at the Group's proportional interest of the investee's shareholders' equity. The fair value of these entities, particularly for publicly traded entities, may differ from the carrying value.
- Investments held by investment companies: Estimated fair values are determined by the investment managers.
- Real estate held for investment: Fair value is determined on a regular basis with reference to current market conditions.
- Mortgage loans: Fair values of loans on real estate are estimated using discounted cash flow calculations based upon the Group's current incremental lending rates for similar types of loans.

- Policyholders' collateral and other loans: Fair values are estimated on the basis of discounted cash flow, pricing models, or other recognized valuation techniques.
- Short-term investments: Carrying amounts approximate fair values.
- Cash and cash equivalents: Carrying amounts approximate fair values.
- Derivative trading assets and liabilities: Fair values are based on quoted market prices, dealer price quotations, discounted cash flow models and option pricing models.
- Debt: Fair values are estimated using discounted cash flow calculations based upon the Group's current incremental borrowing rates for similar types of borrowings with maturities consistent with those remaining for the debt being valued.
- Obligations to repurchase securities: Carrying amounts approximate fair value.

Table 8
Fair value of financial instruments
in USD millions, as of December 31

	Total fair value		Total carrying value	
	2004	2003	**2004**	2003
Debt securities	**130,719**	119,423	**130,512**	119,032
Equity securities (incl. trading equity portfolios in capital markets and banking activities)	**61,513**	56,625	**61,513**	56,625
Investments in associates	**647**	991	**645**	991
Other Investments:				
Investments held by investment companies	**1,728**	1,576	**1,728**	1,576
Real Estate held for investment	**12,541**	11,101	**12,541**	11,101
Mortgage loans	**10,179**	11,387	**10,251**	11,283
Policyholders' collateral and other loans	**15,441**	7,484	**14,902**	7,479
Short-term investments	**1,943**	1,834	**1,943**	1,834
Other	**165**	149	**165**	149
Total other investments	**41,997**	33,531	**41,530**	33,422
Cash and cash equivalents	**16,959**	15,677	**16,959**	15,677
Derivative trading assets	**1,424**	2,583	**1,424**	2,583
Total of financial instruments (assets)	**253,259**	228,830	**252,583**	228,330
Debt	**(10,103)**	(11,037)	**(9,751)**	(10,736)
Obligations to repurchase securities	**(5,009)**	(3,742)	**(5,009)**	(3,742)
Derivative trading liabilities	**(1,300)**	(2,442)	**(1,300)**	(2,442)
Total of financial instruments (liabilities)	**(16,412)**	(17,221)	**(16,060)**	(16,920)

9. Derivative financial instruments

(a) Principles

The Group uses derivative financial instruments to manage risks related to its capital, assets and liabilities and its commitments to third parties. The Group, due to its multinational operations, has foreign currency exposure and, due to the long-term nature of some of its insurance reserves, has exposure to interest rate and reinvestment risks. The Group uses derivative financial instruments to mitigate the risks posed by changes in foreign exchange rates and interest rates. Therefore, derivative financial instruments are part of insurance, investment, asset-liability management, capital raising or cash management activities and must conform to the general guidelines of the Group for these activities, which are documented and reviewed for compliance by the Group. If the Group were required to settle outstanding derivative positions, the sum of gains and losses would not be material to the Group as of December 31, 2004.

Zurich Capital Markets ("ZCM") has a portfolio of derivative products for the benefit of its customers. ZCM does not engage in proprietary trading. ZCM's positions on derivative financial instruments are separately reported in subsection (d) of this note.

For interest rate caps, floors and swap transactions, forward and futures contracts and options written, only the potential market value of the instruments represents a credit risk to the Group. The Group controls the credit risk of its interest rate swap agreements and forward and futures contracts through credit approvals, limits and monitoring procedures.

To limit credit risk exposure derivative financial instruments are typically executed with counterparties rated A or better by Standard & Poor's. Wherever possible, efforts are undertaken to net the credit exposure with individual counterparties in compliance with applicable laws.

The term "contractual amount" is used for derivative financial instruments for which an exchange of the principal sum at maturity could take place, e.g. options, futures, currency swaps. The term "notional amount" describes instruments for which the principal sum is only notionally lent or borrowed, e.g. interest swaps, forward rate agreements (FRAs). The notional principal amounts are used to express the extent of the Group's involvement in derivative transactions. This standard measurement of the volume of derivative transactions is not a quantification of market risk or credit risk and it may not necessarily be recorded on the balance sheet.

(b) Derivative financial instruments used

Interest rate and currency swaps: Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount. Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating interest payments. Currency swaps, in their simplest form, are contractual agreements that involve the exchange of both periodic and final amounts in two different currencies. Exposure to loss on both types of swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest and foreign exchange rates, and the timing of payments. The Group uses currency swaps to manage the currency and interest rate risk of its debt issuances.

Interest rate futures, forwards and options contracts: Interest rate futures are exchange-traded instruments and represent commitments to purchase or sell a designated security or money market instrument at a specified future date and price. Interest rate forward agreements are traded over-the-counter ("OTC") where two parties agree on an interest rate and other terms that will become a reference point in determining, in concert with an agreed notional principal amount, a net payment to be made by one party to the other, depending on what rate in fact prevails at a future point in time. Interest rate options, which consist primarily of caps and floors, are interest rate protection instruments that involve the obligation of the seller to pay the buyer an interest rate differential in exchange for a premium paid by the buyer. This differential represents the difference between the current rate and an agreed rate applied to a notional amount. Exposure to loss on interest rate contracts will increase or decrease over their respective lives as interest rates fluctuate. For interest rate futures and exchange-traded options, the Group's exposure to off-balance sheet credit risk is limited, as these transactions are executed on organized exchanges that assume the obligation of the counterparty and generally require security deposits and daily settlement of margins.

Foreign exchange contracts: Foreign exchange contracts, which include spot, forward and futures contracts, represent agreements to exchange one currency for another currency at an agreed price and settlement date. Foreign exchange option contracts are similar to interest rate option contracts, except that they are based on currencies, rather than interest rates. Exposure to loss on these contracts will increase or decrease over their respective lives as currency exchange and interest rates fluctuate. For exchange-traded foreign exchange contracts, the Group's exposure to off-balance sheet credit risk is limited, as these transactions are executed on organized exchanges that assume the obligation of counterparties and generally require security deposits and daily settlement of margins.

(c) Outstanding positions of the Group (excluding ZCM)

Table 9.1
Maturity profile of notional principal amounts and market values of derivative financial instruments (excluding ZCM)

in USD millions, as of December 31	Remaining life Up to 1 year	1 to 5 years	over 5 years	Notional principal amounts 2004	2003	Market values 2004	2003
Swaps							
Interest rate swaps	–	158	135	**293**	1,052	**(30)**	(79)
Currency swaps	–	523	3,160	**3,683**	765	**306**	132
Total return equity swaps	1	2,663	2,524	**5,188**	5,324	**(249)**	(173)
Other swaps	–	178	–	**178**	–	**(1)**	–
Options							
Purchased call options	1,970	312	4	**2,286**	707	**23**	10
Purchased put options	–	1,173	–	**1,173**	1,893	**44**	43
Written call options	–	792	303	**1,095**	2,251	**(184)**	(146)
Written put options	–	–	–	**–**	245	**(4)**	(3)
Futures/forwards							
Purchased futures/forward contracts	6,375	–	–	**6,375**	8,863	**94**	54
Written futures/forward contracts	6	–	37	**43**	52	**(9)**	1
Total	8,352	5,799	6,163	**20,314**	21,152	**(10)**	(161)
of which:							
derivative trading asset						**560**	431
derivative trading liability						**(570)**	(592)

(d) Outstanding positions of Zurich Capital Markets ("ZCM")

ZCM's risk management model focused on controlling incremental risk and actively monitoring existing portfolio risk. Existing portfolio risk is monitored through a variety of quantitative measures including Value-at-Risk (VaR) and stress testing.

Table 9.2
Maturity profile of notional principal amounts and market values of derivative financial instruments (ZCM)
in USD millions, as of December 31

	Remaining life			Notional principal amounts		Market values	
	Up to 1 year	1 to 5 years	over 5 years	**2004**	2003	**2004**	2003
Swaps							
Interest rate swaps	2,107	3,286	5,295	**10,688**	12,507	**94**	11
Currency swaps	453	68	26	**547**	1,473	**(6)**	7
Total return equity swaps	21	–	67	**88**	313	**(26)**	(41)
Other swaps	–	–	–	**–**	105	**–**	(1)
Options							
Purchased call options	272	–	–	**272**	209	**272**	1,490
Purchased put options	198	446	797	**1,441**	1,497	**(28)**	59
Written call options	40	186	33	**259**	3,253	**(205)**	(1,248)
Written put options	181	521	1,520	**2,222**	2,342	**21**	(12)
Futures/forwards							
Purchased futures/forward contracts	420	–	–	**420**	1,360	**36**	70
Sold futures/forward contracts	443	–	–	**443**	1,333	**(24)**	(33)
Total	4,135	4,507	7,738	**16,380**	24,392	**134**	302
of which:							
derivative trading asset						**864**	2,152
derivative trading liability						**(730)**	(1,850)

10. Insurance benefits, losses and expenses

Table 10.1
Breakdown of insurance benefits, losses and expenses
in USD millions, for the years ended December 31

	Gross		Ceded		Net	
	2004	2003	**2004**	2003	**2004**	2003
Losses and loss adjustment expenses	**28,429**	25,196	**(4,959)**	(4,068)	**23,470**	21,128
Life insurance death and other benefits	**13,320**	10,672	**(278)**	(435)	**13,042**	10,237
(Decrease)/increase in future life policyholders' benefits	**(1,650)**	2,051	**(362)**	(157)	**(2,012)**	1,894
Total insurance benefits and losses	**40,099**	37,919	**(5,599)**	(4,660)	**34,500**	33,259
of which:						
Losses and loss adjustment expenses paid	**22,034**	21,260	**(4,519)**	(4,744)	**17,515**	16,516

Table 10.2
Breakdown of policyholder dividends and participation in profits
in USD millions, for the years ended December 31

	Gross		Ceded		Net	
	2004	2003	**2004**	2003	**2004**	2003
Total policyholder dividends and participation in profits	**7,013**	6,004	**1**	41	**7,014**	6,045

Table 10.3
Breakdown of underwriting and policy acquisition costs
in USD millions, for the years ended December 31

	Gross		Ceded		Net	
	2004	2003	**2004**	2003	**2004**	2003
Underwriting and policy acquisition costs	**8,496**	7,932	**(1,253)**	(1,487)	**7,243**	6,445

The impact of the adoption of SOP 03-01 is discussed in note 3.

11. Insurance reserves

Table 11.1
Insurance reserves
in USD millions, as of December 31

	2004	2003
Gross		
Reserves for losses and loss adjustment expenses	**57,813**	51,068
Reserves for unearned premiums	**14,234**	13,944
Future life policyholders' benefits	**88,856**	85,211
Policyholders' contract deposits and other funds	**24,168**	22,007
Reserves for unit-linked products	**61,091**	51,188
Total insurance reserves, gross	**246,162**	223,418
Ceded		
Reserves for losses and loss adjustment expenses	**(14,339)**	(14,055)
Reserves for unearned premiums	**(2,097)**	(2,157)
Future life policyholders' benefits	**(1,149)**	(875)
Policyholders' contract deposits and other funds	**(3,680)**	(3,799)
Reserves for unit-linked products	**–**	–
Total ceded reserves (reinsurers' share of insurance reserves)	**(21,265)**	(20,886)
Net		
Reserves for losses and loss adjustment expenses	**43,474**	37,013
Reserves for unearned premiums	**12,137**	11,787
Future life policyholders' benefits	**87,707**	84,336
Policyholders' contract deposits and other funds	**20,488**	18,208
Reserves for unit-linked products	**61,091**	51,188
Total insurance reserves, net	**224,897**	202,532

Reserves for unit-linked products relate to the implementation of SOP 03-01 as discussed in note 3.

Table 11.2
Development of reserves for losses and loss adjustment expenses
in USD millions

	2004	2003
As of January 1 (opening balance)		
Gross reserves for losses and loss adjustment expenses	**51,068**	45,306
Reinsurance recoverable	**(14,055)**	(14,940)
Net reserves for losses and loss adjustment expenses	**37,013**	30,366
Net losses and loss adjustment expenses incurred		
Current period	**21,506**	19,254
Prior years	**1,964**	1,874
Total	**23,470**	21,128
Net losses and loss adjustment expenses paid		
Current year	**(7,655)**	(7,593)
Prior years	**(9,860)**	(8,923)
Total	**(17,515)**	(16,516)
Divestments of companies and businesses	**(743)**	(291)
Foreign currency translation effects	**1,249**	2,326
As of December 31 (closing balance)		
Net reserves for losses and loss adjustment expenses	**43,474**	37,013
Reinsurance recoverable	**14,339**	14,055
Gross reserves for losses and loss adjustment expenses	**57,813**	51,068

The Group establishes loss reserves, which are 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, requiring the use of informed estimates and judgments. Any changes in estimates are reflected in the operating statements in the period in which estimates are changed.

Significant delays occur in the notification of claims and a substantial measure of experience and judgment is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty as of the balance sheet date. The reserves for losses and loss adjustment expenses are determined on the basis of information currently available; however, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent developments.

Deferred charges relating to retrospective reinsurance assumed totaling USD 182 million and USD 265 million as of December 31, 2004 and 2003, respectively, have been deducted from reserves for losses and loss adjustment expenses.

Table 11.3
Reserves for losses and loss adjustment expenses for asbestos and environmental claims
in USD millions

	2004		2003	
	Gross	**Net**	Gross	Net
Asbestos				
As of January 1 (opening balance)	**2,930**	**2,420**	2,572	2,030
Losses and loss adjustment expenses incurred	**497**	**433**	322	347
Losses and loss adjustment expenses paid	**(136)**	**(125)**	(156)	(114)
Divestments, commutations, settlements and other	**(410)**	**(297)**	1	1
Foreign currency translation effects	**83**	**93**	191	156
As of December 31 (closing balance)	**2,964**	**2,524**	2,930	2,420
Environmental				
As of January 1 (opening balance)	**703**	**559**	812	648
Losses and loss adjustment expenses incurred	**(55)**	**(50)**	(56)	(43)
Losses and loss adjustment expenses paid	**(91)**	**(61)**	(72)	(58)
Divestments, commutations, settlements and other	**(52)**	**(50)**	(1)	(1)
Foreign currency translation effects	**(5)**	**(3)**	20	13
As of December 31 (closing balance)	**500**	**395**	703	559

Management has considered environmental and latent injury claims and claims expenses in establishing the reserves for losses and loss adjustment expenses. The Group continues to be advised of claims asserting injuries from toxic waste, hazardous materials and other environmental pollutants and alleged damages to cover the clean-up costs of hazardous waste dumpsites relating to policies written in prior years and indemnity claims asserting injuries from asbestos. Coverage and claim settlement issues, such as determination that coverage exists and the definition of an occurrence, may cause the actual loss development to exhibit more variation than the remainder of the Group's book of business. Such claims cannot be estimated with traditional reserving techniques and, accordingly, the uncertainty with respect to the ultimate cost of these types of claims has been greater than the uncertainty relating to standard lines of business.

The uncertainties arise out of changes or potential changes in various laws or the interpretation of laws. While the Group believes that it has made adequate provision for these claims, it is possible that future adverse development could have a material effect on the Group's results of operations, cash flows and financial position. As of December 31, 2004 and 2003, the net reserve amounts related to these claims included above were USD 2,919 million and USD 2,979 million, respectively.

Table 11.4
Future life policyholders' benefits and policyholders' contract deposits and other funds (gross of reinsurance)
in USD millions, as of December 31

	2004	2003
Future life policyholders' benefits		
Long-duration contracts	**88,755**	85,119
Short-duration contracts	**101**	92
Total	**88,856**	85,211
Policyholders' contract deposits and other funds		
Annuities	**2,035**	1,953
Universal life and other investment contracts	**12,809**	12,461
Policyholder dividends	**9,324**	7,593
Total	**24,168**	22,007

Long-duration contract liabilities included in future life policyholders' benefits result primarily from traditional participating and non-participating life insurance products. Short-duration contract liabilities are primarily accident and health insurance products. The liability for future life policyholder benefits has been established based upon the following:
- Interest rates which vary by territory, year of issuance and product
- Mortality rates based on published mortality tables adjusted for actual experience by geographic area and modified to allow for variations in policy form
- Surrender rates based upon actual experience by geographic area and modified to allow for variations in policy form.

The amount of policyholder dividends to be paid is determined annually by each Group life insurance company. Policyholder dividends include life policyholders' share of net income and unrealized appreciation of investments that are required to be allocated by the insurance contract or by local insurance regulations. Experience adjustments relating to future policyholders' benefits and policyholders' contract deposits vary according to the type of contract and the territory. Investment, mortality and morbidity results may be passed through by experience credits or as an adjustment to the premium mechanism, subject to local regulatory provisions.

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 related to this change.

Guarantees arising from minimum death benefits ("GMDB"), retirement income benefits ("GRIB") and annuitization options ("GAO")

The Group sells products for which policyholders bear the full investment risk associated with the underlying invested funds selected by them. Certain of these products contain guarantees for which liabilities have been recorded for additional benefits and minimum guarantees, primarily in the subsidiary Kemper Investors Life Insurance Company which has written variable annuity contracts that provide annuitants with certain guarantees related to minimum death and income benefits. The determination of these liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates, annuitization elections and mortality experience. The assumptions used are consistent with those used in determining estimated gross profits for purposes of amortizing deferred policy acquisition costs.

The Group recorded provisions for certain guarantee features embedded in certain life insurance products for the first time as explained in note 3 on the implementation of SOP 03-01.

Table 11.5
Information on guarantee liabilities arising from minimum death benefits ("GMDB"), retirement income benefits ("GRIB") as well as annuitization options ("GAO")

in USD millions (except average age)	2004	2003
Account balance for products with guarantee features as of December 31		
Gross	**4,074**	3,757
Ceded	**(554)**	(537)
Net	**3,520**	3,220
Amount at risk as of December 31	**2004**	2003
Gross	**735**	740
Ceded	**(284)**	(277)
Net	**451**	463
Average attained age of policyholders (in years)	**61**	61

The Group's exposure after reinsurance recoveries under these policies at the balance sheet date as of December 31, 2004 would be USD 451 million (USD 463 million as of December 31, 2003). The Group believes the crystallization of such liability is not likely.

Development of net liability recorded for additional benefits	2004	2003
Balance as of January 1 (opening balance)	**53**	32
Benefits incurred	**30**	27
Benefits paid	**(5)**	(6)
Balance as of December 31 (closing balance)	**78**	53

12. Income taxes

Table 12.1
Income tax expense

in USD millions, for the years ended December 31	2004	2003
Current	**1,214**	874
Deferred	**(121)**	622
Total income tax expense	**1,093**	1,496

The Group, as a proxy for life insurance policyholders in the UK, is required to record taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK life insurance policyholder earnings is included in income tax expense. The tax expense attributable to UK policyholder earnings was USD 254 million and USD 36 million for the years ended December 31, 2004 and 2003, respectively. In addition, deferred income tax on unrealized investment gains on unit-linked contracts is included as income tax expense and an accrual for future policy fees that will cover the tax charge is included in gross written premiums and policy fees revenue. Income tax is shown before reduction for the element attributable to policyholders.

Table 12.2
Expected and actual income tax expense

in USD millions, for the years ended December 31	2004	2003
Expected income tax expense	**1,144**	1,166
Increase/(reduction) in taxes resulting from:		
Non-taxable income	**(398)**	(320)
Non-deductible expenses	**129**	122
Withholding, state and local taxes	**18**	(69)
Non-utilizable tax losses	**45**	509
Additional tax expense attributable to life insurance policyholder earnings	**154**	59
Other	**1**	29
Actual income tax expense	**1,093**	1,496

The table above illustrates the factors that cause the actual income tax expense to differ from the expected amount computed by applying the expected rate.

The expected weighted average tax rate for the Group was 30.2% and 32.3% for the years 2004 and 2003, respectively. These rates were derived by obtaining a weighted average of the applicable statutory income tax rate in relation to the operating income/loss generated in the main taxable territories in which the Group operates.

Table 12.3
Deferred income taxes

in USD millions, as of December 31	2004	2003
Deferred tax assets		
Reserves for losses and loss adjustment expenses	**632**	787
Reserves for unearned premiums	**374**	390
Accruals not currently deductible	**176**	160
Unrealized losses on investments	**14**	125
Depreciable and amortizable assets	**174**	87
Deferred front-end fees	**490**	423
Life policy reserves	**208**	229
Loss carryforwards	**1,550**	995
Other	**927**	874
Deferred tax assets, gross	**4,545**	4,070
Valuation allowance on deferred tax assets	**(345)**	(351)
Deferred tax assets, net of valuation allowance	**4,200**	3,719
Deferred tax liabilities		
Reserves for losses and loss adjustment expenses	**(716)**	(493)
Deferred policy acquisition costs	**(2,406)**	(2,079)
Unrealized gains on investments	**(527)**	(478)
Depreciable and amortizable assets	**(1,022)**	(1,134)
Life policy reserves	**(678)**	(490)
Insurance reserves for life insurance where the investment risk is carried by policyholders	**(232)**	(59)
Other	**(495)**	(717)
Deferred tax liabilities	**(6,076)**	(5,450)
Net deferred tax liabilities	**(1,876)**	(1,731)

The current income tax payable (net of income tax receivable) as of December 31, 2004 and December 31, 2003 was USD 971 million and USD 614 million, respectively.

As of December 31, 2004 and 2003, respectively, the Group had income tax loss carryforwards of USD 4,835 million and USD 3,251 million available (subject to various statutory restrictions) for use against future taxable income. Deferred tax assets for loss carryforwards of USD 3,300 million and USD 2,218 million were recognized as of December 31, 2004 and 2003, respectively. No deferred tax assets were recognized in respect of the remaining USD 1,535 million and USD 1,033 million as of December 31, 2004 and 2003, respectively. The majority of the income tax loss carryforwards expire after five years.

The Group's deferred tax assets and liabilities are recorded in the tax paying entities throughout the world, which may include several legal entities within each tax jurisdiction. Legal entities are grouped into a single taxpayer only when permitted by local legislation and when deemed appropriate.

The recoverability of the deferred tax asset of each taxpayer is based on its ability to utilize the deferred tax asset over a reasonable period of time. This analysis considers the projected taxable income to be generated by the taxpayer, as well as the ability to offset deferred tax assets with deferred tax liabilities. As of December 31, 2004, the following taxpayer groups carry a net deferred tax asset position on their balance sheets.

Table 12.4
Deferred tax assets by taxpayer group
in USD millions, as of December 31, 2004

	Gross deferred tax assets	Deferred tax assets, net of valuation allowance and other tax liabilities
Taxpayer groups		
North America Corporate group of companies	**1,444**	1,250
Centre group of companies	**555**	132
Zurich Capital Markets companies	**337**	–
UK General Insurance companies	**271**	116
Other	**204**	87

The North America Corporate group of companies has reported tax losses in three of the last four years, thus creating a significant net operating loss carryforward of approximately USD 2,280 million, which is utilizable over a 15 year period. In addition, revenue streams originated by the North America Corporate group of companies also support the recoverability of the Centre group of companies' deferred tax asset. Based on the current taxable income projections for the North America Corporate group of companies and the other taxpayer groups noted above, management believes that the carrying values of the deferred tax assets as of December 31, 2004 are fully recoverable.

13. Receivables

Table 13
Receivables
in USD millions, as of December 31

	2004	2003
Receivables from policyholders	**3,021**	2,634
Receivables from insurance companies, agents, brokers and intermediaries	**5,173**	5,565
Other receivables	**3,245**	3,164
Allowance for uncollectible amounts	**(278)**	(355)
Total	**11,161**	11,008

14. Reinsurance assets

Table 14
Reinsurance assets
in USD millions, as of December 31

	2004	2003
Reinsurers' share of insurance reserves	**21,265**	20,886
Receivable arising from ceded reinsurance	**2,112**	2,155
Allowance for uncollectible amounts	**(373)**	(371)
Total reinsurance assets	**23,004**	22,670

Ceded reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders. Thus, a credit exposure exists with respect to reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. The Group holds substantial collateral as security under related reinsurance agreements in the form of deposits, securities and/or letters of credit. As of December 31, 2004 and 2003, 44% and 41%, respectively, of total reinsurance assets were collateralized.

The life insurance operations limit exposure to loss on any single life policy. Retention limits vary by territory and product line. Approximately 6.3% and 6.7% of gross written premiums and policy fees were ceded as of December 31, 2004 and 2003, respectively, for life operations, and 19.8% and 23.3% for general insurance operations as of December 31, 2004 and 2003, respectively.

Net insurance reserves were USD 224,897 million and USD 202,532 million as of December 31, 2004 and 2003, respectively, after deducting the amount of reinsurance ceded to reinsurers.

15. Deferred policy acquisition costs

Table 15
Deferred policy acquisition costs
in USD millions

	General Insurance		Life Insurance		Other segments[1]		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
As of January 1 (opening balance)	**2,085**	1,895	**9,564**	8,788	**135**	179	**11,784**	10,862
Acquisition costs deferred and transfers	**2,226**	2,127	**1,571**	1,322	**(15)**	6	**3,782**	3,455
Amortization charged to income	**(2,117)**	(1,915)	**(606)**	(528)	**(42)**	(87)	**(2,765)**	(2,530)
Amortization charged to shareholders' equity	**–**	–	**(105)**	(16)	**4**	10	**(101)**	(6)
Divestments	**(14)**	(1)	**(73)**	(781)	**(1)**	–	**(88)**	(782)
Increase/(decrease) due to currency translation	**85**	(21)	**644**	779	**3**	27	**732**	785
As of December 31 (closing balance)	**2,265**	2,085	**10,995**	9,564	**84**	135	**13,344**	11,784

[1] Including eliminations of intersegment transactions.

16. Fixed assets

Table 16
Fixed assets
in USD millions, as of December 31

	2004	2003
Land held for own use	**457**	487
Buildings held for own use	**1,688**	1,820
Furniture and fixtures	**478**	558
Computer equipment	**747**	865
Other fixed assets	**644**	638
Total cost before depreciation	**4,014**	4,368
Less: accumulated depreciation	**(1,898)**	(2,062)
Total	**2,116**	2,306
Activity during the years ended December 31		
Carrying value as of January 1 (opening balance)	**2,306**	2,362
Additions, capital improvements and transfers	**239**	237
Disposals and transfers	**(316)**	(205)
Depreciation	**(247)**	(357)
Foreign currency translation effects	**134**	269
Carrying value as of December 31 (closing balance)	**2,116**	2,306

The fire insurance value of the Group's own-use real estate, investment real estate and further fixed assets totaled USD 10,160 million and USD 12,173 million as of December 31, 2004 and 2003, respectively.

17. Goodwill and other intangible assets

Table 17
Intangible assets
in USD millions

	Goodwill		**Present value of profits of acquired insurance contracts**		**Other intangible assets**		**Attorney-in-fact relationship**		**Total**	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
Carrying value as of January 1 (opening balance)	**779**	792	**1,025**	1,200	**702**	765	**1,067**	1,110	**3,573**	3,867
Additions and transfers	**47**	47	**–**	4	**135**	150	**–**	–	**182**	201
Disposals and transfers	**(31)**	(69)	**–**	(216)	**(22)**	(13)	**–**	–	**(53)**	(298)
Amortization	**(92)**	(107)	**(89)**	(63)	**(224)**	(223)	**(43)**	(43)	**(448)**	(436)
Foreign currency translation effects	**41**	116	**37**	100	**2**	23	**–**	–	**80**	239
Carrying value as of December 31 (closing balance)	**744**	779	**973**	1,025	**593**	702	**1,024**	1,067	**3,334**	3,573
Accumulated amortization as of December 31	**(598)**	(463)	**(1,334)**	(1,352)	**(1,197)**	(1,425)	**(685)**	(642)	**(3,814)**	(3,882)

18. Debt

Table 18.1
Debt
in USD millions, as of December 31

		2004	2003
a) Debt related to capital markets and banking activities			
Zurich Capital Markets	Commercial paper, due in the following year	**–**	2,113
	Notes and loans payable, due in the following year	**2,873**	2,855
	Notes and loans payable, due 2006–2014	**726**	546
	Notes and loans payable, due after 2014	**150**	150
Dunbar Bank	Short-term borrowings	**19**	136
Centre Solutions (Bermuda) Ltd.	Various debt instruments	**112**	161
Debt related to capital markets and banking activities		**3,880**	5,961
b) Senior debt			
Zurich Finance (USA), Inc.	2.75% CHF bond, due July 2006	**438**	403
	3.5% CHF bond, due July 2008	**263**	242
	4.5% EUR bond, due September 2014	**1,342**	–
Zurich International (Bermuda) Ltd.	Zero coupon CHF exchangeable bond, due July 2004	**–**	427
Kemper Corporation	Various debt instruments, due in 2009	**27**	27
Zurich Insurance Company	3.875% CHF bond, due July 2011	**880**	807
	Various borrowings and notes	**99**	94
Zurich Financial Services (UKISA)	Short-term bank borrowings	**–**	54
Other	Various short- and medium-term debt instruments	**306**	306
Senior debt		**3,355**	2,360
c) Subordinated debt			
Zurich Capital Trust I	8.376% USD Capital Securities, due June 2037	**1,000**	1,000
Zurich Finance (UK) p.l.c.	6.625% GBP bond, undated notes	**848**	795
Zurich Finance (USA), Inc.	5.75% EUR bond, due October 2023	**668**	620
Subordinated debt		**2,516**	2,415
Total senior and subordinated debt		**5,871**	4,775
Total debt		**9,751**	10,736

(a) Debt related to capital markets and banking activities

In 2003 a framework agreement was signed with BNP Paribas for the transfer of certain derivative transactions, credit facilities and related assets by Zurich Capital Markets (“ZCM”) to BNP Paribas. As of December 31, 2004, these transfers were completed and this contributed to a reduction of ZCM debt compared to December 31, 2003. In March 2004, all Commercial Paper outstanding under ZCM Matched Funding Corp.’s USD 2.5 billion US Commercial Paper Program matured and were fully repaid. As the program was not renewed, there were no amounts as of December 31, 2004.

As of December 31, 2004, the major part of ZCM’s debt comprised a number of structured notes, most of which carried floating rate coupons. The remainder consisted of fixed rate deposits with Zurich Bank.

Dunbar Bank p.l.c., a wholly-owned banking subsidiary of Allied Dunbar Assurance p.l.c., had total outstanding borrowings of GBP 10 million and GBP 76 million at December 31, 2004 and 2003, respectively. These short-term borrowings were drawn under various committed credit facilities totaling GBP 400 million and GBP 415 million as of December 31, 2004 and 2003, respectively. Net proceeds of these funds were used to finance Dunbar Bank’s lending activities.

(b) Senior debt

The Group has a Euro Medium Term Note Programme (EMTN Programme) which allows for the issuance of up to USD 4 billion of senior and subordinated notes. Issuing entities under the EMTN Programme include Zurich Finance (USA), Inc. and Zurich Finance (UK) p.l.c.

On September 17, 2004, Zurich Finance (USA), Inc. issued EUR 1 billion of 4.5% notes, due September 2014. The notes were issued under the EMTN Programme and are guaranteed by Zurich Insurance Company.

The zero coupon CHF 539 million exchangeable bond issued by Zurich International (Bermuda) Ltd. which was exchangeable into 4,800,000 registered shares of UBS AG and guaranteed by Zurich Insurance Company was due and repaid in July 2004. No exchange options were exercised over the whole term of the bond issue.

(c) Subordinated debt

The USD 1,000 million Capital Securities, issued by Zurich Capital Trust I, a wholly-owned subsidiary of Zurich Holding Company of America, will mature in 2037. The Group has the option at any time on or after June 1, 2007 to redeem the securities in whole or in part at a price of 104.188%, decreasing each year to a price of 100% on June 1, 2017.

The 6.625% GBP 450 million perpetual bond is callable in 2022 and the 5.75% EUR 500 million bond, maturing in 2023, is callable in 2013.

Table 18.2
Maturity schedule of outstanding debt

in USD millions	2004
2005	**3,008**
2006	**652**
2007	**612**
2008	**292**
after 2008	**5,187**
Total	**9,751**

Table 18.3
Interest expense on debt

in USD millions, for the years ended December 31	2004	2003
Debt related to capital markets and banking activities	**94**	160
Senior debt	**109**	150
Subordinated debt	**159**	135
Total	**362**	445

Loan facilities

On April 21, 2004, a USD 3 billion syndicated revolving credit facility was signed to replace the USD 1.5 billion facility, which was due to mature on May 28, 2004. The 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 facility and can draw up to USD 1.25 billion, USD 1.5 billion and USD 250 million, respectively. No borrowings were outstanding as of December 31, 2004. Farmers Group, Inc. cancelled their USD 250 million credit facility, which was due to mature in September 2004.

Eagle Star Holdings Ltd.'s GBP 400 million revolving credit facility matured on August 18, 2004.

Zurich Capital Markets' USD 1.27 billion syndicated revolving credit facility which was in place as of December 31, 2003 as a backstop for the USD 2.5 billion Commercial Paper Program mentioned above, was terminated as per March 12, 2004.

In addition, there are facilities in place for Dunbar Bank as mentioned above under (a) Debt related to capital markets and banking activities.

19. Other liabilities

Table 19
Other liabilities

in USD millions, as of December 31	2004	2003
Amounts due to reinsurers, agents and other insurance companies	**3,238**	3,264
Amounts due to life policyholders	**701**	551
Other payables	**6,584**	6,675
Tax payables	**1,834**	1,159
Derivative trading liabilities	**1,300**	2,442
Deferred income and other liabilities	**1,867**	1,890
Total	**15,524**	15,981

20. Minority interests

Table 20
Minority interests

in USD millions, as of December 31	2004	2003
Preferred securities	**407**	390
Other	**439**	579
Total	**846**	969

Minority interests include third-party equity interests, preferred securities and similar instruments issued by consolidated subsidiaries of the Group in connection with providing structured financial solutions to its customers.

In December 1999, Zurich Financial Services (Jersey) Limited, a subsidiary of Zurich Group Holding (formerly Zurich Financial Services), issued 12,000,000 perpetual non-voting, non-cumulative Series A Preference Shares on the Euromarket with a par value of EUR 25 (EUR 300,000,000). The securities benefit from a subordinated support agreement of Zurich Group Holding and carry a fixed coupon of 7.125%, payable quarterly. The securities are, subject to certain conditions, redeemable at the option of the issuer in whole, but not in part, from time to time on or after five years from the issue date. Proceeds from the issue were used to refinance existing intercompany debt and for general corporate purposes. With this issue, the Group was able to reinforce its capital base while raising equity-like but non-dilutive long-term funds.

As of December 31, 2004, and 2003, minority interests in Zurich Capital Markets ("ZCM") totaled USD nil million and USD 212 million, respectively. These minority interests primarily represented third-party equity interests in consolidated alternative investment vehicles arising from ZCM's managed asset business.

21. Shareholders' equity

Table 21.1
Common and treasury stock
number of shares, as of December 31

	2004	2003
Authorized, contingent and issued common stock, CHF 6.50 and CHF 9 par value, respectively	**156,988,783**	156,988,783
Issued common stock, CHF 6.50 and CHF 9 par value, respectively	**144,006,955**	144,006,955
Treasury stock	**298,113**	762,507

Table 21.2
Preferred securities
in USD millions, as of December 31

	2004	2003
Preferred securities, USD 1,000 par value	**1,125**	1,125

(a) Issued stock

At the Annual General Meeting of April 16, 2004, shareholders approved a share capital reduction in the form of a capital nominal value reduction of each registered share from CHF 9 to CHF 6.50. As a result of this reduction, the share capital was reduced by CHF 360,017,387.50 from CHF 1,296,062,595 to a new total of CHF 936,045,207.50. In the previous year, shareholders approved, at the Annual General Meeting of April 30, 2003, a share capital reduction in the form of a capital nominal value reduction of each registered share from CHF 10 to CHF 9. As a result of that reduction, the share capital was reduced by CHF 144,006,955 from CHF 1,440,069,550 to CHF 1,296,062,595.

As of December 31, 2004 and 2003, Zurich Financial Services had 144,006,955 shares of CHF 6.50 par value and CHF 9 par value, respectively, common stock issued and fully paid.

(b) Authorized stock

Until June 1, 2005, the Board of Zurich Financial Services is authorized to increase its share capital by an amount not exceeding CHF 39,000,000 by issuing up to 6,000,000 fully paid registered shares with a nominal value of CHF 6.50 each. An increase in partial amounts is permitted. The Board determines the date of issue of such new shares, the issue price, type of payment, conditions for exercising pre-emptive rights, and the beginning of the dividend entitlement. The Board may issue such new shares by means of a firm underwriting by a banking institution or syndicate with subsequent offer of those shares to the current shareholders. The Board may allow the expiry of pre-emptive rights which have not been exercised, or it may place these rights as well as shares, the pre-emptive rights of which have not been exercised, at market conditions.

The Board is further authorized to restrict or withdraw the pre-emptive rights of shareholders and to allocate them to third-parties if the shares are to be used: for the take-over of an enterprise, or parts of an enterprise or of participations or if issuing shares for the financing including re-financing of such transactions; or for the purpose of expanding the scope of shareholders in connection with the quotation of shares on foreign stock exchanges.

(c) Contingent stock

Capital market instruments and option rights to shareholders: The share capital of Zurich Financial Services may be increased by an amount not exceeding CHF 35,631,882 by issuing up to 5,481,828 fully paid registered shares with a nominal value of CHF 6.50 each (1) through the exercise of conversion and/or option rights which are granted in connection with the issuance of bonds or similar debt instruments by Zurich Financial Services or one of its Group companies in national or international capital markets and/or (2) by the exercise of option rights which are granted to the shareholders. When issuing bonds or similar debt instruments connected with conversion and/or option rights, the pre-emptive rights of the shareholders will be excluded. The current owners of conversion and/or option rights shall be entitled to subscribe for the new shares. The conversion and/or option conditions are to be determined by the Board.

The Board of Directors is authorized, when issuing bonds or similar debt instruments connected with conversion and/or option rights, to restrict or withdraw the right of shareholders for advance subscription in cases where such bonds are issued for the financing or re-financing of a takeover of an enterprise, of parts of an enterprise, or of participations. If the right for advance subscription is withdrawn by the Board, the convertible bond or warrant issues are to be offered at market conditions (including standard dilution protection provisions in accordance with market practice) and the new shares are issued at then current convertible bond or warrant issue conditions. The conversion rights may be exercisable during a maximum of 10 years and option rights for a maximum of seven years from the time of the respective issue. The conversion or option price or its calculation methodology shall be determined in accordance with market conditions, whereby for shares of Zurich Financial Services the quoted share price is to be used as a basis.

Employee participation: The share capital may be increased by an amount not exceeding CHF 9,750,000 by issuing up to 1,500,000 fully paid registered shares with a nominal value of CHF 6.50 each to employees of Zurich Financial Services and Group companies. The pre-emptive rights of the shareholders, as well as the right for advance subscription, are excluded. The issuance of shares or respective option rights to employees shall be subject to one or more regulations to be issued by the Board of Directors and taking into account performance, functions, levels of responsibility and criteria of profitability. Shares or option rights may be issued to the employees at a price lower than that quoted on the stock exchange.

(d) Preferred securities

In February 2001, the Group placed six series of Trust Capital Securities (Zurich RegCaPS) in the total amount of USD 1,125 million (USD 1,096 million net of issuance costs) with a limited number of qualified institutional and corporate US investors. The securities, which were issued under Rule 144A in the United States, are perpetual, non-cumulative and have a par value of USD 1,000 each. They have no voting rights, except for certain specified circumstances and are linked to Farmers Group, Inc. Class C shares. The Group has the option to call the securities after five, seven or ten years, depending on the series. Two series have a fixed rate coupon (6.01% and 6.58%) and four have a floating rate coupon (between Libor +46 bps and +71 bps). These coupon rates step up after the first call dates.

(e) Additional paid-in capital (capital reserve)

This reserve is not ordinarily available for distribution.

(f) Dividends

Dividends for Zurich Financial Services shares are declared in CHF.

(g) Dividend restrictions and capital and solvency requirements

Zurich Financial Services is not subject to legal restrictions on the amount of dividends it may pay to its shareholders other than under the Swiss Code of Obligations. The Swiss Code of Obligations provides that 5% of the annual profit must be allocated to the general legal reserve until such reserve in the aggregate has reached 20% of the paid-in share capital. As of December 31, 2004, the amount of the general legal reserve exceeded 20% of the paid-in share capital of Zurich Financial Services. Similarly, the company laws of many countries in which Zurich Financial Services' subsidiaries operate may restrict the amount of dividends payable by such subsidiaries to their parent companies.

Other than by operation of the restrictions mentioned above, the ability of Zurich Financial Services' subsidiaries to pay dividends may be restricted or, while dividend payments per se may be legally permitted, may be indirectly influenced by minimum capital and solvency requirements that are imposed by insurance, bank and other regulators in the countries in which the subsidiaries operate as well as by other limitations existing in certain of these countries (e.g. foreign exchange control restrictions).

In the United States, restrictions on payment of dividends may be imposed by the insurance laws or regulations of an insurer's state of domicile. For general insurance subsidiaries, dividends are generally limited over a twelve month period to 10% of the previous year's policyholders' surplus or previous year's net income. For life, accident and health insurance subsidiaries, dividends are generally limited over a twelve month period to 10% of the previous year's policyholders' surplus or the previous year's net gain from operations. Dividends paid in excess of statutory limitations require prior approval of the Insurance Commissioner of the insurer's state of domicile.

Insurance enterprises in European Union member countries are required to maintain minimum solvency margins. The required minimum solvency margin for general insurers is the greater of 16% of premiums written for the year or 23% of a three-year average of claims, subject to the first tranche (EUR 50 million) of premiums being at 18% and the first tranche (EUR 35 million) of claims at 26%. Life insurance companies are required to maintain a minimum solvency margin of generally 4% of insurance reserves (up to 1% of "insurance reserves for life insurance where the investment risk is carried by policyholders") plus 0.3% of the amount at risk under insurance policies. The same minimum capital requirements are applicable for insurance enterprises operating in Switzerland. In addition, in certain European countries further requirements may apply.

Zurich Financial Services is further subject to certain solvency and its own fund requirements based on a Decree on the Consolidated Supervision of the Zurich Financial Services Group issued by the Swiss Federal Office of Private Insurance on April 23, 2001.

As of December 31, 2004, the subsidiaries were substantially in compliance with applicable regulatory capital adequacy requirements.

(h) Earnings per share

Table 21.3
Earnings per share

	Net income (in USD millions)	Number of shares	Per share (USD)	Per share (CHF)[1]
2004				
Basic earnings per share	**2,587**	**143,577,437**	**18.01**	**22.34**
Effect of potentially dilutive shares related to share-based compensation plans	**–**	**1,067,047**	**(0.13)**	**(0.16)**
Diluted earnings per share	**2,587**	**144,644,484**	**17.88**	**22.18**
2003				
Basic earnings per share	2,009	142,064,985	14.14	19.00
Effect of potentially dilutive shares related to share-based compensation plans	–	1,025,296	(0.10)	(0.14)
Diluted earnings per share	2,009	143,090,281	14.04	18.86

[1] The translation from USD into CHF has been done for information purposes only at the Group's average exchange rates for the years ended December 31, 2004 and 2003, respectively.

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period, excluding the weighted average number of shares held as treasury shares. Diluted earnings per share reflects the effect of potentially dilutive shares.

22. Employee benefits

The Group had 53,246 and 58,667 employees (full time equivalents) as of December 31, 2004 and 2003, respectively. Personnel and other related costs incurred for 2004 and 2003 were USD 4,462 million and USD 4,702 million, respectively.

The Group operates a number of active retirement benefit arrangements for pensions. The majority of employees belong to defined benefit plans. Other employees participate in defined contribution plans providing benefits equal solely to contributions paid plus investment returns.

The Group also operates post-employment plans, which provide employees with certain defined post-employment benefits other than pensions; the major plans are in the United States.

The summary of the status of the defined benefit plans and other defined post-employment benefits is given below.

(a) Defined benefit plans

Defined benefit pension plans: Employees of the Group's operating companies are covered under various pension plans. Certain companies run defined benefit plans, some of which provide benefits related to final pensionable earnings and others provide cash balance plans, where the participants receive the benefit of annual contributions and a credit for the investment return achieved on the assets. Eligibility for participation in the various plans is either based on completion of a specified period of continuous service or date of hire. Benefits are generally based on the employees' years of credited service and average compensation in the years preceding retirement. Annual funding requirements are determined based on actuarial cost methods.

Most of the Group's defined benefit plans are funded through the Group making contributions to trusts or foundations independent of the Group's finances. In these cases, the annual funding requirements are determined in accordance with local funding and actuarial cost methods. Where plans are not specifically funded, for example, as is usual in the case of pension plans in Germany, a liability for the accrued pension obligations is recognized in the Group's balance sheet.

Other defined post-employment benefits: Certain of the Group's operating companies provide a post-employment benefit program for medical care and life insurance. Eligibility in the various plans is generally based on completing a specified period of eligible service and reaching a specified age. The programs pay a stated percentage of medical expenses reduced by deductibles and other coverage. The cost of post-employment benefits is accrued during the employees' service period. The method of accounting and the frequency of valuations are similar to those for defined benefit pension plans.

Table 22.1
Weighted average assumptions used in determining the actuarial liabilities
as of December 31

	Defined benefit pension plans		**Other defined post-employment benefits**	
	2004	2003	**2004**	2003
Discount rate	**5.1%**	5.3%	**5.7%**	5.7%
Expected long-term rate of return on assets	**6.1%**	6.1%	**5.0%**	6.6%
Future salary increases	**3.8%**	3.8%	**3.7%**	4.1%
Future pension increases	**2.3%**	1.7%	**–**	–
Increase in long-term health cost	**–**	–	**9.5%**	9.3%

Table 22.2
Status of funded defined benefit plans
in USD millions, as of December 31

	Defined benefit pension plans		Other defined post-employment benefits	
	2004	2003	**2004**	2003
Present value of obligations	**(10,640)**	(8,562)	**(104)**	(108)
Fair value of plan assets	**8,451**	7,256	**17**	22
Funded status	**(2,189)**	(1,306)	**(87)**	(86)
Unrecognized net actuarial losses	**2,457**	1,708	**20**	27
Asset/(liability) as of December 31	**268**	402	**(67)**	(59)

The funded status discloses the balance of pension plan assets at current fair values less the pension liability at current conditions. Pensions, however, are long-term by nature. Short-term variations between long-term actuarial assumptions and actual experience may be positive or negative, i.e. resulting in actuarial gains or losses. In principle, such actuarial gains or losses are not recognized under IAS 19 as it is expected that such actuarial gains and losses will equalize over time. Only unrecognized actuarial gains or losses exceeding certain "corridors" as defined in IAS 19 are amortized through the operating statement (see table 22.4 below, "Net actuarial losses recognized in year").

The funded status of the Group's funded defined benefit plans moved from a deficit of USD 1,306 million as of December 31, 2003 to a deficit of USD 2,189 million as of December 31, 2004. Pension plans in the UKISA region accounted for substantially all of the movement in the balances. The increase in the present value of the pension obligations in UKISA, which increased greater proportionally than the fair value of plan assets thus impacting the funded status, is due to changes in actuarial assumptions about future pension benefits. The funded status was further impacted by the pension contribution holiday in the UK which continued in 2004, during which time pension assets of approximately USD 140 million were liquidated to pay benefits without new contributions added to plan assets. Foreign exchange movements also had a total impact on the funded status of the Group's funded defined benefit plans in Switzerland and the UKISA region of approximately USD 72 million.

Table 22.3
Status of unfunded defined benefit plans
in USD millions, as of December 31

	Defined benefit pension plans		Other defined post-employment benefits	
	2004	2003	**2004**	2003
Present value of obligations	**(894)**	(775)	**(224)**	(199)
Unrecognized net actuarial losses	**55**	5	**66**	63
Unrecognized prior service cost	**–**	–	**(1)**	(2)
Liability as of December 31	**(839)**	(770)	**(159)**	(138)

The summary of the amounts recognized in the consolidated operating statements is given below.

Table 22.4
Components of net periodic expenses
in USD millions, for the years ended December 31

	Defined benefit pension plans		Other defined post-employment benefits	
	2004	2003	**2004**	2003
Current service cost	**(351)**	(332)	**(8)**	(5)
Interest cost	**(520)**	(460)	**(17)**	(13)
Expected return on plan assets	**475**	417	**1**	1
Net actuarial losses recognized in year	**(106)**	(137)	**(5)**	(2)
Past service cost	**(11)**	(1)	**–**	(2)
Gains on curtailment or settlement	**15**	13	**–**	–
Net periodic pension expense	**(498)**	(500)	**(29)**	(21)

The actual returns on defined benefit pension plan assets for the years ended December 31, 2004 and 2003 were USD 637 million and USD 778 million, respectively. The actual returns on other defined post-employment plan assets were USD nil million and USD 1 million for the years ended December 31, 2004 and 2003, respectively.

The summary of the balance sheet movements in relation to defined benefit plans and other defined post-employment benefits is given below.

Table 22.5
Summary of balance sheet movements
in USD millions

	Defined benefit pension plans		Other defined post-employment benefits	
	2004	2003	**2004**	2003
Liability as of January 1 (opening balance)	**(368)**	(182)	**(197)**	(186)
Current year expense	**(498)**	(500)	**(29)**	(21)
Contributions paid	**303**	381	**6**	4
Divestments	**24**	18	**–**	13
Foreign currency translation effects	**(32)**	(85)	**(6)**	(7)
Liability in the consolidated balance sheets as of December 31 (closing balance)	**(571)**	(368)	**(226)**	(197)

(b) Defined contribution pension plans

Certain of the Group's operating companies sponsor various defined contribution plans. Eligibility for participation in the various plans is either based on completion of a specified period of continuous service or date of hire. The plans provide for voluntary contributions by employees and contributions by employer which typically range from 3% to 15% of annual salaries, depending on the employees' years of service. The Group's contributions under these plans amounted to USD 13 million and USD 12 million in 2004 and 2003, respectively.

23. Share-based compensation and cash incentive plans

The Group has adopted various share-based compensation and cash incentive plans to attract, retain and motivate executives and employees. The plans are designed to reward employees for their contribution to the performance of the Group and to encourage employee share ownership. Share-based compensation plans include plans under which shares and options to purchase shares, based on the performance of the businesses, are awarded. Share-based plans are based on the provision of Zurich Financial Services shares.

(a) Cash incentive plans

Various businesses throughout the Group operate short-term incentive programs for executives, management and, in some cases, for employees of that business unit. Awards are made in cash, based on the accomplishment of both organizational and individual performance objectives. The expenses recognized for these cash incentive plans amounted to USD 242 million and USD 213 million for the years ended December 31, 2004 and 2003, respectively.

(b) Share-based compensation plans for employees

The Group encourages employees to own shares of Zurich Financial Services and has set up a framework based on the implementation of either share options and/or performance share programs. Actual plans are tailored to meet local market requirements.

Table 23.1

Expenses recognized in the operating statements

in USD millions, for the years ended December 31	**2004**	2003
Total option-based expenses	**23**	10
Total share-based expenses	**45**	41
Total expenses	**68**	51

The explanations below give a more detailed overview of the plans of the Group.

Share option plans for UK employees

UK Sharesave Plan: The plan is open to employees in the United Kingdom. Participants enter into a savings contract with a bank for the accumulation of contributions of between GBP 5 and GBP 250 per month for a period of three or five years. An interest bonus is credited at the end of the savings period. Participants are granted options to acquire Zurich Financial Services shares at a pre-determined price, which is not less than 80% of the market price prior to grant. Options under the plan can normally be exercised for a period of six months after the end of the savings period. Early exercise, limited to the value of shares that can be acquired with accrued savings, is permitted in certain circumstances. There were a total of 2,409 and 3,303 participants in this plan as of December 31, 2004 and 2003, respectively. The first grants were made in March 1999.

Allied Dunbar Share Option Plan: Inland Revenue unapproved share options were granted to selected managers and franchisees in the United Kingdom. Vesting is over a maximum five-year period with an exercise period of six months after vesting occurs. Participants have the right to acquire Zurich Financial Services shares at the exercise price determined at the day of grant. The first grants were made in February 2000 and based on performance achievements, additional grants were made in 2002, 2003 and 2004. All grants under this plan vested on December 31, 2004. There were a total of 492 and 1,232 participants in this plan as of December 31, 2004 and 2003, respectively.

Employee share plans

Share Incentive Plan for employees in the UK: In June 2003, the Group established an Inland Revenue approved Share Incentive Plan and launched the partnership shares element of this plan. This plan enabled participating employees to make monthly purchases of Zurich Financial Services shares at the ruling market price out of their gross earnings. There were 500 and 507 participants in the plan as of December 31, 2004 and 2003 respectively. The Group also launched reward shares, the profit-sharing element of the Share Incentive Plan in March 2004 with share allocations being made in May 2004. The awards were based on the performance of the participating employee's business units for the year, subject to a maximum award of 5% of participant's base salary (before any flexible benefit adjustments) or GBP 3,000. The total number of participating employees as of December 31, 2004, was 6,149.

Share Incentive Plans for employees in Switzerland: In 2004, a new Employee Incentive Plan was introduced for employees in Switzerland that combined the features of the annual cash-based incentive plan and the previous employee performance share plan. Under this new plan employees who receive an incentive payment under the Employee Incentive Plan have the option to acquire sales-restricted shares at a 30% discount on the market value, with the maximum value of the discount being CHF 1,500. During 2004, 6,115 employees participated in the Employee Incentive Plan. As of December 31, 2004, 4,613 employees received shares under the 2003 employee performance share plan.

(c) Share based compensation plans for executives

The Group operates long-term incentive plans for selected executives. These plans comprise the allocation of a target number of share options grants and/or shares grants with the vesting of these option/share grants being subject to the achievement of specific financial performance goals. The Group can also make Restricted Share grants to selected employees, which provide share awards if the individual remains employed with the Group on selected dates in the future.

Senior executive Group long-term incentive plans
Senior Executives are granted annually performance options and performance shares which vest on an annual basis over the subsequent three year period. The actual level of vesting, which can be between 0% and 150% of the original number granted, depends on the performance of the Group during the previous calendar year. The current performance metrics are the Group's return on equity (ROE) and the positioning of the Group's total shareholder return against an international peer group of insurance companies. One-half of the shares that actually vest are sales-restricted/deferred for a further period of three years. The options have a seven-year term from the date of grant. Grants under the plan are made annually on April 3. The actual number of performance options and performance shares granted is determined such that the economic value is a defined percentage of the annual salary in the year of allocation. During 2004 and 2003, a total of 186 and 184 participants were granted shares and options under this plan.

Executive long-term performance share plans
Selected executives are granted annually performance shares which vest over a period of three years, either on an annual basis or at the end of the three-year period. Specific performance parameters are established for each of the business divisions and include, for example, return on equity or business operating profit objectives. The actual number of performance shares granted at the beginning of the performance period is determined such that the economic value is defined percentage of the annual salary in the year of allocation. Actual awards under these plans are made fully in shares of Zurich Financial Services, of which 50% are sales-restricted/deferred for a further period of three years. There were a total of 535 and 497 participants in this plan as of December 31, 2004 and 2003, respectively.

(d) Further information on share and option plans

Table 23.2
Movements in options granted under the various equity participation plans

	Number of shares under option		Weighted average exercise price[1] (in CHF)	
	2004	2003	**2004**	2003
Outstanding as of January 1	**1,795,120**	1,554,177	**340**	445
Options granted	**477,022**	597,894	**202**	121
Options forfeited	**(260,671)**	(356,951)	**397**	435
Options exercised	**(24,692)**	–	**121**	n/a
Expired during period	**(111,763)**	–	**405**	n/a
Outstanding as of December 31	**1,875,016**	1,795,120	**297**	340
Exercisable as of December 31	**693,892**	138,004	**407**	698

[1] Only fixed exercise prices were applied.

As certain plan participants elected in 2002 to take their option award in the form of Share Appreciation Rights, the above table includes in the number of shares under option, outstanding as of December 31, 2004, 77,234 shares under option which will be settled through cash payments rather than through actual shares.

The average share price for Zurich Financial Services shares in 2004 and 2003 was CHF 188.76 and CHF 154.65, respectively.

Table 23.3
Range of exercise prices of options outstanding as of December 31, 2004
in CHF

	Weighted average contractual life in years	Weighted average remaining expected life in years
100– 400	**6.8**	**5.2**
401– 700	**6.5**	**2.2**
701–1,000	**6.7**	**1.0**

Table 23.4
Options and shares granted during the period

	Number		Weighted average fair value at grant date (in CHF)	
	2004	2003	**2004**	2003
Shares granted during the period	**384,420**	530,341	**213**	121
Options granted during the period[1]	**477,022**	597,894	**67**	47

[1] Number of options granted is shown as the number of shares under option granted during the period.

Additional information
The shares and options granted during the period are the target allocations made under the performance option and the performance share plans together with any restricted share awards granted during the year. Whether these grants become vested or not will depend upon whether the performance achievements are met and the expense is then adjusted accordingly.

The fair value of the options granted to senior executives is estimated using the Black-Scholes option pricing model, with the following assumptions.

Table 23.5

Black-Scholes assumptions	2004	2003
Share price	**CHF 213.25**	CHF 120.50
Exercise price	**CHF 213.25**	CHF 120.50
Implied volatility	**31.75%**	41.00%
Risk-free interest rate	**2.47%**	2.34%
Expected dividend rate	**1.50%**	1.50%
Contracted option life	**7 years**	7 years

The risk-free interest rate was determined by using the seven year CHF swap rate for 2004 and 2003, respectively. The fair value of any other share options granted during the year has been determined using the same methodology.

24. Related party transactions

In the normal course of business, the Group enters into various transactions with related companies, including various reinsurance and cost-sharing arrangements. These transactions are not considered material to the Group, either individually or in the aggregate. Parties are considered to be related if one party has the ability to control or exercise significant influence over the other party in making financial or operational decisions. The table below sets forth related party transactions reflected in the consolidated balance sheets and consolidated operating statements.

Table 24

Related party transactions

in USD millions	2004	2003
Consolidated operating statements for the years ended December 31		
Net earned premiums and policy fees	**7**	1
Net investment income	**105**	96
Other income/(expense)	**(9)**	11
Losses and loss adjustment expenses	**(11)**	(7)
Consolidated balance sheets as of December 31		
Policyholders' collateral and other loans	**23**	32
Reinsurance assets	**1**	4
Other receivables	**2**	11
Reserves for losses and loss adjustment expenses	**(4)**	(4)

Outstanding loans and guarantees granted to members of the Group Executive Committee amounted to USD 3 million for both years ended December 31, 2004 and 2003. No outstanding loans or guarantees were granted to directors of Zurich Financial Services for either of the years ended December 31, 2004 and 2003. The term "directors" and "members of the Group Executive Committee" in this context includes the individual as well as members of their respective households. Remuneration paid to the members of the Board of Directors of Zurich Financial Services in 2004 and 2003 were USD 2.0 million and USD 1.9 million, respectively.

25. Farmers Exchanges

Farmers Group, Inc. and its subsidiaries ("FGI") provide certain non-claims related management services to the Farmers Exchanges. In addition, the Group has the following relationships with the Farmers Exchanges.

Certificates of contribution and surplus notes of the Farmers Exchanges

As of December 31, 2004 and 2003, FGI and other Group companies held the following surplus note and certificates of contribution of the Farmers Exchanges. Originally these were purchased by FGI in order to supplement the policyholders' surplus of the Farmers Exchanges.

in USD millions	2004	2003
6.15% surplus note, due December 2013 (in 2003: 8.5%, due February 2005)	**88**	88
6.15% certificates of contribution, due December 2013	**524**	–
6.15% certificates of contribution, due August 2014 (in 2003: 7.85%, due March 2010)	**296**	370
6.00% certificates of contribution, due September 2006	**107**	557
Various other certificates of contribution	**23**	23

Conditions governing payment of interest and repayment of principal are outlined in the certificates of contribution and the surplus note. Generally, repayment of principal may be made only when the issuer has an appropriate amount of surplus, and then only after approval is granted by the issuer's governing Board and the appropriate state insurance regulatory department. In addition, payment of interest may generally be made only when the issuer has an appropriate amount of surplus and then only after approval is granted by the appropriate state insurance regulatory department.

Quota share reinsurance treaties with the Farmers Exchanges

The Farmers Exchanges have Quota Share reinsurance treaties with Farmers Reinsurance Company ("Farmers Re"), a wholly owned subsidiary of FGI, and Zurich Insurance Company ("ZIC").

With effect from January 1, 2004, Farmers Re assumes annually USD 200 million (USD 200 million in 2003) and ZIC assumes USD 800 million (USD 1,200 million in 2003) of gross written premiums under an Auto Physical Damage ("APD") Quota Share reinsurance agreement with the Farmers Exchanges.

Effective December 31, 2002, Farmers Re and ZIC entered into a 10% All Lines Quota Share reinsurance treaty with the Farmers Exchanges under which each reinsured a percentage of all lines of business written by the Farmers Exchanges. Under this treaty, Farmers Re assumes a 2% quota share of the premiums written and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges (ZIC reinsures 8% under this agreement after the APD reinsurance treaty has been applied). Losses assumed are subject to a maximum combined ratio of 112.5% (except in Texas where they are subject to a combined ratio of 116.2%) as well as USD 800 million of catastrophe losses and a minimum combined ratio of 93.5%. The reinsurance agreement, which can be terminated after 60 days notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 22% of premiums for acquisition expenses and 14.1% of premiums for other expenses with additional experience commissions that depend on loss experience. As of December 31, 2004, this All Lines Quota Share reinsurance treaty was increased from 10% to 12%.

For the year ended December 31, 2004, Group companies assumed USD 1,269 million of gross written premiums (USD 1,056 million in the prior year) from the Farmers Exchanges under this treaty.

In addition, effective December 31, 2002, Farmers Re and ZIC entered into a 20% Personal Lines Auto Quota Share reinsurance treaty with the Farmers Exchanges under which each reinsured a percentage of the personal lines auto business written by the Farmers Exchanges. Under this treaty, Farmers Re assumes a 4% quota share of the premiums written and the ultimate net losses sustained in the personal lines auto liability and physical damage lines written by the Farmers Exchanges after all other reinsurance treaties are applied (ZIC reinsures 16% under this agreement). Losses assumed are subject to a maximum combined ratio of 112.5% as well as USD 150 million of catastrophe losses and a minimum combined ratio of 97.0%. The reinsurance agreement, which can be terminated after 60 days notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 20% of premiums for acquisition expenses and 17.2% of premiums for other expenses with additional experience commissions that depend on loss experience.

For the year ended December 31, 2004, Group companies assumed USD 859 million of gross written premiums (USD 1,019 million in the prior year) from the Farmers Exchanges under this treaty.

Effective December 31, 2004, this 20% Personal Lines Auto Quota Share reinsurance treaty was cancelled and unearned premiums (USD 338 million) net of acquisition costs (USD 68 million) were transferred to the Farmers Exchanges.

26. Commitments and contingencies

The Group has provided guarantees or commitments to external parties, associates, partnerships and joint ventures. These arrangements include commitments under certain conditions to make liquidity advances to cover delinquent principal and interest payments, make capital contributions or provide equity financing.

Table 26.1
Quantifiable commitments and contingencies

in USD millions, as of December 31	**2004**	2003
Commitments under investment agreements	**3,642**	3,638
Less funded	**(2,785)**	(2,349)
Remaining commitments under investment agreements	**857**	1,289
Guarantees[1], surety bonds, letters of credit	**3,168**	2,824
Future rent commitments	**1,619**	1,673
Undrawn loan commitments (capital markets and banking activities)	**570**	1,577
Other commitments and contingent liabilities	**271**	1,082

[1] Guarantee features embedded in life insurance products are not included. For such guarantee features refer to note 11, insurance reserves.

Commitments under investment agreements

The Group has committed to contribute capital to subsidiaries, associates and third parties that engage in making investments in direct private equity, private equity funds, emerging market funds and hedge funds. Included in the remaining commitments is USD 473 million to Capital Z Investments II, L.P., USD 167 million to Capital Z Investments, L.P. and USD 116 million to Gresham. Part of these commitments may be called at any time and in any amount, based on various criteria. The remaining commitments also include a minimum allocation for hedge fund investments.

Guarantees, surety bonds, letters of credit

The Group knows of no event of default that would require it to satisfy guarantees. Irrevocable letters of credit and surety bonds were issued to secure certain reinsurance contracts.

Future rent commitments

The Group has entered into various operating leases as lessee for office space and certain computer and other equipment. Rent expenses for these items totaled USD 190 million and USD 197 million for the years ended December 31, 2004 and 2003, respectively.

Table 26.2
Future payments under non-cancellable operating leases with terms in excess of one year
in USD millions

	Rental payments
2005	205
2006	186
2007	172
2008	157
2009	136
2010 and thereafter	763
Total	**1,619**

The Group also leases its real estate held for investment to outside parties under operating leases.

Indemnity agreements

The Group, through certain of its subsidiaries, has agreed to arrangements that cap Converium's net exposure for losses arising out of the September 11, 2001 event at USD 289 million. Additionally, the Group has provided Converium with coverage for net losses in excess of USD 59 million, including non-performance of the retrocessionaire, related to Amerisafe business ceded to the Unicover pool. As of December 31, 2004, the Group has recorded provisions in respect of both arrangements of USD 162 million and USD 13 million, respectively.

Pledged assets

Total assets pledged including securities pledged in respect of securities repurchase agreements amounted to USD 5,048 million and USD 4,133 million as of December 31, 2004 and December 31, 2003, respectively. Assets pledged were financial assets.

Other contingent liabilities

The Group has received notices from various tax authorities asserting deficiencies in taxes for various years. The Group believes that it has meritorious legal defenses to those claims and believes that the ultimate outcome of the cases will not result in a material impact on the Group's consolidated results of operation or financial position.

In common with other groups with life assurance businesses in the UK, the Group remains exposed to a number of Conduct of Business issues which are currently under review by the UK Financial Services Authority. While provisions are maintained which reflect management's evolving best estimate of the probable costs and expenses of resolving these matters, significant uncertainty regarding the ultimate costs remains. The main area of uncertainty concerns sales advice related complaints. The key assumptions used to derive the complaint provision are the volume of complaints, both those already recorded and an assumption as to the future complaint levels, the percentage of complaints which will be successful (the uphold rate), the average redress payable per complaint and the expenses of reviewing each case or complaint. The assumptions used to set the provision have been based on actual experience over the past three years weighted towards more recent experience.

In 2003, the Group completed the divestments of various asset management operations. As part of these agreements, the Group has guaranteed certain minimum levels of "assets under management" to the acquirers. The guarantees provide that if the "assets under management" fall below those defined levels under certain conditions, the Group may be required to compensate for these shortfalls. The compensation is limited to the considerations received and the Group does not believe any such compensation to be probable.

Litigation

The Group and its subsidiaries are continuously involved in legal proceedings, claims and litigation arising, for the most part, in the ordinary course of its business operations. The Group and its subsidiaries are also involved in a number of regulatory investigations. These investigations involve certain business practices between insurance brokers and insurance companies, the purchase and sale of "non-traditional" products, certain reinsurance transactions engaged in by the Group and its subsidiaries and other matters. The Group has been conducting its own internal reviews with respect to these matters and is cooperating fully in these investigations.

The outcome of such current legal proceedings, claims, litigation and investigations could have a material effect on operating results and/or cash flows when resolved in a future period. However, in the opinion of management these matters would not materially affect the Group's consolidated financial position.

27. Segment information

Table 27.1
Operating statements by business segment
in USD millions, for the years ended December 31

	General Insurance		Life Insurance	
	2004	2003	**2004**	2003
Revenues				
Direct written premiums and policy fees	**32,838**	30,944	**10,876**	11,547
Assumed written premiums	**4,800**	5,306	**103**	78
Gross written premiums and policy fees	**37,638**	36,250	**10,979**	11,625
Less premiums ceded to reinsurers	**(7,440)**	(8,460)	**(695)**	(777)
Net written premiums and policy fees	**30,198**	27,790	**10,284**	10,848
Net change in reserves for unearned premiums	**(38)**	(652)	**3**	35
Net earned premiums and policy fees	**30,160**	27,138	**10,287**	10,883
Management fees	**–**	–	**17**	156
Net investment income	**2,425**	1,952	**6,224**	5,883
Net capital gains on investments and impairments	**87**	278	**4,525**	4,380
Net gain/(loss) on divestments of businesses	**(34)**	(89)	**37**	427
Other income	**517**	451	**853**	861
Total revenues	**33,155**	29,730	**21,943**	22,590
Intersegment transactions	**(361)**	(227)	**(369)**	7
Benefits, losses and expenses				
Losses and loss adjustment expenses, net of reinsurance	**23,249**	19,617	**89**	76
Life insurance death and other benefits, net of reinsurance	**118**	206	**12,166**	9,303
(Decrease)/increase in future life policyholders' benefits, net of reinsurance	**9**	8	**(2,075)**	1,820
Insurance benefits and losses, net of reinsurance	**23,376**	19,831	**10,180**	11,199
Policyholder dividends and participation in profits, net of reinsurance	**9**	11	**6,754**	5,861
Underwriting and policy acquisition costs, net of reinsurance	**5,361**	4,715	**1,361**	1,271
Administrative and other operating expenses	**2,557**	2,403	**1,243**	1,528
Amortization of intangible assets	**106**	101	**230**	176
Interest expense on debt	**138**	187	**33**	49
Interest credited to policyholders and other interest	**150**	118	**755**	885
Total benefits, losses and expenses	**31,697**	27,366	**20,556**	20,969
Net income/(loss) before income taxes and minority interests	**1,458**	2,364	**1,387**	1,621
Net income/(loss)	**1,427**	1,779	**873**	1,148
Supplementary segment information				
Losses and loss adjustment expenses paid, net	**16,639**	15,184	**92**	94
Purchases of fixed and intangible assets	**83**	161	**153**	92
Significant non-cash expenses:				
Depreciation and impairments of fixed assets	**101**	171	**68**	101
Amortization and impairments of intangible assets	**106**	101	**230**	176

Farmers Management Services		Other Businesses		Corporate Center		Eliminations		Total	
2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
–	–	**452**	224	**16**	32	**13**	34	**44,195**	42,781
–	–	**906**	1,475	**661**	570	**(1,361)**	(1,405)	**5,109**	6,024
–	–	**1,358**	1,699	**677**	602	**(1,348)**	(1,371)	**49,304**	48,805
–	–	**(183)**	(202)	**(655)**	(578)	**1,348**	1,371	**(7,625)**	(8,646)
–	–	**1,175**	1,497	**22**	24	**–**	–	**41,679**	40,159
–	–	**159**	62	**1**	(7)	**–**	–	**125**	(562)
–	–	**1,334**	1,559	**23**	17	**–**	–	**41,804**	39,597
1,985	1,885	**26**	24	**11**	8	**(9)**	(11)	**2,030**	2,062
86	77	**798**	892	**468**	422	**(887)**	(831)	**9,114**	8,395
1	–	**206**	342	**115**	180	**–**	–	**4,934**	5,180
–	–	**32**	13	**53**	–	**–**	–	**88**	351
12	–	**235**	261	**674**	338	**(583)**	(288)	**1,708**	1,623
2,084	1,962	**2,631**	3,091	**1,344**	965	**(1,479)**	(1,130)	**59,678**	57,208
(118)	(108)	**(382)**	(427)	**(249)**	(375)	**1,479**	1,130	**–**	–
–	–	**138**	1,341	**30**	213	**(36)**	(119)	**23,470**	21,128
–	–	**722**	597	**28**	41	**8**	90	**13,042**	10,237
–	–	**70**	133	**(23)**	(72)	**7**	5	**(2,012)**	1,894
–	–	**930**	2,071	**35**	182	**(21)**	(24)	**34,500**	33,259
–	–	**251**	348	**–**	(175)	**–**	–	**7,014**	6,045
–	–	**514**	458	**7**	1	**–**	–	**7,243**	6,445
915	854	**387**	618	**766**	633	**(552)**	(257)	**5,316**	5,779
92	90	**12**	15	**8**	54	**–**	–	**448**	436
–	46	**142**	170	**778**	723	**(729)**	(730)	**362**	445
–	2	**248**	275	**33**	27	**(177)**	(119)	**1,009**	1,188
1,007	992	**2,484**	3,955	**1,627**	1,445	**(1,479)**	(1,130)	**55,892**	53,597
1,077	970	**147**	(864)	**(283)**	(480)	**–**	–	**3,786**	3,611
686	604	**96**	(1,012)	**(495)**	(510)	**–**	–	**2,587**	2,009
–	–	**818**	1,276	**(2)**	80	**(32)**	(118)	**17,515**	16,516
64	89	**4**	16	**117**	80	**–**	–	**421**	438
40	43	**11**	28	**27**	14	**–**	–	**247**	357
92	90	**12**	15	**8**	54	**–**	–	**448**	436

Table 27.2
Assets and liabilities by business segment
in USD millions, as of December 31

	General Insurance		Life Insurance	
	2004	2003	**2004**	2003
Total investments	**67,727**	56,862	**170,611**	153,628
Investments held on account and at risk of life insurance policyholders	**–**	6	**8,272**	6,916
Reinsurance assets	**16,670**	17,128	**1,787**	1,105
Deposits made under assumed reinsurance contracts	**1,786**	1,683	**24**	9
Deferred policy acquisition costs	**2,265**	2,085	**10,995**	9,564
Goodwill	**164**	184	**514**	524
Other related intangible assets[1]	**–**	–	**973**	1,025
Other assets	**12,985**	12,575	**11,365**	11,984
Total assets after consolidation of investments in subsidiaries	**101,597**	90,523	**204,541**	184,755
Reserves for losses and loss adjustment expenses, gross	**54,121**	45,337	**116**	85
Reserves for unearned premiums, gross	**14,008**	13,470	**147**	131
Future life policyholders' benefits, gross	**174**	157	**86,510**	82,642
Policyholders' contract deposits and other funds, gross	**1,038**	1,058	**16,251**	13,968
Reserves for unit-linked products, gross	**–**	–	**61,034**	51,127
Insurance reserves, gross	**69,341**	60,022	**164,058**	147,953
Insurance reserves for life insurance where the investment risk is carried by policyholders	**–**	–	**8,345**	7,004
Debt related to capital markets and banking activities	**–**	–	**–**	–
Senior debt	**8,508**	7,585	**679**	1,488
Subordinated debt	**–**	–	**–**	–
Other liabilities	**13,542**	13,067	**19,129**	18,472
Total liabilities	**91,391**	80,674	**192,211**	174,917

[1] Other related intangible assets consists of present value of profits of acquired insurance contracts and attorney-in-fact relationship.

Supplementary segment information

	General Insurance 2004	General Insurance 2003	Life Insurance 2004	Life Insurance 2003
Reserves for losses and loss adjustment expenses, net	**41,079**	31,986	**95**	76
Reserves for unearned premiums, net	**11,776**	11,215	**145**	129
Future life policyholders' benefits, net	**174**	159	**85,195**	82,002
Policyholders' contract deposits and other funds, net	**1,011**	1,043	**16,144**	13,844
Reserves for unit-linked products, net	**–**	–	**61,034**	51,127
Insurance reserves, net	**54,040**	44,403	**162,613**	147,178

Farmers Management Services		Other Businesses		Corporate Center		Eliminations		Total	
2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
2,547	2,219	**18,927**	21,361	**16,176**	14,644	**(24,829)**	(22,967)	**251,159**	225,747
–	–	**15,917**	15,058	**–**	–	**–**	–	**24,189**	21,980
441	429	**6,457**	7,250	**639**	385	**(2,990)**	(3,627)	**23,004**	22,670
–	–	**1,516**	1,931	**54**	51	**(68)**	(66)	**3,312**	3,608
–	–	**83**	137	**1**	1	**–**	(3)	**13,344**	11,784
–	–	**60**	64	**6**	7	**–**	–	**744**	779
1,024	1,067	**–**	–	**–**	–	**–**	–	**1,997**	2,092
708	767	**2,786**	4,721	**2,406**	2,196	**(1,916)**	(3,261)	**28,334**	28,982
4,720	4,482	**45,746**	50,522	**19,282**	17,284	**(29,803)**	(29,924)	**346,083**	317,642
–	–	**4,376**	7,813	**624**	715	**(1,424)**	(2,882)	**57,813**	51,068
–	–	**261**	481	**148**	115	**(330)**	(253)	**14,234**	13,944
–	–	**2,343**	2,146	**619**	674	**(790)**	(408)	**88,856**	85,211
–	–	**7,199**	7,354	**–**	–	**(320)**	(373)	**24,168**	22,007
–	–	**57**	61	**–**	–	**–**	–	**61,091**	51,188
–	–	**14,236**	17,855	**1,391**	1,504	**(2,864)**	(3,916)	**246,162**	223,418
–	–	**15,916**	15,059	**–**	–	**–**	–	**24,261**	22,063
–	–	**5,010**	6,321	**–**	–	**(1,130)**	(360)	**3,880**	5,961
–	–	**103**	191	**16,530**	14,288	**(22,465)**	(21,192)	**3,355**	2,360
–	429	**–**	–	**3,749**	3,398	**(1,233)**	(1,412)	**2,516**	2,415
1,389	1,379	**8,542**	9,942	**2,391**	1,706	**(2,111)**	(3,044)	**42,882**	41,522
1,389	1,808	**43,807**	49,368	**24,061**	20,896	**(29,803)**	(29,924)	**323,056**	297,739

Farmers Management Services 2004	2003	Other Businesses 2004	2003	Corporate Center 2004	2003	Eliminations 2004	2003	Total 2004	2003
–	–	**2,154**	4,737	**151**	219	**(5)**	(5)	**43,474**	37,013
–	–	**202**	390	**9**	9	**5**	44	**12,137**	11,787
(199)	(194)	**1,939**	1,788	**593**	577	**5**	4	**87,707**	84,336
(242)	(235)	**3,633**	3,676	**–**	–	**(58)**	(120)	**20,488**	18,208
–	–	**57**	61	**–**	–	**–**	–	**61,091**	51,188
(441)	(429)	**7,985**	10,652	**753**	805	**(53)**	(77)	**224,897**	202,532

Table 27.3
Premiums, revenues and assets by geographical segment
in USD millions

	Gross written premiums and policy fees for the years ended December 31		Revenues for the years ended December 31		Assets as of December 31	
	2004	2003	**2004**	2003	**2004**	2003
North America Corporate	**15,709**	15,476	**11,530**	10,001	**43,589**	36,549
North America Consumer	**3,696**	4,204	**6,046**	6,342	**15,576**	14,671
Continental Europe	**18,278**	18,267	**20,828**	20,529	**120,698**	113,070
UKISA	**8,733**	7,998	**15,849**	14,579	**117,180**	100,149
Rest of the World	**2,834**	2,851	**2,393**	2,176	**10,777**	10,428
Centrally Managed Businesses	**2,508**	3,078	**3,970**	4,213	**58,056**	61,366
Eliminations	**(2,454)**	(3,069)	**(938)**	(632)	**(19,793)**	(18,591)
Total	**49,304**	48,805	**59,678**	57,208	**346,083**	317,642

Table 27.4
Purchases of fixed and intangible assets by geographical segment
in USD millions, for the years ended December 31

	Fixed assets		Intangible assets	
	2004	2003	**2004**	2003
North America Corporate	**10**	47	**44**	31
North America Consumer	**56**	39	**9**	54
Continental Europe	**25**	66	**84**	58
UKISA	**35**	31	**11**	5
Rest of the World	**16**	6	**11**	4
Centrally Managed Businesses	**97**	48	**23**	49
Total	**239**	237	**182**	201