# Financial Review

# Financial Review

The information contained within the Financial Review is unaudited. This document should be read in conjunction with the Zurich Financial Services Group Annual Report 2007. Certain comparatives in the Financial Review have been restated as a result of the adoption of the SoRIE option under IAS 19 Employee Benefits. Comparatives are as of or for the year ended December 31, 2006, unless otherwise specified.

## Financial highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change [1] |
|---|---|---|---|
| Business operating profit | **6,614** | 6,035 | 10% |
| Net income attributable to shareholders | **5,626** | 4,620 | 22% |
| | | | |
| General Insurance gross written premiums and policy fees | **35,650** | 34,123 | 4% |
| Global Life gross written premiums, policy fees and insurance deposits | **21,703** | 21,022 | 3% |
| Farmers Management Services management fees and other related revenues | **2,266** | 2,133 | 6% |
| | | | |
| General Insurance business operating profit | **4,024** | 3,804 | 6% |
| General Insurance combined ratio | **95.6%** | 93.9% | (1.7 pts) |
| | | | |
| Global Life business operating profit | **1,443** | 1,200 | 20% |
| Global Life gross new business annual premium equivalent (APE) | **2,947** | 2,500 | 18% |
| Global Life new business margin, after tax (as % of APE) | **24.7%** | 21.6% | 3.1 pts |
| Global Life new business value, after tax | **729** | 539 | 35% |
| | | | |
| Farmers Management Services business operating profit | **1,271** | 1,225 | 4% |
| Farmers Management Services gross operating margin | **46.6%** | 50.1% | (3.5 pts) |
| Farmers Management Services managed gross earned premium margin [2] | **6.8%** | 7.3% | (0.5 pts) |
| | | | |
| Group investments average invested assets | **191,790** | 185,371 | 3% |
| Group investments result, net | **10,089** | 9,434 | 7% |
| Group investments return (as % of average invested assets) | **5.3%** | 5.1% | 0.2 pts |
| | | | |
| Shareholders' equity | **28,804** | 25,587 | 13% |
| Diluted earnings per share (in CHF) | **46.37** | 39.52 | 17% |
| | | | |
| Return on common shareholders' equity (ROE) | **21.0%** | 20.4% | 0.6 pts |
| Business operating profit (after tax) return on common shareholders' equity | **18.7%** | 19.5% | (0.8 pts) |

[1] Parentheses around numbers represent an adverse variance.
[2] Farmers Management Services managed gross earned premium margin is calculated as gross operating profit of Farmers Management Services divided by the gross earned premiums of the Farmers Exchanges, which we manage, but do not own.

## Performance overview

**Business operating profit** increased by 10 percent to USD 6.6 billion demonstrating the strength of our diversified portfolio in difficult market conditions.

- **General Insurance business operating profit** increased by USD 220 million, or 6 percent, to USD 4.0 billion. This reflects the strength of our diversified portfolio to absorb the adverse impacts of Winter storm Kyrill (USD 183 million) and the UK floods in June and July (USD 567 million).
- **Global Life business operating profit** increased by USD 243 million, or 20 percent, to USD 1.4 billion, primarily resulting from increases in the US, benefiting from lower amortization of acquisition costs, the UK and Germany. **New business value, after tax,** increased by 35 percent in US dollar terms (28 percent on a local currency basis), reflecting both selective growth and margin improvements in accordance with our strategic priorities.
- **Farmers Management Services business operating profit** increased by USD 46 million, which represents the net result from increased management fees, resulting from strategic and operational growth initiatives, including the acquisition of Bristol West, as well as increased expenses to support the implementation of these initiatives.

**Other Businesses business operating profit** increased by USD 110 million with strong results contributed by **Farmers Re**, **Centre** and **Centrally Managed Businesses**. The **Corporate Functions** result decreased by USD 38 million mainly due to increased funding expenses.

**Net income attributable to shareholders** increased by USD 1.0 billion, or 22 percent, to USD 5.6 billion, with the prior year affected by regulatory settlements in the US. The **shareholders' effective tax rate** was 24.7 percent compared with 26.9 percent for the year ended December 31, 2006. The decrease of 2.2 percentage points is a result of the continuous optimization of the tax efficiency of our operating model.

Business volumes in our core operating segments developed as follows:

- **General Insurance** gross written premiums and policy fees increased by 4 percent in US dollar terms, while remaining flat on a local currency basis, reflecting both underwriting discipline in all our General Insurance businesses in a competitive market environment and our ability to capitalize on attractive growth opportunities.
- **Global Life** insurance deposits increased by 12 percent in US dollar terms, and by 3 percent on a local currency basis, while gross written premiums and policy fees decreased by 6 percent in US dollar terms, and by 12 percent on a local currency basis. These movements reflect the strategic shift in business mix from traditional to unit-linked products. New business annual premium equivalent (APE) increased by 18 percent in US dollar terms, and by 11 percent on a local currency basis, with increases across most regions, in particular in Ireland and at Zurich International Solutions, our international expatriate business based in the Isle of Man.
- **Farmers Management Services** management fees and other related revenues increased by 6 percent, reflecting the underlying increase in the gross earned premiums of 6 percent in the Farmers Exchanges, which we manage but do not own, as a result of organic and inorganic growth initiatives.

**Return on common shareholders' equity** increased by 0.6 percentage points to 21.0 percent as the prior year was affected by the costs of regulatory settlements in the US. These regulatory settlement costs were excluded from business operating profit, resulting in a decrease in **business operating profit (after tax) return on common shareholders' equity** of 0.8 percentage points to 18.7 percent.

**Diluted earnings per share** increased by CHF 6.85, or 17 percent, to CHF 46.37 for the year ended December 31, 2007, compared with CHF 39.52 for the same period in 2006.

## General Insurance highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Gross written premiums and policy fees | 35,650 | 34,123 | 4% |
| Net earned premiums and policy fees | 29,731 | 28,417 | 5% |
| Insurance benefits and losses, net of reinsurance | (20,966) | (19,913) | (5%) |
| Net underwriting result | 1,305 | 1,732 | (25%) |
| Net investment income | 3,662 | 3,203 | 14% |
| **Business operating profit** | **4,024** | **3,804** | 6% |
| Loss ratio | 70.5% | 70.1% | (0.4 pts) |
| Expense ratio | 25.1% | 23.8% | (1.3 pts) |
| **Combined ratio** | **95.6%** | **93.9%** | **(1.7 pts)** |

| in USD millions, for the years ended December 31 | Business operating profit | | Combined ratio | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| Global Corporate | 736 | 692 | 96.1% | 94.4% |
| North America Commercial | 1,460 | 1,123 | 94.5% | 95.6% |
| Europe General Insurance | 1,453 | 1,740 | 96.6% | 91.5% |
| International Businesses | 167 | 178 | 98.8% | 98.1% |
| Group Reinsurance | 208 | 72 | nm | nm |
| Total | 4,024 | 3,804 | 95.6% | 93.9% |

**Business operating profit** increased by USD 220 million, or 6 percent, to USD 4.0 billion for the year ended December 31, 2007, driven by Global Corporate, North America Commercial and positive claims experience within Group Reinsurance. Our businesses continued to demonstrate underlying strength and have benefited from our reserving policy with positive development emerging from reserves established in prior years. This positive development, together with higher investment income, which reflects both an increase in the average invested asset base and higher interest rates in Europe, more than offset losses arising from Winter storm Kyrill and the UK floods in June and July.

**Gross written premiums and policy fees** increased by USD 1.5 billion, or 4 percent in US dollar terms, to USD 35.7 billion, while remaining flat on a local currency basis, which reflects our continued ability to maintain underwriting discipline and manage different business areas for margin and/or volume. The market environment continued to be competitive with pressure on rates, although the picture was mixed by geography and by line of business, with the commercial lines of business in North America, the UK and Ireland most affected.

The **net underwriting result** decreased by USD 427 million to USD 1.3 billion driven by the impact of losses associated with Winter storm Kyrill and UK floods in June and July amounting to USD 677 million for Europe General Insurance and USD 73 million for Global Corporate. Together these two events increased the overall loss ratio and combined ratio by 2.5 percentage points. In 2006 we reported no comparable catastrophe losses. Favorable development emerging from reserves established in prior years reduced the loss ratio by 3.6 percentage points in 2007. Net technical expenses increased by USD 685 million, and by USD 345 million on a local currency basis, primarily as a result of higher commissions and increased investments in growth and operational transformation initiatives, driving an overall 1.3 percentage point increase in the expense ratio.

## Global Corporate

| in USD millions, for the years ended December 31 | **2007** | 2006 | Change |
|---|---|---|---|
| Gross written premiums and policy fees | 7,505 | 7,407 | 1% |
| Net underwriting result | 184 | 278 | (34%) |
| **Business operating profit** | **736** | **692** | **6%** |
| Loss ratio | 76.9% | 77.0% | 0.1 pts |
| Expense ratio | 19.2% | 17.3% | (1.9 pts) |
| **Combined ratio** | **96.1%** | **94.4%** | **(1.7 pts)** |

**Business operating profit** increased by USD 44 million, or 6 percent, to USD 736 million for the year ended December 31, 2007. A decrease in the net underwriting result was more than offset by a USD123 million increase in net investment income driven by a higher average invested asset base and higher interest rates.

**Gross written premiums and policy fees** increased by 1 percent in US dollar terms to USD 7.5 billion, while decreasing by 2 percent on a local currency basis primarily as a result of continued rate pressures across most major portfolios, particularly in North America and the UK. The increased level of customer renewals continued, with some new business growth achieved on targeted lines.

The **net underwriting result** decreased by USD 94 million to USD 184 million, leading to a 1.7 percentage point increase in the combined ratio. Positive impacts were attritional loss experience across a number of lines of business, a reduced incidence of large property losses and an improved result emerging from reserves established in prior years. These positive developments mitigated the impact of rate reductions and the USD 73 million of catastrophe losses associated with Winter storm Kyrill and the UK floods in June and July. Overall, there was an improvement in the loss ratio of 0.1 percentage points to 76.9 percent. An increase in premium refunds on loss-sensitive business was the primary driver of the 1.9 percentage point increase in the expense ratio to 19.2 percent.

## North America Commercial

| in USD millions, for the years ended December 31 | **2007** | 2006 | Change |
|---|---|---|---|
| Gross written premiums and policy fees | 11,532 | 11,856 | (3%) |
| Net underwriting result | 521 | 415 | 26% |
| **Business operating profit** | **1,460** | **1,123** | **30%** |
| Loss ratio | 67.0% | 69.5% | 2.5 pts |
| Expense ratio | 27.5% | 26.2% | (1.3 pts) |
| **Combined ratio** | **94.5%** | **95.6%** | **1.1 pts** |

**Business operating profit** increased by USD 337 million, or 30 percent, to USD 1.5 billion for the year ended December 31, 2007, primarily driven by an increase of USD 106 million in the net underwriting result and by a USD 131 million increase in net investment income.

**Gross written premiums and policy fees** decreased by USD 324 million, or 3 percent, to USD 11.5 billion. Our focus on disciplined growth through our market segmentation strategy has enabled us to maintain an effective market presence within our chosen customer segments despite continued market pressure together with changing economic conditions within a few key segments.

The **net underwriting result** increased by USD 106 million to USD 521 million, driven by a 2.5 percentage point decrease in the loss ratio. The 1.3 percentage point increase in the expense ratio to 27.5 percent arose primarily from an increase in net commission expenses, which was predominantly attributable to certain portfolio segments that delivered improved profitability.

## Europe General Insurance

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Gross written premiums and policy fees | 13,852 | 12,445 | 11% |
| Net underwriting result | 440 | 993 | (56%) |
| **Business operating profit** | **1,453** | **1,740** | **(16%)** |
| Loss ratio | 72.7% | 68.9% | (3.8 pts) |
| Expense ratio | 23.9% | 22.6% | (1.3 pts) |
| **Combined ratio** | **96.6%** | **91.5%** | **(5.1 pts)** |

**Business operating profit** decreased by USD 287 million, or 16 percent, to USD 1.5 billion, attributable to the lower net underwriting result following the catastrophe losses of USD 677 million from Winter storm Kyrill and the UK floods in June and July. Net investment income increased across Europe by USD 247 million, driven by higher interest rates throughout most of the year and a higher average invested asset base, in particular in the UK.

**Gross written premiums and policy fees** increased by 11 percent in US dollar terms, and by 3 percent on a local currency basis with growth in competitive market conditions, supported by contributions from acquisitions and a stable level of customer renewals. Pressure on rates in commercial lines continued, and rate changes on new business written varied by country, with decreases in Italy, Ireland and the UK and improvements in other countries.

The **net underwriting result** decreased by USD 553 million to USD 440 million, primarily due to the impact of Winter storm Kyrill (USD 165 million) and the UK floods in June and July (USD 512 million), which had a combined impact of 5.2 percentage points on the loss ratio. Excluding the impact of these catastrophes, the loss ratio improved by 1.4 percentage points to 67.5 percent, driven by favorable development emerging from reserves established in prior years, primarily in the UK, Switzerland, Ireland and Spain. The expense ratio increased by 1.3 percentage points to 23.9 percent as a result of investments in our Pan-European platform, Zurich Connect and other growth and operational transformation-related activities.

## International Businesses

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Gross written premiums and policy fees | 3,205 | 2,875 | 11% |
| Net underwriting result | 28 | 42 | (33%) |
| **Business operating profit** | **167** | **178** | **(6%)** |
| Loss ratio | 65.0% | 63.4% | (1.6 pts) |
| Expense ratio | 33.8% | 34.7% | 0.9 pts |
| **Combined ratio** | **98.8%** | **98.1%** | **(0.7 pts)** |

**Business operating profit** decreased by USD 11 million, or 6 percent, to USD 167 million for the year ended December 31, 2007, driven by the decrease in the net underwriting result.

**Gross written premiums and policy fees** increased by USD 330 million, or 11 percent, and by 10 percent on a local currency basis, to USD 3.2 billion, with increases across all regions despite rate pressures in Australia and Asia. The primary drivers of the increase were Latin America with an increase in new business written, and Africa due to rate increases.

**Net underwriting result** decreased by USD 14 million to USD 28 million. The combined ratio increased by 0.7 percentage points, a combination of a 1.6 percentage point increase in the loss ratio and 0.9 percentage point decrease in the expense ratio. The increase in the loss ratio was primarily driven by a number of businesses incurring higher weather-related losses and an increase in the number of large losses. The expense ratio improved by 0.9 percentage points as a consequence of growth in premiums.

## Global Life highlights

| in USD millions, for the years ended December 31 | **2007** | 2006 | Change |
|---|---|---|---|
| Insurance deposits | 12,064 | 10,769 | 12% |
| Gross written premiums and policy fees | 9,640 | 10,254 | (6%) |
| Net investment income on Group investments | 4,226 | 4,104 | 3% |
| Insurance benefits and losses, net of reinsurance | (694)[1] | (8,655) | 92% |
| Underwriting and policy acquisition costs, net of reinsurance | (1,640) | (1,448) | (13%) |
| Administrative and other operating expenses | (1,678) | (1,583) | (6%) |
| **Business operating profit** | **1,443** | **1,200** | **20%** |
| | | | |
| **Embedded value – highlights** | | | |
| **New business annual premium equivalent (APE)** | **2,947** | **2,500** | **18%** |
| Present value of new business premiums (PVNBP) | 23,781 | 20,598 | 15% |
| **New business margin, after tax (as % of APE)** | **24.7%** | **21.6%** | **3.1 pts** |
| New business margin, after tax (as % of PVNBP) | 3.1% | 2.6% | 0.5 pts |
| **New business value, after tax** | **729** | **539** | **35%** |

[1] The Group's life operations in the UK entered into a reinsurance agreement to transfer the risk associated with a significant annuities portfolio as of January 1, 2007. The initial impact of the transaction was an increase of USD 7.0 billion in ceded insurance benefits and losses.

In 2007, Global Life achieved its growth targets with an 18 percent increase in APE (11 percent on a local currency basis) and an increase in new business margin of 3.1 percentage points to 24.7 percent, which led to an increase in new business value of 35 percent (28 percent on a local currency basis) to USD 729 million.

**New business annual premium equivalent** (APE) increased by USD 447 million, or 18 percent in US dollar terms, and by 11 percent on a local currency basis. Growth accelerated in each quarter of 2007, reaching 17 percent on a local currency basis for the fourth quarter. The increase was driven by Ireland, the emerging markets served by Zurich International Solutions (ZIS) and in Southeast Asia, and by the UK in the latter half of the year. Innovative new propositions resulted in higher APE volumes in the US and Switzerland despite challenging conditions in both markets.

**Business operating profit** increased by USD 243 million, or 20 percent, to USD 1.4 billion for the year ended December 31, 2007. Increases in the US, UK and Germany compensated for the new business strain from the strong growth in ZIS and Southeast Asia.

**Insurance deposits** increased by 12 percent, while **gross written premiums and policy fees** decreased by 6 percent. The sustained attractiveness of our unit-linked products, giving customers choices based upon need and risk attitudes, resulted in increases in deposits, while traditional premiums decreased as we continued to focus on unit-linked products. Gross written premiums and policy fees decreased primarily due to the transfer of a further block of traditional group life business to independent pension foundations in Switzerland, to which we provide services but do not control.

During 2007, the majority of the UK annuity liabilities were reinsured as the first step in a transaction in which, subject to local regulatory and court approvals, the policies will be commuted to the reinsurer. This transaction reduced our exposure to longevity risk and reduced economic capital requirements.

## APE by product

| in USD millions, for the years ended December 31 | Unit-linked [1] | | Individual protection | | Other [2] | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| United States | 6 | 6 | 106 | 102 | 7 | 6 | 119 | 113 |
| United Kingdom | 416 | 386 | 100 | 98 | 410 | 336 | 926 | 820 |
| Germany | 406 | 335 | 40 | 26 | 124 | 202 | 570 | 563 |
| Switzerland | 30 | 17 | 7 | 10 | 67 | 63 | 104 | 104 |
| Rest of Europe | 741 | 565 | 35 | 30 | 203 | 155 | 979 | 750 |
| *of which:* | | | | | | | | |
| *Ireland* | *180* | *120* | *24* | *21* | *97* | *69* | *301* | *210* |
| *ZIS* | *445* | *312* | *–* | *–* | *8* | *6* | *453* | *319* |
| International Businesses | 150 | 88 | 36 | 38 | 63 | 38 | 249 | 164 |
| *of which:* | | | | | | | | |
| *Southeast Asia* | *130* | *62* | *2* | *3* | *3* | *5* | *135* | *70* |
| *Latin America* | *20* | *15* | *14* | *13* | *42* | *30* | *75* | *58* |
| Total | 1,750 | 1,397 | 324 | 303 | 873 | 800 | 2,947 | 2,500 |

[1] Unit-linked includes insurance and investment contracts.
[2] Other includes individual savings, deferred and immediate annuities and group and collective business.

**New business annual premium equivalent** (APE) increased by 18 percent (11 percent on a local currency basis), primarily reflecting the continued success of our unit-linked range of products.

Unit-linked APE increased by 25 percent (16 percent on a local currency basis) and represented 59 percent of total APE compared with 56 percent in 2006. Protection APE increased by 7 percent (2 percent on a local currency basis). Other products increased 9 percent (1 percent on a local currency basis), driven mainly by new group pension schemes in the UK and Ireland.

The independent broker sector was the main growth driver in 2007, providing 49 percent of total APE volumes. Openwork, our exclusive multi-tied distribution network in the UK, produced 8 percent of total APE and the Farmers Exchanges tied-agent network in the US produced 4 percent. Other tied-agent distribution contributed 16 percent with an increasing proportion coming from our tied-agent networks in emerging markets. Distribution through bank partnerships contributed 23 percent of total APE volumes.

The APE increase of 5 percent in the **US** was driven by an innovative simple protection proposition launched late in 2006, which also contributed to a record number of new policies issued in one year. In the **UK**, APE increased by 13 percent, and by 4 percent on a local currency basis, benefiting in the latter half of the year from a range of new propositions and enhancements including e-enablement. The UK also won a number of group pension schemes. In **Germany**, APE increased by 1 percent, while decreasing by 7 percent on a local currency basis in an overall declining market, while new unit-linked business increased by 21 percent, and by 11 percent on a local currency basis, driven by the success of our new unit-linked tax-advantaged pension product. APE in **Switzerland** increased by 16 percent, and by 11 percent on a local currency basis, with strong growth in individual unit-linked business following the introduction of new propositions. In **Ireland**, APE increased by 43 percent, and by 31 percent on a local currency basis. Momentum from 2006 carried through into 2007 with particularly strong growth in regular and single premium pension business in both unit-linked and individual savings products.

APE in the emerging markets served by **ZIS**, and in **Southeast Asia** and **Latin America** increased by 49 percent in US dollar terms. ZIS produced strong growth through bank partners and international broker networks and the maturing of branches that were opened in prior years. This growth reflected increased value-added propositions for our key distributors from improved segmentation and adaptation to the different customer and distributor needs. In Southeast Asia, the driver was strong unit-linked APE through the tied-agent channel, and in Latin America growth arose in Chile, Mexico and Argentina.

| in USD millions, for the years ended December 31 | Business operating profit | | New business value, after tax | | New business margin, after tax (as % of APE) | |
|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| United States | 313 | 230 | 108 | 59 | 90.8% | 52.0% |
| United Kingdom | 439 | 305 | 121 | 100 | 13.1% | 12.2% |
| Germany | 213 | 171 | 184 | 133 | 32.3% | 23.7% |
| Switzerland | 175 | 193 | 33 | 35 | 31.4% | 38.8% |
| Rest of Europe | 197 | 200 | 198 | 160 | 20.3% | 21.4% |
| *of which:* | | | | | | |
| *Ireland* | *64* | *52* | *69* | *49* | *23.0%* | *23.2%* |
| *ZIS* | *27* | *41* | *93* | *65* | *20.4%* | *20.5%* |
| International Businesses | 106 | 101 | 85 | 52 | 34.0% | 31.6% |
| *of which:* | | | | | | |
| *Southeast Asia* | *5* | *11* | *65* | *29* | *48.2%* | *41.9%* |
| *Latin America* | *47* | *43* | *19* | *16* | *25.4%* | *27.1%* |
| Total | 1,443 | 1,200 | 729 | 539 | 24.7% | 21.6% |

**Business operating profit** in the US increased by USD 83 million, benefiting from lower amortization of deferred policy acquisition costs (USD 106 million) partially offset by higher mortality claims. An increase in the in-force business drove the underlying increase of USD 10 million. In the UK, business operating profit improved by USD 134 million as a result of lower insurance benefits and losses before reinsurance and improved performance in Openwork. Business operating profit in Germany increased due to continued efficiency gains from the merger of our life entities. Business operating profit in Switzerland decreased due to the continued transfer of group life business to the independent pension foundations.

**New business value, after tax**, increased by USD 190 million, as a result of the US and Germany, due mainly to higher margins, and from Ireland, ZIS and Southeast Asia, mainly due to higher APE.

**New business margin, after tax**, increased by 3.1 percentage points, mainly due to strong improvements in the US and Germany and a small increase in our largest market, the UK. The improvement in the US mainly reflected a restructuring of our reinsurance program in that market. The improvement in Germany reflected the synergy benefits following the merger of our life entities. The decreased margin in Switzerland was due to increased selling expenses from the individual business line.

## Farmers Management Services highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Management fees and other related revenues | 2,266 | 2,133 | 6% |
| Management and other related expenses | (1,210) | (1,062) | (14%) |
| Gross operating margin | 46.6% | 50.1% | (3.5 pts) |
| Managed gross earned premium margin [1] | 6.8% | 7.3% | (0.5 pts) |
| | | | |
| Other income and expense items, net | 215 | 154 | 40% |
| **Business operating profit** | **1,271** | **1,225** | **4%** |

[1] This measure is calculated as the gross operating profit of Farmers Management Services divided by the gross earned premiums of the Farmers Exchanges. For additional information on the calculation, refer to the explanatory notes in the Financial Supplement.

**Management fees and other related revenues** increased by USD 133 million, or 6 percent, driven by an increase in management fees, including USD 64 million related to the recently acquired Bristol West Holdings, Inc. (Bristol West). The increase was driven by an overall 6 percent increase in gross earned premiums at the Farmers Exchanges, which we manage but do not own, in line with growth initiatives. Management and other related expenses increased by USD 148 million as a result of the increased volumes generated by the Exchanges, continued investments in growth and IT-related initiatives, as well as USD 41 million related to the first time inclusion of Bristol West. As a result, the **gross operating margin** decreased to 46.6 percent.

We are introducing an alternative measure of Farmers Management Services' profitability relative to the gross earned premiums of the Farmers Exchanges as they are the relevant indicator for the volumes managed by Farmers Management Services, **managed gross earned premium margin**. Farmers Management Services continues to evolve its business model through additional product lines and distribution channels, such as Foremost and Bristol West. As a consequence, a measure of its profitability against the underlying insurance businesses in the Farmers Exchanges will provide a relevant view of its profitability over time. For the year ended December 31, 2007, the managed gross earned premium margin decreased by 0.5 percentage points to 6.8 percent, due to the continued investments in growth and IT-related initiatives by Farmers Management Services.

**Business operating profit** increased by USD 46 million, or 4 percent, to USD 1.3 billion for the year ended December 31, 2007, as a result of the initiatives described above together with an increase in net investment income and in net other income, which was driven by one-time gains from the sale of properties vacated as a result of the concentration of customer service activities into two ServicePoints.

## Farmers Exchanges – highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Gross written premiums | 15,806 | 15,003 | 5% |
| Gross earned premiums | 15,547 | 14,721 | 6% |

Gross written premiums at the Farmers Exchanges, which we manage but do not own, increased by 5 percent, which includes premiums written by Bristol West. This led to a 6 percent increase in gross earned premiums, with all major lines of business contributing to the increase.

## Other Businesses highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| **Business operating profit:** | | | |
| Farmers Re | 173 | 181 | (4%) |
| Centre | 167 | 249 | (33%) |
| Centrally Managed Businesses | 291 | 305 | (5%) |
| Rest of Other Businesses | 56 | (158) | nm |
| Total business operating profit | 687 | 577 | 19% |

**Farmers Re** contributed USD 173 million to business operating profit reflecting the development of business with the Farmers Exchanges, which we manage but do not own. **Centre** business operating profit decreased by USD 82 million to USD 167 million due to reserve strengthening in the disability business. **Centrally Managed Businesses**,which largely comprise portfolios that we proactively manage to achieve a profitable run-off, decreased by USD 14 million to USD 291 million. Gains on commutations and increases in net investment income were offset by lower premiums and reinsurance commissions as a result of the successful run-off of these businesses. The result in the rest of Other Businesses benefited from the absence of reserve strengthening compared with 2006, as well as higher net investment income.

## Corporate Functions highlights

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Net investment income | 731 | 646 | 13% |
| Interest expense on debt | (1,317) | (1,162) | (13%) |
| **Business operating loss** | **(810)** | **(772)** | **(5%)** |
| Headquarter expenses, after allocations to operating businesses and excluding foreign currency impacts | (168) | (189) | 11% |

**Business operating loss** increased by USD 38 million to USD 810 million for the year ended December 31, 2007. Interest expense on debt increased by USD 155 million due to the one-time costs of USD 52 million associated with the early redemption of subordinated debt, which was replaced with lower cost hybrid debt, and due to interest expense on higher net intercompany funding levels. The increase in interest expense was partially offset by an increase of USD 85 million in net investment income.

**Headquarter expenses** decreased by USD 21 million as a result of higher allocations to the operating businesses.

# Investment position and performance

Reflecting our outlook for the economy and the capital markets, our equity allocation during the greater part of 2007 was close to neutral, and we continued our underweight stance to debt security exposure relative to our long-term strategic benchmark. Fixed maturity debt securities are invested in accordance with the profile of the liabilities to limit the overall economic interest rate exposure of the Group. Derivative instruments are primarily used to improve the management of interest rate risk and to provide equity downside protection in Life with-profit funds.

## Breakdown of investments

| in USD millions, as of December 31 | Group investments | | Unit-linked investments | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| Cash and cash equivalents | 13,943 | 17,438 | 2,993 | 5,685 |
| Equity securities: | 18,589 | 18,339 | 100,178 | 90,666 |
| Common stocks, including equity unit trusts | 12,418 | 11,461 | 90,593 | 84,823 |
| Unit trusts (debt securities, real estate and short-term investments) | 3,291 | 3,014 | 9,585 | 5,842 |
| Common stock portfolios backing participating with-profit policyholder contracts | 1,274 | 1,604 | – | – |
| Trading equity portfolios in capital markets and banking activities | 1,606 | 2,260 | – | – |
| Debt securities | 123,762 | 126,435 | 10,112 | 8,922 |
| Real estate held for investment | 7,563 | 6,921 | 7,823 | 8,360 |
| Mortgage loans | 12,718 | 10,806 | – | – |
| Policyholders' collateral and other loans | 12,936 | 12,634 | 2 | 2 |
| Investments in associates | 238 | 153 | – | – |
| Other investments | 3,851 | 2,951 | 985 | 693 |
| Total | 193,600 | 195,676 | 122,092 | 114,327 |

Group investments have decreased by USD 2.1 billion to USD 193.6 billion since December 31, 2006. After excluding the effect of foreign currency translation, Group investments decreased by 6 percent, primarily driven by a decrease in debt securities following the USD 7.3 billion sale of investments relating to our UK Life annuity business, which was reinsured in June 2007.

Our investment policy remains conservative; investment grade securities comprise 99 percent of our debt securities, of which 63 percent are rated AAA. US sub-prime mortgage-backed securities comprise approximately 0.2 percent of Group investments, with 78 percent of these securities being rated AAA, and only USD 16 million of impairments recognized in the current period.

## Performance of Group investments

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Net investment income | 8,591 | 7,899 | 9% |
| Net capital gains on investments and impairments | 1,498 | 1,536 | (2%) |
| Net investment result | 10,089 | 9,434 | 7% |
| **Net investment return on Group investments** | **5.3%** | **5.1%** | **0.2 pts** |
| Movements in net unrealized gains/(losses) on investments included in total equity | (2,654) | (1,555) | 71% |
| **Total investment result, net of investment expenses** [1] | **7,435** | **7,879** | **(6%)** |
| Average investments [2] | 191,790 | 185,371 | 3% |
| **Total return on Group investments** | **3.9%** | **4.3%** | **(0.4 pts)** |

[1] After deducting investment expenses of USD 247 million and USD 265 million for the years ended December 31, 2007 and 2006, respectively.
[2] Excluding average cash received as collateral for securities lending of USD 2.8 billion and USD 4.2 billion in the years ended December 31, 2007 and 2006, respectively.

Total return (net of investment expenses) was 3.9 percent on average Group investments, driven by other investments and equity securities, for which the total return was 5.9 percent and 5.5 percent respectively. Debt securities, which are invested to match our liability profiles, returned 3.1 percent.

Total **net investment income** was USD 8.6 billion, with a return of 4.5 percent, an increase of 22 basis points compared with 2006. This increase arose mainly from debt securities, with a return of 4.6 percent compared with 4.4 percent in 2006. Rising interest rates in the euro and Swiss franc markets and higher dividend income drove the USD 692 million increase, mainly contributed by General Insurance.

Total **net capital gains on investments and impairments** were USD 1.5 billion, a decrease of USD 38 million compared with the prior year. Realized gains on sales of securities of USD 790 million were USD 127 million less than 2006 largely as result of increased realized losses from the sale of debt securities at higher interest rate levels. Net gains from market revaluations of USD 708 million were USD 89 million higher than 2006. Hedge funds and private equity investments were the main drivers, contributing USD 702 million, a net increase of USD 240 million over 2006. This increase was offset by decreased gains from equities and increased impairments on equity and debt securities. The net gains from market revaluations included USD 136 million of impairments, an increase of USD 110 million over 2006. Debt securities contributed USD 81 million to the 2007 total, while equity securities contributed a further USD 44 million.

Net unrealized gains decreased by USD 2.7 billion since December 31, 2006. Net unrealized gains on debt securities decreased by USD 1.5 billion to a net loss of USD 1.4 billion as interest rates rose across major markets except in the US during the first part of 2007. Net unrealized gains on equity securities decreased by USD 1.1 billion mainly due to the realization of USD 1.1 billion of gains following sales in positive markets in the first half of the year to maintain the desired asset allocation to equities.

## Performance of unit-linked investments

| in USD millions, for the years ended December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Net investment income | 3,000 | 2,384 | 26% |
| Net capital gains on investments and impairments | 4,142 | 9,203 | (55%) |
| Net investment result, net of investment expenses [1] | 7,142 | 11,587 | (38%) |
| Average investments | 118,210 | 104,082 | 14% |
| **Total return on unit-linked investments** | **6.0%** | **11.1%** | **(5.1 pts)** |

[1] After deducting investment expenses of USD 528 million and USD 461 million for the years ended December 31, 2007 and 2006, respectively.

Net investment income on **unit-linked investments** increased by 26 percent, primarily attributable to dividends on unit trust equity and short-term securities and a higher average invested asset base. Net capital gains on investments decreased by 55 percent as a result of negative market revaluations on preferred equity securities, as a result of comparatively lower rate of market appreciation in the UK, and on real estate.

# Insurance and investment contract liabilities

## Reserves for losses and loss adjustment expenses

| in USD millions | **2007** | 2006 |
|---|---|---|
| As of January 1 | | |
| Gross reserves for losses and loss adjustment expenses | 64,535 | 60,425 |
| Reinsurers' share | (13,722) | (14,231) |
| Net reserves for losses and loss adjustment expenses | 50,814 | 46,194 |
| Net losses and loss adjustment expenses incurred: | | |
| Current year | 23,374 | 21,448 |
| Prior years | (1,219) | (218) |
| Total | 22,155 | 21,230 |
| Total net losses and loss adjustment expenses paid | (19,856) | (18,908) |
| Acquisitions/(divestments) | 51 | (65) |
| Foreign currency translation effects | 1,548 | 2,363 |
| As of December 31 | | |
| **Net reserves for losses and loss adjustment expenses** | **54,712** | **50,814** |
| Reinsurers' share | 13,179 | 13,722 |
| Gross reserves for losses and loss adjustment expenses | 67,890 | 64,535 |

The majority of the Group's gross reserves for losses and loss adjustment expenses are attributable to the General Insurance segment.

As of December 31, 2007, net reserves for losses and loss adjustment expenses increased by USD 3.9 billion, or 8 percent, to USD 54.7 billion compared with USD 50.8 billion as of December 31, 2006. Net loss and loss adjustment expenses incurred in the current year are impacted by foreign currency effects and higher catastrophe losses, in addition to increases in underlying exposure and claims inflation. Favorable prior year development arose primarily from our General Insurance business (USD 1.1 billion) across a number of countries and lines of business.

**Development of cumulative net loss ratios**

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | **2007** |
|---|---|---|---|---|---|---|---|
| In the year | 81.4% | 70.6% | 67.1% | 68.3% | 73.3% | 69.6% | **72.7%** |
| One year later | 85.7% | 72.0% | 66.1% | 64.2% | 68.1% | **66.2%** | |
| Two years later | 85.8% | 72.3% | 65.4% | 63.5% | **66.6%** | | |
| Three years later | 87.4% | 74.5% | 65.5% | **63.7%** | | | |
| Four years later | 88.5% | 74.7% | **65.7%** | | | | |
| Five years later | 90.2% | **73.4%** | | | | | |
| Six years later | **90.2%** | | | | | | |

This table represents the loss ratio development for individual accident years for the Group, with the General Insurance segment being the primary driver. Individual accident years are affected by the level of large catastrophe losses. In the General Insurance segment, excluding the effects of the hurricanes in 2004 and 2005 of 2.8 and 4.6 percentage points, respectively, and the 2007 Winter storm Kyrill and the UK floods of

2.5 percentage points, the underlying loss ratios year-on-year would have been relatively more stable. The Zurich Way of Reserving adopts a conservative view in the initial accident year, suggesting that most years would develop favorably over time as is demonstrated by accident years 2003 to 2006.

## Reserves for life insurance contracts and liabilities for investment contracts

The majority of the Group's reserves for life insurance contracts and liabilities for investment contracts are attributable to Global Life. Life insurance reserves for other segments relate predominately to companies that are in run-off or are centrally managed, and are only included in this first table.

### Group reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts

| in USD millions | Global Life | Other segments |
|---|---|---|
| Net reserves as of January 1, 2007 | 187,525 | 19,882 |
| Movements in net reserves | 3,592 | 300 |
| Net reserves as of December 31, 2007 | 191,116 | 20,182 |

More details on the development of the Group's total life reserves and liabilities can be found in notes 8 and 9 in the consolidated financial statements. In the following section we provide further detail on the development and composition of **Global Life** business on a stand-alone basis.

### Global Life – Development of reserves and liabilities

| in USD millions | Unit-linked and investment contracts [1] | | Other life insurance liabilities [2] | | Total reserves and liabilites | |
|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| As of January 1 | | | | | | |
| Gross reserves | 101,330 | 80,528 | 87,949 | 82,478 | 189,278 | 163,006 |
| Reinsurers' share | – | – | (1,753) | (1,537) | (1,753) | (1,537) |
| Net reserves | 101,330 | 80,528 | 86,196 | 80,940 | 187,525 | 161,469 |
| Premiums and claims | (2,030) | 387 | (13,612) | (5,688) | (15,642) | (5,301) |
| Interest and bonuses credited to policyholders | 6,798 | 10,151 | 3,864 | 3,673 | 10,662 | 13,824 |
| Change in assumptions | – | (14) | 215 | 335 | 215 | 321 |
| Divestments | (514) | (4) | – | (53) | (514) | (57) |
| Decreases recorded in shareholders' equity | (33) | (31) | (1,691) | (1,118) | (1,724) | (1,149) |
| Foreign currency translation effects | 3,522 | 10,313 | 7,072 | 8,106 | 10,594 | 18,419 |
| As of December 31 | | | | | | |
| **Net reserves** | **109,073** | **101,330** | **82,044** | **86,196** | **191,116** | **187,525** |
| Reinsurers' share | – | – | 9,551 | 1,753 | 9,551 | 1,753 |
| Gross reserves | 109,073 | 101,330 | 91,595 | 87,949 | 200,667 | 189,278 |

[1] Includes reserves for unit-linked contracts and liabilities for investment contracts, the net amounts of which were USD 54.3 billion and USD 50.4 billion, and USD 54.7 billion and USD 51.0 billion as of December 31, 2007 and 2006, respectively.
[2] Includes reserves for future life policyholders' benefits and policyholders' contract deposits and other funds, the net amounts of which were USD 68.0 billion and USD 72.2 billion, and USD 14.0 billion and USD 14.0 billion as of December 31, 2007 and 2006, respectively.

## Global Life – Reserves and liabilities, net of reinsurance, by region

| in USD millions, as of December 31 | Unit-linked and investment contracts | | Other life insurance liabilities | | Total reserves and liabilites | |
|---|---|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 | **2007** | 2006 |
| United States | 856 | 774 | 4,803 | 4,733 | 5,658 | 5,506 |
| United Kingdom | 73,400 | 70,967 | 5,971 | 13,109 | 79,371 | 84,076 |
| Germany | 8,768 | 6,878 | 43,672 | 40,108 | 52,439 | 46,986 |
| Switzerland | 1,630 | 1,454 | 15,086 | 16,804 | 16,716 | 18,258 |
| Rest of Europe | 20,789 | 17,460 | 9,860 | 9,070 | 30,650 | 26,529 |
| *of which:* | | | | | | |
| *Ireland* | *7,324* | *5,655* | *1,536* | *1,406* | *8,860* | *7,061* |
| *ZIS* | *6,816* | *5,559* | *727* | *652* | *7,543* | *6,212* |
| International Businesses | 3,630 | 3,798 | 2,652 | 2,372 | 6,282 | 6,170 |
| *of which:* | | | | | | |
| *Southeast Asia* | *386* | *201* | *771* | *776* | *1,157* | *977* |
| *Latin America* | *322* | *272* | *1,457* | *1,205* | *1,779* | *1,477* |
| Total | 109,073 | 101,330 | 82,044 | 86,196 | 191,116 | 187,525 |

**Unit-linked insurance and investment contracts**, net of reinsurance, increased by 8 percent, and by 4 percent after excluding the impact of currency translation, compared with December 31, 2006. The increase reflects inflows from new and renewal premiums and the benefit to policyholders from equity market appreciation (reported as interest and bonuses credited to policyholders), offset by claims and related charges. The excess of claims over premiums of USD 2.0 billion is driven by the overall maturity of the UK pension portfolio, accelerated by the 2006 pension rule changes, which made it easier for pension plan holders in the UK to consolidate small plans or retire early.

**Other life insurance liabilities**, net of reinsurance, decreased by 5 percent, and by 13 percent after excluding the impact of currency translation, compared with December 31, 2006. The decrease was mainly due to the initial impact of the reinsurance of USD 7.1 billion of UK annuity liabilities that removed the related longevity risk and reduced economic capital requirements. Additionally, in 2007 there was a reduction of USD 2.5 billion of liabilities relating to traditional group life contracts in Switzerland, of which USD 1.8 billion was transferred to independent pension foundations, to which we provide services but do not control.

# Indebtedness and capitalization

| in USD millions, as of December 31 | 2007 | 2006 | Change |
|---|---|---|---|
| Total operational debt | 8,578 | 9,465 | (9%) |
| Total financial debt [1] | 8,999 | 8,708 | 3% |
| Total equity | 29,177 | 26,105 | 12% |

[1] For more information on financial debt, refer to note 20 in the consolidated financial statements.

Total operational debt was USD 8.6 billion as of December 31, 2007, a decrease of 9 percent compared with December 31, 2006, primarily attributable to reduced repo activities in our UK Life business.

Total financial debt was USD 9.0 billion as of December 31, 2007, an increase of 3 percent compared with December 31, 2006. As market conditions allowed for lower borrowing costs, we redeemed a USD 1 billion subordinated debt issuance early at a total pre-tax cost of USD 52 million and replaced it with two lower cost, hybrid debt issuances totaling USD 1.5 billion.

Total equity increased to USD 29.2 billion as of December 31, 2007, a 12 percent increase driven by net income after taxes, which more than offset the impact from treasury share transactions and dividends paid to shareholders.

| in USD millions | Shareholders' equity | Minority interests | Total equity |
|---|---|---|---|
| As of December 31, 2006, as previously reported | 26,531 | 525 | 27,056 |
| Adjustment arising from change in accounting policy related to IAS 19 | (944) | (8) | (952) |
| **As of December 31, 2006, as restated** | **25,587** | **517** | **26,105** |
| Issuance of share capital | 147 | – | 147 |
| Dividends | (1,339) | (10) | (1,348) |
| Share-based payment transactions | 30 | – | 30 |
| Treasury share transactions | (1,652) | – | (1,652) |
| Total recognized income and expense, net of tax | 6,030 | 90 | 6,120 |
| *Net income after taxes* | *5,626* | *83* | *5,708* |
| *Net other recognized income and expenses* | *403* | *7* | *410* |
| Net changes in capitalization and minority interests | – | (223) | (223) |
| **As of December 31, 2007** | **28,804** | **374** | **29,177** |

As of December 31, 2007, the number of treasury shares deducted from equity was 5,839,154, which included 3,432,500 shares repurchased through the share buyback program completed as of July 3, 2007. The balance is held to meet potential future obligations under employee share and option plans. A proposal to cancel the shares repurchased through the share buyback program will be submitted to shareholders at the Annual General Meeting in 2008. As of December 31, 2007, the number of common shares issued, including those held as treasury shares, was 145,546,820 corresponding to share capital of CHF 14.6 million.

Total recognized income and expense included in total equity, after minority interests, was USD 6.1 billion. The major drivers were net income after taxes of USD 5.7 billion, an increase in cumulative translation adjustments of USD 572 million and reductions in net unrealized gains/(losses) on investments of USD 635 million, which offset an improvement in actuarial gains/(losses) on pension plans of USD 476 million.

# Cash flows

## Summary of cash flows

| in USD millions, for the years ended December 31 | 2007 | 2006 |
|---|---|---|
| Net cash (used in)/provided by operating activities | (1,580) | 640 |
| Net cash (used in)/provided by investing activities | (617) | 54 |
| Net cash used in financing activities | (2,686) | (1,940) |
| Foreign currency translation effects on cash and cash equivalents | 642 | 1,637 |
| Cash and cash equivalents excluding cash received as collateral for securities lending | 15,061 | 19,302 |
| Change in cash received as collateral for securities lending | (1,943) | (751) |
| Cash and cash equivalents as of January 1, including cash received as collateral for securities lending | 23,122 | 23,482 |
| **Cash and cash equivalents as of December 31, including cash received as collateral for securities lending** | **16,936** | **23,122** |

Net cash used in operating activities was USD 1.6 billion for the year ended December 31, 2007, with the variance over last year predominantly driven by a lower proportion of cash in total investments. Net cash used in investing activities was USD 617 million for the year ended December 31, 2007, mainly attributable to the Bristol West and Nasta transactions. Net cash used in financing activities was USD 2.7 billion, driven by the dividends paid in April 2007 and treasury share transactions, offset by a net positive contribution of USD 322 million from the issuance of hybrid debt in May 2007, exceeding the early redemption of subordinated debt.

## Currency translation impact

We operate worldwide in multiple currencies and seek to match our foreign exchange exposures on an economic basis. As we have chosen the US dollar as our presentation currency, differences arise when functional currencies are translated into our presentation currency. The table below shows the effect of foreign currency rates on the translation of selected line items.

**Selected Group income statement items**

| variance over the prior period, for the year ended December 31, 2007 | in USD millions | in % |
|---|---|---|
| Gross written premiums and policy fees | 2,021 | 4% |
| Insurance benefits and losses, gross of reinsurance | (1,669) | (5%) |
| Net income attributable to shareholders | 199 | 4% |

**Selected Group balance sheet items**

| variance over December 31, 2006, as of December 31, 2007 | in USD millions | in % |
|---|---|---|
| Total investments | 13,036 | 4% |
| Reserves for insurance contracts, gross | 11,024 | 5% |
| Cumulative translation adjustment in total equity | 663 | 2% |

The income statements are translated at average exchange rates where the weakening of the US dollar during the year ended December 31, 2007, compared with 2006, resulted in an increase to most line items.

The balance sheets are translated at end-of-period rates. The weakness of the US dollar as of December 31, 2007, compared with December 31, 2006, resulted in an increase in most balance sheet positions.