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## **Annual Results Reporting 2004 – Media Conference**

*Remarks by James J. Schiro*

*Chief Executive Officer*

*February 17, 2005*

My colleagues and I are very pleased with our performance. Business operating profit is 3.1 billion dollars, up 36%, net income is 2.6 billion dollars, up 29%, and return on equity is 13.3%, up 1.2 percentage points.

Current operations in General Insurance were strong in all regions, with excellent underwriting results in particular in Continental Europe, the United Kingdom and our International Businesses. They were offset by the impact of catastrophes and our decisive action to address the legacy that poor underwriting in the years 1997 to 2001 had left on our commercial business in North America.

Farmers Management Services produced record earnings and the Exchanges, which we manage but do not own, grew their surplus by 462 million dollars despite more than 100 million dollars in hurricane losses. That was well ahead of the 400 million dollar target announced in April.

I am particularly satisfied with the progress in our life business. Germany, based on our strong distribution network, achieved record volume growth and new business value, while Switzerland and the UK continued their recovery.

Finally, Group Investment generated a strong investment result. The exposure to common stock for which the Group bears equity investment risk was reduced from 6.4% to 4.9%. At the same time, total return on our investments increased by one percentage point to 5.9% despite a continued difficult economic environment.

Based on our strong underlying performance, and in light of our regained financial strength, the Board of Directors proposes a payout of 4 Swiss francs per share in form of a nominal value reduction.

Clearly, in 2004 we reaped the benefits of our well diversified portfolio. Today, we have high quality earnings, generated on a firm foundation for sustained profitability.

Too often the quality of earnings has been overlooked because of issues from the past. We have been determined to get them behind us.

I have talked before about issues that arose in our industry from the cash flow underwriting in the years 1997 to 2001. Today, we have dealt with them. We strengthened prior year loss reserves by 2.0 billion dollars. This is a net figure which includes 2.6 billion dollars strengthening in North America Corporate mitigated by releases in some of our other operations without departing from our overall conservative stance.

Throughout the year, we have been talking about the implementation of our new approach to the reserving process and we have now completed a global review of our reserves. We carried out peer reviews on our worldwide reserves. This included the use of leading third-party actuaries where appropriate. In addition, in the fourth quarter we moved to more conservative actuarial assumptions in the US in order to be sure we had addressed the legacy of the 1997 to 2001 underwriting years. As a result, reserves were increased across the board.

To put our reserving in a broader perspective: In the last two years we made adjustments for prior year developments of 3.8 billion dollars, while our net insurance reserves increased from 30.4 billion dollars at the end of 2002 to 43.5 billion dollars at the end of 2004. Over

the same two years, shareholders' equity grew by 5.7 billion dollars to 22.2 billion dollars while the financial capital in support of our business increased by 7.1 billion dollars to 28.1 billion dollars. Clearly, our balance sheet has become much stronger over the years and we have a solid platform to grow our business.

The strengthening of our balance sheet completes our turnaround. We are confident that the legacies are now addressed. We sharpened our focus and improved our performance. Today, we are operating from a firm foundation for future sustainable profitability. We are now in a good position worldwide on our reserves and we have the resilience to absorb the future impacts of risks which are clearly inherent in our business.

### **The insurance industry – issues and outlook**

Last year, the insurance industry, including Zurich, came under heightened scrutiny by public authorities and regulators concentrating primarily on certain business practices involving insurance carriers and brokers, the use of non traditional products and reinsurance. We proactively performed our internal reviews and have taken remedial actions where necessary. In particular, we completed our response to the information requests relating to certain business practices involving insurance brokers and insurance carriers. We continue to strengthen our processes and are committed to comply with laws, regulations and ethical standards as embodied in our core principles Zurich Basics, our internal core values and basic principles.

We may not like the cause of change brought on by these investigations. But I believe that we are better off by accepting the unavoidable in a proactive manner. Over the last three years, we have been reviewing all practices and procedures with a view to making us more competitive and efficient. We have instilled financial discipline, improved our internal controls and promoted transparency. We worked hard to build trust and credibility, and we continue to strive for the highest levels of operational efficiency and professional integrity. We know that the success of our business depends on the trust of our customers just as much as on our ability to provide value to the market.

No doubt, the current year will be challenging us on many fronts. I just mentioned heightened regulatory scrutiny; other challenges relate to strength of the insurance cycle. An industry forecaster recently predicted net written premium in the US to grow at less than 3% in the current year after growth of more than 4% in 2004 and of nearly 10% in 2003. Obviously, these are averages, and there is a considerable degree of variation between different lines, regions and countries.

Despite declining prices in some lines of business, current rates continue to be more than adequate to write profitable business. Where market rates do not meet our hurdle, we will either write less business or withdraw completely. Our preference is clear: we would rather forego growth than write unprofitable business.

However, more important is the fact that we do not see the widespread loss of discipline typically associated with the late stages of the insurance cycle. Terms and conditions are fairly stable. Recent reinsurance renewals, although not necessarily representative for direct insurers, appear to be firmer than most would have predicted earlier, and a couple of weeks ago Lloyd's announced that they were going to reduce capacity by 9% in 2005.

Barring extraordinary events, our markets will be satisfying in 2005. On the basis of our strong balance sheet and the fundamental improvements in our businesses, we are well positioned to benefit from this market and write profitable business at adequate prices.

### **The way forward**

In the last three years, we have laid the foundation and created a stable platform. Now we are building the future. Our goal is to perform consistently in the top quartile of our industry through all stages of the cycle. On April 2, 2004 we presented our clear direction and we are now implementing processes that will help us achieve world-class best practices. We call this The Zurich Way of doing business.

Let me be more specific.

The Zurich Way was developed in seven major project initiatives, each containing the blueprints for achieving consistent and sustained performance improvements. These workstreams include: personal lines underwriting; corporate and commercial underwriting; claims management; distribution; life operations; finance; and the most important talent management. The finance workstream, for example, has helped the Group enhance financial discipline during the 2005 planning and budgeting process and our approach to reserving was shaped by The Zurich Way.

Based on the lessons learned from the pilots in 2004, there will be a total of more than 100 projects running through 2005, each closely defined and monitored with monthly review processes and well defined milestones to be met. It is our old and proven devise: what gets measured gets done. We saw the results in the success of our profit improvement initiatives in 2003 and 2004. Disciplined project implementation is part of The Zurich Way of driving our business.

The Zurich Way has become an integral part of our planning process. Initiatives designed to deliver sustainable improvements in 2005 and subsequent years were identified with a benefit of 500 million dollars after tax expected in 2005. Let me remind you that our last improvement programs have delivered. We achieved more than 1 billion dollars in 2003 and more than 540 million dollars in 2004.

For us, The Zurich Way is a method by which to identify areas of possible improvement. That is why our expected improvements are moving away from predominantly cost cutting initiatives to a growing contribution from improvements in technical areas. These are the core processes that deliver our results. Improvements in these areas do not come at the exposure of our forms on cost discipline.

Let me give you an example about the potential of technical improvements.

One of our goals is to minimize leakage. Underwriters define leakage as the difference in premium between the one price an expert would have charged and the actual price that went out the door. A precondition is to have a full documentation, or a narrative, on our transactions. We found in the US, for example, that more than half of the narratives were either missing or inadequate, and where no narrative was present, there was nearly 40% leakage. We are going to fix this. Our actions are based on our UK best practice where pre-runners to The Zurich Way of underwriting have been implemented more than two years ago.

Clearly, having to fix underwriting leakage is indicative of both an operational and a “cultural” problem. But once identified and acted upon, the solution will lead to powerful improvements. We are in the midst of changing the culture and mindset of our underwriters. They are excited, because they see results, and that is why we are confident that we will reach our improvement goals.

However, this is not just about changing the mindset of our underwriters. It is about changing the culture and raising the bar for all of our employees. An important part of The Zurich Way talent management initiative is that our Top 200 senior executives have been assessed by external consultants. We have taken an inventory of our talent and where we have found gaps, we will fill them and we will continue to fill and upgrade our talent.

### **Our structure is right**

We feel good about our businesses and the structure we are operating in. We have a well diversified General Insurance book and are a global player in Life Insurance.

Our main portfolio in General Insurance covers North America and Europe. These are very attractive markets where we are operating from a position of strength. Our beachheads in the emerging markets of our International Businesses ensure that we can benefit from the growth dynamics seen in these regions. They are part of our new International Businesses division and we will develop these markets in line with their potential. We just made a big investment in China, and we are prepared to apply our global expertise to new markets.

The new Global Corporate division had an excellent start. It is our answer to the challenge of globalization, offering our large global corporate customers a network that provides service in more than 120 countries. We were able to win a number of large customers, and the division has achieved 7.4 billion dollars in gross written premium.

We are driving our businesses on a global scale while being mindful of cultivating our local markets. Our centrally coordinated allocation of risk capital allows us to benefit from the best return profiles in our worldwide portfolio.

Let me recap.

Three years ago I said that I was excited about Zurich's future based on the Group's strong business and its excellent market presence. Today, I feel even better.

We have dealt with the issues from the past. We are stronger for having done so, and we will continue to deal with issues swiftly, forcefully and in a transparent manner. Our turnaround is now complete.

We have sharpened our focus, improved our earnings capacity, and strengthened the Group's balance sheet. Our underlying performance has never been better.

In short, we have laid a firm foundation for sustainable profitable growth in our endeavour to deliver attractive returns to shareholders independently of market conditions.

Thank you.