

Operating and financial review 2011

Zurich Financial Services Group
Results for the nine months to September 30, 2011

Operating and financial review

The information contained within the Operating and financial review is unaudited. This document should be read in conjunction with the Annual Report 2010 and with the unaudited Consolidated financial statements as of September 30, 2011, for the Zurich Financial Services Group. Comparatives are for the nine months ended September 30, 2010, or as of December 31, 2010, unless otherwise stated. All amounts are shown in U.S. dollars, rounded to the nearest million unless otherwise stated with the consequence that the rounded amounts may not add to the rounded total in all cases. All ratios and variances are calculated using the underlying amount rather than the rounded amount.

In addition to the figures stated according to the International Financial Reporting Standards (IFRS), Zurich Financial Services Group uses business operating profit (BOP) measures and other performance indicators to enhance the understanding of its results. These additional measures should be viewed as complementary to, and not a substitute for, the figures determined according to the IFRS. For a reconciliation of BOP to net income after income taxes see note 15 of the unaudited Consolidated financial statements. Certain comparative figures have been restated, as set out in note 1 of the unaudited Consolidated financial statements.

Financial highlights

in USD millions, for the nine months ended September 30, unless otherwise stated	2011	2010	Change ¹
Business operating profit	3,258	3,537	(8%)
Net income attributable to shareholders	3,210	2,399	34%
General Insurance gross written premiums and policy fees	27,047	25,528	6%
Global Life gross written premiums, policy fees and insurance deposits	19,350	18,894	2%
Farmers Management Services management fees and other related revenues	2,071	2,096	(1%)
Farmers Re gross written premiums and policy fees	2,261	3,722	(39%)
General Insurance business operating profit	1,732	1,972	(12%)
General Insurance combined ratio	98.8%	97.7%	(1.0 pts)
Global Life business operating profit	1,005	1,098	(8%)
Global Life new business annual premium equivalent (APE)	2,770	2,495	11%
Global Life new business margin, after tax (as % of APE) ²	26.3%	23.6%	2.7 pts
Global Life new business value, after tax ²	729	589	24%
Farmers business operating profit	1,096	1,295	(15%)
Farmers Management Services gross management result	995	1,024	(3%)
Farmers Management Services managed gross earned premium margin	7.3%	7.4%	(0.1 pts)
Average Group investments	197,063	197,138 ³	–
Net investment result on Group investments	7,616	6,288	21%
Net investment return on Group investments ⁴	3.9%	3.2%	0.7 pts
Total return on Group investments ⁴	4.4%	6.1%	(1.7 pts)
Shareholders' equity ⁵	31,874	31,905	–
Swiss Solvency Test capitalization ratio ⁶	225%	223%	2 pts
Diluted earnings per share (in CHF)	19.07	17.43	9%
Book value per share (in CHF) ⁵	197.53	202.18	(2%)
Return on common shareholders' equity (ROE)	13.5%	10.8%	2.7 pts
Business operating profit (after tax) return on common shareholders' equity (BOPAT ROE)	10.6%	12.3%	(1.7 pts)

¹ Parentheses around numbers represent an adverse variance.

² Changes to the basis of calculation of embedded value, including new business, are set out in the New business overview and in the Global Life section of the Operating and financial review.

³ Excluding average cash received as collateral for securities lending of USD 342 million in the nine months ended September 30, 2010.

⁴ Not annualized and calculated on average Group investments.

⁵ As of September 30, 2011 and December 31, 2010, respectively.

⁶ As filed with the regulator for the periods ended June 30, 2011 and December 31, 2010, respectively, based on the results for the Group on a consolidated basis, subject to the Group regulator's review, as well as its approval of the Group's internal model.

Performance overview for the nine months to September 30, 2011

Zurich Financial Services Ltd and its subsidiaries, collectively "the Group," delivered a strong result for its shareholders that reflects the strategic focus on profitability, market risk mitigation and the maintenance of growth despite the volatile and difficult economic environment in most mature markets. The Group continued to execute its margin enhancement strategies and to develop its business in emerging markets where the outlook for economic growth remains positive. Significant acquisitions have been closed recently in Latin America and Malaysia providing the Group with substantial further presence and size in its target emerging markets.

The Group's focus on the mitigation of market risk is reflected in the investment gains on derivatives which have more than offset incurred losses in business and investment results. Robust and sustained underwriting discipline during the continued economic difficulties has improved the underlying General Insurance result compensating for the above average catastrophe and weather loss experience.

The Group's capital position remains strong with shareholders' equity of USD 31.9 billion at the same level as of December 31, 2010 after recording the total cost of USD 2.7 billion for dividends and USD 801 million higher than as of June 30, 2011, despite the volatile financial markets. In March 2011, Moody's Investors Service upgraded the insurance financial strength rating of Zurich Insurance Company Ltd to Aa3 from A1 and also upgraded its debt ratings.

As part of the establishment of the 51 percent participation in the Latin American insurance operations of Banco Santander SA, the Group has appointed senior management and completed acquisitions in Brazil, Mexico, Chile, Argentina and Uruguay in the fourth quarter of 2011. In Malaysia the Group also closed the acquisition of the composite insurer, Malaysian Assurance Alliance Berhad.

Business operating profit for the first nine months of 2011 decreased by USD 279 million to USD 3.3 billion, or by 8 percent in U.S. dollar terms and 11 percent on a local currency basis and decreased by USD 131 million to 1.1 billion for the three months ended September 30, 2011 compared with the same period of 2010.

- **General Insurance** business operating profit decreased by USD 240 million to USD 1.7 billion, or by 12 percent in U.S. dollar terms and 17 percent on a local currency basis. Sustained focus on margin enhancement strategies has continued to produce strong improvements in the underlying loss ratio, but these improvements were more than offset by the exceptional frequency and overall severity of catastrophe and significant weather-related loss events, as well as by higher large losses in the Global Corporate business. Aggregate catastrophe losses of USD 662 million were recorded in the first nine months of 2011 for the major natural disasters in Asia-Pacific during the first six months of 2011 as well as for hurricane Irene in the U.S. at the end of August, compared with USD 200 million in 2010 for the Chilean earthquake.
- **Global Life** business operating profit decreased by USD 93 million to USD 1.0 billion, or by 8 percent in U.S. dollar terms and 15 percent on a local currency basis. Increases in fee income from higher average assets under management plus higher margins from protection business were more than offset by deferred acquisition cost impacts resulting from the fall in European equity markets at the end of September and higher costs related to both investments in the global operations strategy and allocations of Group expenses.
- **Farmers** business operating profit decreased by USD 200 million to USD 1.1 billion or by 15 percent. **Farmers Management Services** business operating profit decreased by USD 28 million to USD 1.0 billion or by 3 percent, driven by reduced revenues, largely as a result of the planned run-off of the 21st Century agency auto book of business in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Group. **Farmers Re** business operating profit decreased by USD 172 million to USD 76 million or by 69 percent reflecting the reduction in the All Lines quota share reinsurance treaty with the Farmers Exchanges (All Lines quota share treaty) and exceptionally high weather-related losses in the U.S. in 2011.

Other Operating Businesses reported an increase in its business operating loss of USD 14 million to USD 588 million primarily as a result of positive one-off items included in 2010, as well as the strengthening of the Swiss franc.

Non-Core Businesses reported a business operating profit of USD 13 million compared with a loss of USD 256 million in the same period of 2010. The improvement resulted mainly from lower banking loan loss provisions of USD 108 million compared with USD 345 million in the same period of 2010.

Operating and financial review *continued*

Business volumes for the core business segments, comprising gross written premiums, policy fees, insurance deposits and management fees, increased by USD 490 million to USD 50.7 billion, or by 1 percent in U.S. dollar terms, but decreased 5 percent on a local currency basis. Volumes developed as follows:

- **General Insurance** gross written premiums and policy fees increased by USD 1.5 billion to USD 27.0 billion, or by 6 percent in U.S. dollar terms, but remained flat on a local currency basis. The focus on selective growth through disciplined underwriting to increase profit margins remains unchanged. Average rate increases of more than 3 percent were achieved despite the slow economic recovery in the U.S. and in many European countries. Growth continues to be achieved in Global Corporate businesses as well as in Latin America and Asia-Pacific.
- **Global Life** gross written premiums, policy fees and insurance deposits increased by USD 455 million to USD 19.4 billion or by 2 percent in U.S. dollar terms but reduced by 4 percent on a local currency basis. Volume increases in strategic growth markets in Latin America and Asia-Pacific and Middle East were offset by lower volumes in Ireland, Spain and Germany as difficult market conditions persisted in those countries, together with the impact of the divestment of Caixa Sabadell in Spain.
- **Farmers Management Services** management fees and other related revenues decreased by USD 25 million to USD 2.1 billion or by 1 percent in line with a decrease of 2 percent in gross earned premiums in the Farmers Exchanges, due mainly to the effect of the planned run-off of the 21st Century agency auto book of business. The 39 percent decrease to USD 2.3 billion in gross written premiums of **Farmers Re** reflected the reduction in the All Lines quota share treaty.

Net income attributable to shareholders increased by USD 811 million to USD 3.2 billion, or by 34 percent. The overall result benefited from net capital gains including a realized gain on the sale of part of the Group's investment in New China Life Insurance Co., Ltd, and valuation gains on derivatives. In the same period of 2010 costs for the settlement of a class action suit in the U.S. were recorded. The **shareholders' effective tax rate** was 22.3 percent for the nine months ended September 30, 2011 compared with 22.7 percent for the same period of 2010 and 20.3 percent for the year ended December 31, 2010. The shareholders' effective tax rate for the year ended December 31, 2010, was primarily impacted by a combination of favorable tax settlements and shifts in the geographic profit mix.

ROE of 13.5 percent increased by 2.7 percentage point due to the effect of the increase in net income attributable to shareholders. **BOPAT ROE** was 10.6 percent. **Diluted earnings per share** increased to CHF 19.07 for the nine months ended September 30, 2011, compared with CHF 17.43 for the same period of 2010.

General Insurance

in USD millions, for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	27,047	25,528	6%
Net earned premiums and policy fees	21,708	20,794	4%
Insurance benefits and losses, net of reinsurance	(15,704)	(14,762)	(6%)
Net underwriting result	263	470	(44%)
Net investment income	2,131	2,144	(1%)
Net non-technical result (excl. items not included in BOP)	(667)	(659)	(1%)
Business operating profit	1,732	1,972	(12%)
Loss ratio	72.3%	71.0%	(1.4 pts)
Expense ratio	26.4%	26.7%	0.3 pts
Combined ratio	98.8%	97.7%	(1.0 pts)

in USD millions, for the nine months ended September 30	Business operating profit (BOP)		Combined ratio	
	2011	2010	2011	2010
Global Corporate	232	591	103.2%	93.7%
North America Commercial	767	850	96.3%	96.6%
Europe	727	566	97.1%	97.5%
International Markets	(108)	35	108.0%	104.2%
GI Global Functions including Group Reinsurance	113	(70)	nm	nm
Total	1,732	1,972	98.8%	97.7%

Business operating profit decreased by USD 240 million to USD 1.7 billion, or by 12 percent in U.S. dollar terms and 17 percent on a local currency basis. The sustained focus on margin increases has continued to improve the underlying result, but these improvements were more than offset by the exceptional frequency and overall severity of natural catastrophes and significant weather-related events throughout the first nine months of 2011. The total estimate for these loss events has triggered the Group's aggregate catastrophe reinsurance cover with recoveries recorded in the Group Reinsurance result. Investment income declined by 1 percent in U.S. dollar terms, mainly due to lower yields in Europe and the U.S. Despite the continued frequency of major events, business operating profit improved in both the three months ended June 30, 2011 and September 30, 2011 compared with the same periods of 2010.

Gross written premiums and policy fees increased by USD 1.5 billion to USD 27.0 billion or by 6 percent in U.S. dollar terms, but remained flat on a local currency basis. In line with the strategy to improve margins, average rates increased by more than 3 percent, an improvement of 1.4 percentage points and, despite these rate increases, customer retention levels improved slightly compared with the same period of 2010. Premium growth has been achieved in the Global Corporate business and in selected countries in International Markets. In the North American market, rates have improved, while growth has been generated in certain customer segments. European volumes continued to decline on a local currency basis, mainly due to underwriting actions implemented to improve profitability, particularly in the personal lines motor business, but also from the depressed levels of economic activity in certain European markets.

The **net underwriting result** decreased by USD 207 million to USD 263 million reflected in the deterioration of 1.0 percentage points in the combined ratio to 98.8 percent. The underlying loss ratio continues to improve as the rate and re-underwriting strategies continue to increase the Group's profit margin. However, the impact of the exceptional frequency and severity of loss events arising from catastrophes and weather-related events, including Hurricane Irene which accounted for USD 105 million in the three months ended September 30, as well as higher levels of large losses, more than offset the positive developments in the underlying loss ratio. The underwriting result was further impacted by changes in reserving assumptions for certain lines of business in Germany including the development of reserves established in prior years. The expense ratio developed favorably by 0.3 percentage points to 26.4 percent driven by the other underwriting expense ratio. Absolute underlying expenses decreased as continued focus on expenses maintained a balance between investments in emerging markets and expense management actions.

Operating and financial review *continued*

Global Corporate

in USD millions, for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	6,528	5,917	10%
Net underwriting result	(131)	227	nm
Business operating profit	232	591	(61%)
Loss ratio	83.7%	73.2%	(10.5 pts)
Expense ratio	19.5%	20.5%	1.0 pts
Combined ratio	103.2%	93.7%	(9.5 pts)

Business operating profit of USD 232 million was USD 358 million lower than in the same period of 2010. The decrease was entirely attributable to the reduction in the underwriting result as described below. Investment income increased compared with the same period of 2010 due to increased invested assets, offset by a deterioration of non-technical expenses as a result of losses on foreign currency transactions in the current period compared with gains in the same period of 2010.

Gross written premiums and policy fees increased by USD 611 million to USD 6.5 billion, or by 10 percent in U.S. dollar terms and 4 percent on a local currency basis. Part of the growth is attributable to a higher level of fronting business for corporate customers. The focus remained on underwriting and pricing discipline. As a result, average rate increases of 3 percent were obtained on business written in the European and North American markets and despite this very competitive market environment, higher retention rates have been achieved. Customer insured exposures have increased in North America, whilst in Europe they remained broadly flat. Asia-Pacific and Middle East premiums increased by 14 percent on a local currency basis, although from a small base, reflecting the strategy to expand the Group's presence in those markets.

The **net underwriting result** deteriorated by USD 358 million to a loss of USD 131 million reflected in the 9.5 percentage points increase in the combined ratio to 103.2 percent. The loss ratio deteriorated by 10.5 percentage points compared with the same period of 2010, which included underlying loss ratio improvements resulting from increased rates and better risk selection, but these were more than offset by the significant impact of the catastrophe and weather-related events, including the earthquakes in Asia-Pacific and significant weather-related events in Australia and the U.S. in the first six months of 2011 and hurricane Irene in the three months ended September 2011. In addition to these events, Global Corporate experienced higher levels of large losses, mainly in Europe. The expense ratio improved 1.0 percentage points to 19.5 percent mainly driven by a reduction in other underwriting expenses as a result of the disciplined approach to cost management. This was partially offset by continued strategic investments in both Asia-Pacific and the Middle East.

North America Commercial

in USD millions, for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	7,278	7,408	(2%)
Net underwriting result	208	191	9%
Business operating profit	767	850	(10%)
Loss ratio	67.0%	66.3%	(0.6 pts)
Expense ratio	29.3%	30.3%	1.0 pts
Combined ratio	96.3%	96.6%	0.4 pts

Business operating profit decreased by USD 84 million to USD 767 million, or by 10 percent. The net underwriting result improved by USD 17 million as described below. Investment income reduced compared with the same period of 2010 as a result of lower yields and lower hedge fund gains reflecting market volatility.

Gross written premiums and policy fees decreased by USD 130 million to USD 7.3 billion, or by 2 percent, reflecting the continued challenging economic environment in a number of sectors in the U.S. Volumes continued to be negatively impacted by strong competition and the effects of rigorous re-underwriting and tiering strategies which resulted in the non-renewal of certain unprofitable accounts. Retention of profitable business through risk selection and segmentation strategies continued to be the focus as evidenced by the retention improvement in the three months ended September 2011 compared with the same period in 2010. In the three months ended September 2011, growth of 2 percent in new business, compared with the same period of 2010, has been achieved in specific targeted segments, in particular middle market commercial business, energy casualty, direct markets and segmented programs in the U.S. and in Canada. Overall, North America Commercial achieved average rate increases of 3 percent in its highly competitive marketplace.

The **net underwriting result** improved by USD 17 million to USD 208 million, or by 9 percent reflected in a 0.4 percentage points improvement in the combined ratio to 96.3 percent. The underwriting result was favorably impacted by an improvement in the underlying loss ratio, reflecting the Group's disciplined underwriting, lower levels of large losses and higher levels of favorable development of reserves established in prior years. These improvements were partially offset by higher weather-related losses due to a series of tornadoes which hit the Midwest and Southeast regions of the U.S. in April and May and hurricane Irene which struck the eastern seaboard of the U.S. in August. The expense ratio improved by 1.0 percentage points driven primarily by a reduction in commissions relating to certain one-off impacts including profit commissions on crop business paid in the same period of 2010.

Operating and financial review *continued*

Europe

in USD millions, for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	10,366	9,745	6%
Net underwriting result	280	232	20%
Business operating profit	727	566	28%
Loss ratio	71.6%	72.4%	0.9 pts
Expense ratio	25.5%	25.1%	(0.4 pts)
Combined ratio	97.1%	97.5%	0.4 pts

Business operating profit increased by USD 161 million to USD 727 million or by 28 percent in U.S. dollar terms and 13 percent on a local currency basis. The performance was driven by an improvement in the underwriting result as described below. On a local currency basis, investment income decreased mainly due to lower yields and capital repatriation to the Group reducing the asset base. This reduction was more than offset by an improvement in the non-technical expenses with a reduction in regional costs in the first nine months of 2011 and the effect of the 2010 impairment in Russia.

Gross written premiums and policy fees increased by USD 621 million to USD 10.4 billion or by 6 percent in U.S. dollar terms but decreased 3 percent on a local currency basis. The overall market and economic environment in many European countries continued to remain challenging with depressed economic activity and higher unemployment. Actions taken to improve profitability have resulted in lower volumes. An overall rate increase of 4 percent was achieved in the first nine months of 2011, with the highest increases in the UK, Italy and Spain. Despite these increases, customer retention levels improved compared with the same period of 2010.

The **net underwriting result** increased by USD 47 million to USD 280 million reflected in an improvement in the combined ratio of 0.4 percentage points to 97.1 percent. Underlying improvements in the underwriting result arising from the continued focus on underwriting strategies, including rate increases, were partially offset by increased weather-related losses, such as the severe hailstorms in Switzerland and Germany amounting to approximately USD 130 million in total and by the riots in the UK, as well as lower favorable development of reserves established in prior years. In Germany, the underwriting result was impacted by the strengthening of loss reserves and changes in assumptions on unearned premium reserves in certain lines of business. Corrective actions on personal motor lines in the UK, Italy and Russia improved the overall result. The expense ratio increased by 0.4 percentage points due to the impact of lower net earned premiums with the absolute amount of other underwriting expenses having slightly decreased.

International Markets

for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	3,358	2,857	18%
Net underwriting result	(199)	(88)	nm
Business operating profit	(108)	35	nm
Loss ratio	73.7%	68.6%	(5.0 pts)
Expense ratio	34.3%	35.5%	1.2 pts
Combined ratio	108.0%	104.2%	(3.8 pts)

Business operating loss of USD 108 million deteriorated by USD 142 million from a profit of USD 35 million in the same period of 2010, driven by the decreased underwriting result as described below. An increase in investment income was generated due to higher yields as well as a higher asset base driven by portfolio growth. Non-technical expenses reverted to normal levels following favorable currency revaluations in Latin America in the same period of 2010.

Gross written premiums and policy fees increased by USD 501 million to USD 3.4 billion, or by 18 percent in U.S. dollar terms and 10 percent on a local currency basis. Growth in Latin America was 20 percent on a local currency basis, mainly driven by overall growth in Brazil as well as growth in motor business in Argentina. The Asia-Pacific region achieved growth of 7 percent on a local currency basis driven by rate increases in Australia and strong growth in motor lines in Japan. Premiums in the Middle East and Africa remained broadly flat despite re-underwriting actions in South Africa.

The **net underwriting result** decreased by USD 111 million to a loss of USD 199 million reflected in the 3.8 percentage points increase in the combined ratio to 108.0 percent. The loss ratio increased by 5.0 percentage points to 73.7 percent, impacted by the losses from the earthquakes in Japan and New Zealand and the severe weather events in Australia including the Brisbane floods as well as the Victoria storms and cyclone Yasi. These impacts were partially offset by benign catastrophe experience in Latin America, where the Chilean earthquake impacted the results in the same period of 2010. The lower expense ratio was mainly driven by targeted expense saving initiatives in certain countries while continuing with investments in emerging markets.

Operating and financial review *continued*

Global Life

in USD millions, for the nine months ended September 30	2011	2010	Change
Insurance deposits	10,758	10,331	4%
Gross written premiums and policy fees	8,592	8,563	–
Net investment income on Group investments	3,125	2,906	8%
Insurance benefits and losses, net of reinsurance	(7,007)	(6,933)	(1%)
Business operating profit	1,005	1,098	(8%)
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts ¹	182,226	187,196	(3%)
Assets under management ^{1,2}	216,985	222,326	(2%)
Net policyholder flows ³	1,572	3,747	(58%)
New Business – highlights^{4,5}			
New business annual premium equivalent (APE)	2,770	2,495	11%
Present value of new business premiums (PVNBP)	22,643	20,875	8%
New business margin, after tax (as % of APE)	26.3%	23.6%	2.7 pts
New business margin, after tax (as % of PVNBP)	3.2%	2.8%	0.4 pts
New business value, after tax	729	589	24%

¹ As of September 30, 2011 and December 31, 2010

² Assets under management comprise Group and unit-linked investments that are included in the Global Life balance sheet plus assets that are managed by third parties, on which the business earns fees.

³ Net policyholder flows are defined as the sum of gross written premiums and policy fees and deposits, less policyholder benefits.

⁴ In 2011 new business figures have been determined including a liquidity premium in the discount rate and, for greater consistency with other European Insurers, a cost of capital applied to residual non-hedgeable risks of 4 percent. The 2010 comparatives have been restated to reflect these changes.

⁵ A refinement in methodology for calculating new business value for corporate protection business was introduced in 2011 contributing USD 109 million to new business value, after tax, of which USD 106 million relates to international group protection business included in Other businesses, and 3.9 percent to new business margin, after tax in the first nine months of 2011. The refinement results from the inclusion of the value expected to be generated over the entire life of the contract in corporate protection business rather than the value expected to be generated up to the next review date in those contracts.

in USD millions, for the nine months ended September 30	New business value (NBV), after tax		New business annual premium equivalent (APE)		New business margin, after tax (as % of APE)		Business operating profit (BOP)	
	2011	2010	2011	2010	2011	2010	2011	2010
	North America	36	48	82	71	44.1%	67.2%	174
Latin America	52	40	231	155	22.5%	25.8%	40	63
Europe	385	391	1,908	1,848	20.2%	21.2%	684	799
<i>of which:</i>								
<i>United Kingdom</i>	106	89	784	618	13.5%	14.4%	190	263
<i>Germany</i>	112	128	390	422	28.8%	30.4%	235	246
<i>Switzerland</i>	18	5	108	61	16.3%	8.6%	184	173
<i>Ireland</i>	53	66	254	279	20.9%	23.7%	15	43
<i>Spain</i>	73	77	234	339	31.0%	22.7%	20	27
<i>Rest of Europe</i>	24	26	138	129	17.2%	20.1%	41	47
Asia-Pacific and Middle East	103	78	423	321	24.4%	24.2%	93	61
Other	152	33	126	100	120.4%	32.6%	14	(4)
Total	729	589	2,770	2,495	26.3%	23.6%	1,005	1,098

Global Life continues to make progress toward its strategic objective of diversifying into the higher growth markets of Latin America and Asia-Pacific and Middle East and is approaching its target of generating 30 percent of total new business value in these regions. The new business annual premium equivalent (APE) and new business value (NBV) generated by growth in these regions mitigated challenging market conditions in individual life business in Europe. In Spain and Ireland pricing behavior in the market on certain lines of business was on terms considered uneconomic by the Group and the single premium market in Germany has declined compared with the same period of 2010. Protection products, which generate higher margins, contributed to value growth across most regions except North America where new business value on protection business declined, despite increasing volumes, as a result of a change in persistency assumptions.

New business value, after tax was USD 729 million, an increase of USD 140 million or 24 percent in U.S. dollar terms and 14 percent on a local currency basis. Excluding the effect of the refinement in methodology, described in note 5 of the table, new business value increased by USD 31 million or 5 percent in U.S. dollar terms and remained largely flat in local currency. Growth in Asia-Pacific and Middle East was driven by strong sales of corporate savings business and growth in sales from the International/Expats pillar. Growth in Latin America came from increased sales of profitable individual protection business and Corporate Life & Pensions business in Brazil, and also Corporate Life & Pensions business in Mexico. Growth in Other arose from international group protection business, a large proportion of which is distributed in Asia-Pacific and Middle East. In Europe, growth in the Private Banking Client Solutions and Corporate Life & Pensions business in the UK was more than offset by reduced volumes in Germany, Ireland and Spain due to challenging market conditions in those countries. In Spain, despite the lower sales of savings products, new business value decreased by only USD 4 million compared with the same period of 2010, mainly as a result of higher sales of more profitable protection business.

New business annual premium equivalent (APE) was USD 2.8 billion, an increase of USD 275 million or 11 percent in U.S. dollar terms and 4 percent on a local currency basis. This increase was driven by strong sales of Corporate Life & Pensions business, particularly in the UK, Asia-Pacific and Middle East, and Switzerland, and by protection sales in Brazil. These increases were partly offset by lower sales in Ireland, Spain and Germany, with a further negative volume effect in Spain due to the divestment of Caixa Sabadell which ceased to be consolidated in September 2010.

Business operating profit decreased by USD 93 million to USD 1.0 billion or by 8 percent in U.S. dollar terms and 15 percent on a local currency basis. Margins from protection business increased as a result of higher volumes and disciplined underwriting, reflected in positive prior year development. In addition, higher average stock market levels and assets under management compared with the same period of 2010 increased fee income. These improvements were more than offset by deferred acquisition cost impacts driven by the fall in European equity markets at the end of September, as well as investment margin reduction from the continuing low interest rate environment and increased costs related to both investments in the global operations strategy and higher allocations of Group expenses.

Insurance deposits increased by USD 427 million to USD 10.8 billion or by 4 percent in U.S. dollar terms but decreased by 2 percent on a local currency basis driven by reductions in Germany, Ireland and Spain partially offset by increased volumes in the UK and Asia-Pacific and Middle East.

Gross written premiums and policy fees increased by USD 28 million to USD 8.6 billion, broadly flat in U.S. dollar terms but decreased by 8 percent on a local currency basis. This decrease on a local currency basis was driven by lower single premium volumes in Germany and Spain together with the divestment of Caixa Sabadell in Spain.

Net reserves decreased by USD 5.0 billion or by 3 percent in both U.S. dollar terms and on a local currency basis compared with December 31, 2010. **Assets under management** decreased by USD 5.3 billion or by 2 percent in U.S. dollar terms and 3 percent in local currency compared with December 31, 2010. **Net policyholder flows** remained positive at USD 1.6 billion despite the lower deposit and premium volumes in Germany, Ireland and Spain.

Operating and financial review *continued*

NBV and APE by pillar	in USD millions, for the nine months ended September 30	New business value (NBV), after tax		New business annual premium equivalent (APE)		New business margin, after tax (as % of APE)	
		2011	2010	2011	2010	2011	2010
		Bank Distribution	135	157	467	628	28.9%
IFA/Brokers	130	144	705	713	18.5%	20.2%	
Agents	85	91	349	334	24.5%	27.3%	
International/Expats	66	47	230	183	28.7%	25.9%	
Total Retail pillars	416	439	1,750	1,858	23.8%	23.7%	
Corporate Life & Pensions	246	89	729	409	33.7%	21.8%	
Private Banking Client Solutions	13	9	198	157	6.5%	5.5%	
Direct and Central Initiatives	54	52	93	72	57.5%	71.8%	
Total	729	589	2,770	2,495	26.3%	23.6%	

Bank Distribution new business value decreased by USD 22 million to USD 135 million or by 14 percent in U.S. dollar terms and 19 percent on a local currency basis. Growth in Latin America and several European countries was more than offset by reduced volumes of single premium sales in Germany and significantly reduced volumes of savings business in Spain where pricing behavior in the market was on terms considered uneconomic by the Group leading to lower participation in this business. However increased volumes of higher margin protection products in Spain drove an overall improvement in new business margin of 3.9 percentage points to 28.9 percent.

IFA/Brokers new business value decreased by USD 14 million to USD 130 million or by 9 percent in U.S. dollar terms and 16 percent on a local currency basis. Lower volumes put pressure on new business margins which fell by 1.7 percentage points. Growth in North America and Latin America was more than offset by lower sales in the UK and Ireland. In Ireland, both domestic business and cross-border business distributed in Italy reported reduced volumes, where Italy benefited in 2010 from additional sales resulting from an Italian fiscal amnesty.

Agents new business value decreased by USD 6 million to USD 85 million or by 7 percent in U.S. dollar terms and 10 percent on a local currency basis. Increased sales in Switzerland and Latin America improved new business value but were offset by the negative impact of the reduced new business margin in North America resulting from a change in persistency assumptions and lower sales in Italy and Germany.

International/Expats new business value increased by USD 18 million to USD 66 million or by 39 percent in U.S. dollar terms and 30 percent on a local currency basis. This was predominantly driven by volume growth in Asia-Pacific and Middle East together with an improvement of 2.8 percentage points in the overall new business margin to 28.7 percent.

Corporate Life & Pensions new business value increased by USD 157 million to USD 246 million. Excluding the corporate protection methodology refinement, new business value increased by USD 48 million or by 54 percent in U.S. dollar terms and 38 percent on a local currency basis. Global relationships with major employee benefit consultants and leverage of the Group's Global Corporate presence drove volume increases in most regions, the most significant of which were in Asia-Pacific and Middle East and in the UK.

Private Banking Client Solutions new business value increased by USD 4 million to USD 13 million or by 50 percent in U.S. dollar terms and 42 percent on a local currency basis. The growth in new business value was driven by the continued placements of tranches of an investment bond through bank partners in the UK.

Direct and Central Initiatives new business value increased by USD 2 million to USD 54 million or by 4 percent in U.S. dollar terms and 2 percent on a local currency basis.

Farmers

Farmers business operating profit decreased by USD 200 million to USD 1.1 billion or by 15 percent. This reduction reflects the reduced participation in the All Lines quota share treaty in Farmers Re and a significant increase in weather-related losses compared with the same period of 2010, as well as lower revenues in Farmers Management Services from the lower gross earned premiums in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Group.

Farmers Management Services

in USD millions, for the nine months ended September 30	2011	2010	Change
Management fees and other related revenues	2,071	2,096	(1%)
Management and other related expenses	(1,077)	(1,072)	–
Gross management result	995	1,024	(3%)
Other net income	25	24	5%
Business operating profit	1,020	1,048	(3%)
Managed gross earned premium margin	7.3%	7.4%	(0.1 pts)

Business operating profit of USD 1.0 billion decreased by USD 28 million or by 3 percent driven by the lower gross management result.

Management fees and other related revenues of USD 2.1 billion decreased by USD 25 million or by 1 percent largely driven by the effect of the planned run-off of the 21st Century agency auto book of business. This was partially offset by continued increasing gross earned premiums in the Farmers Exchanges from 21st Century direct, small business solutions, and specialty businesses. **Management and other related expenses** of USD 1.1 billion were consistent with the level of expenses in the same period of 2010.

As a result, the **gross management result** decreased by USD 29 million to USD 995 million, or by 3 percent, while the **managed gross earned premium margin** decreased by 0.1 percentage points to 7.3 percent.

Operating and financial review *continued*

Farmers Re

in USD millions, for the nine months ended September 30	2011	2010	Change
Gross written premiums and policy fees	2,261	3,722	(39%)
Net underwriting result	(30)	101	nm
Business operating profit	76	248	(69%)
Loss ratio	71.1%	66.6%	(4.5 pts)
Expense ratio	30.2%	31.1%	0.9 pts
Combined ratio	101.3%	97.7%	(3.6 pts)

Business operating profit of USD 76 million decreased by USD 172 million or by 69 percent primarily due to the reduction in the All Lines quota share treaty as well as a significant increase in weather-related losses in 2011. As a result of the reduction in the All Lines quota share treaty, **gross written premiums and policy fees** decreased by USD 1.5 billion or by 39 percent to USD 2.3 billion and investment income decreased by USD 41 million or by 28 percent.

The **net underwriting result** deteriorated by USD 131 million to a loss of USD 30 million primarily due to higher losses assumed from the Farmers Exchanges during the first nine months of 2011, as well as the effect of the reduction in the All Lines quota share treaty from 35 percent to 25 percent effective June 30, 2010, and a further decrease to 12 percent effective December 31, 2010, resulting in a lower contribution from net earned premiums.

The **loss ratio** increased by 4.5 percentage points compared with the same period of 2010, mainly driven by the exceptionally high impact of large weather-related events, especially in the homeowners and specialty lines of business. The **expense ratio** decreased 0.9 percentage points mainly driven by lower commissions.

Farmers Exchanges

Farmers Exchanges	in USD millions, for the nine months ended September 30	2011	2010	Change
	Gross written premiums	13,903	13,860	–
	Gross earned premiums	13,564	13,773	(2%)

Gross written premiums in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Group, increased by USD 43 million to USD 13.9 billion. This increase was driven by premium growth in nearly all active lines of business partially offset by the planned run-off of the 21st Century agency auto book of business. Excluding this effect, gross written premiums grew by 1 percent compared with the same period of 2010. In the three months ended September 2011, gross written premiums increased by 2 percent driven by premium growth in all active lines of business.

Gross earned premiums in the Farmers Exchanges, decreased by USD 209 million to USD 13.6 billion, or by 2 percent, driven mainly by the continuing effect of the planned run-off of the 21st Century agency auto book of business on earned premiums in 2011. This was partially offset by increased gross earned premiums from 21st Century direct, small business solutions, and specialty businesses as gross written premiums growth in previous periods has been earned.

Other Operating Businesses

in USD millions, for the nine months ended September 30	2011	2010	Change
Business operating profit:			
Holding and financing	(443)	(473)	6%
Headquarters	(131)	(80)	(63%)
Alternative investments	(14)	(20)	31%
Total business operating profit	(588)	(573)	(3%)

Holding and financing reduced its business operating loss by USD 30 million to USD 443 million or by 6 percent mainly reflecting movements in foreign currencies. **Headquarters** increased its business operating loss by USD 51 million to USD 131 million or by 63 percent, driven mainly by the effects of the strong Swiss franc in 2011 combined with the one-off reduction in pension expenses in 2010 following the outsourcing of an IT data center.

Non-Core Businesses

in USD millions, for the nine months ended September 30	2011	2010	Change
Business operating profit:			
Centrally managed businesses:	16	(260)	nm
Centre	96	(12)	nm
Banking activities	(73)	(314)	77%
Other centrally managed businesses	(8)	66	nm
Other run-off	(3)	4	nm
Total business operating profit	13	(256)	nm

Centrally managed businesses, which comprise run-off portfolios that are managed with the intention to proactively reduce capital risk while maximizing profit opportunities, reported a profit of USD 16 million, compared with a loss of USD 260 million in the same period of 2010. This change was primarily driven by lower loan loss provisions in Zurich's Banking activities of USD 108 million compared with USD 345 million in the first nine months of 2010, and the positive impact of financial markets on Centre's insurance portfolio where both assets and liabilities are carried at fair value. Other centrally managed businesses reported a loss of USD 8 million driven by costs and accounting-related charges in connection with the run-off of Zurich Specialties London Limited. In the first nine months of 2010, Other centrally managed businesses showed a profit of USD 66 million, mainly driven by positive reserve developments.

Other run-off, which largely comprises U.S. life insurance and annuity portfolios, remained flat with a loss of USD 3 million.

Operating and financial review *continued*

Investment position and performance

Breakdown of investments	in USD millions, as of	Group investments		Unit-linked investments	
		09/30/11	12/31/10	09/30/11	12/31/10
Cash and cash equivalents		8,954	8,182	1,868	1,544
Equity securities:		11,095	13,729	76,227	85,765
Common stocks, including equity unit trusts		8,216	9,881	65,727	76,187
Unit trusts (debt securities, real estate and short-term investments)		2,406	3,208	10,501	9,577
Common stock portfolios backing participating with-profit policyholder contracts		381	515	–	–
Trading equity portfolios in capital markets and banking activities		92	125	–	–
Debt securities		144,954	140,254	11,293	9,376
Real estate held for investment		8,742	8,274	3,959	4,081
Mortgage loans		11,593	11,851	–	–
Policyholders' collateral and other loans		12,702	13,419	6,930	7,182
Equity method accounted investments		189	188	–	–
Total		198,229	195,898	100,277	107,947

Group investments increased by USD 2.3 billion or 1 percent in both U.S. dollar terms and on a local currency basis since December 31, 2010, driven mainly by the effects of falling interest rates on the value of debt securities, partially offset by lower equity markets.

Unit-linked investments decreased by USD 7.7 billion to USD 100.3 billion since December 31, 2010, or by 7 percent in both U.S. dollar and local currency terms, as a result of the performance of financial markets.

The quality of the Group's investment portfolio remains high. Investment grade securities comprise 98 percent of the Group's debt securities, of which 39 percent are rated AAA as of September 30, 2011, a decline of 13 percentage points since June 30, 2011 due to the downgrade of the credit ratings of U.S. Government securities. The Group's investment strategy remains disciplined and the Group continues to selectively reduce risks which it believes to be unacceptable, where the risks are not adequately compensated, or which incur disproportionately high regulatory capital charges.

Performance of Group investments

in USD millions, for the nine months ended September 30		2011	2010	Change
Net investment income		5,454	5,307	3%
Net capital gains/(losses) on investments and impairments		2,162	981	nm
of which: net capital gains/(losses) on investments and impairments attributable to shareholders		1,593	344	nm
Net investment result		7,616	6,288	21%
Net investment return on Group investments¹		3.9%	3.2%	0.7 pts
Movements in net unrealized gains/(losses) on investments included in total equity		983	5,732	(83%)
Total investment result, net of investment expenses²		8,599	12,020	(28%)
Average group investments ³		197,063	197,138	–
Total return on Group investments¹		4.4%	6.1%	(1.7 pts)

¹ Net investment return and total return are not annualized.

² After deducting investment expenses of USD 180 million and USD 165 million for the for the nine months ended September 30, 2011 and 2010, respectively.

³ Excluding average cash received as collateral for securities lending of USD 342 million for the nine months ended September 30, 2010.

Total **net investment income** increased by 3 percent in U.S. dollar terms to USD 5.5 billion, but decreased by 3 percent on a local currency basis, driven mainly by lower reinvestment yields on debt securities.

Total **net capital gains on investments and impairments** were USD 2.2 billion, compared with gains of USD 981 million in the same period of 2010. This includes USD 1.5 billion of positive asset revaluations and gains realized from active management of USD 1.1 billion offset by impairments of USD 359 million.

Positive asset revaluations on securities booked at fair value through profit and loss were driven by gains on other investments of USD 1.1 billion, largely due to the result from derivatives, and gains on debt securities at fair value of USD 410 million, partially offset by losses on equity securities at fair value of USD 15 million. The gains on derivatives arose, as financial markets have fallen, on instruments held as economic hedges, where an underlying business or investment loss has largely been offset or balance sheet risk protected.

The net capital gains from active management include USD 441 million from the sale of shares in New China Life Insurance Co., Ltd. that took place in the first six months of 2011.

Impairments consisted of USD 206 million attributable to equity securities, USD 112 million to mortgages and other investments and USD 41 million to debt securities.

Net investment return on Group investments increased to 3.9 percent compared with 3.2 percent in the same period of 2010 due to higher investment income and net capital gains while average Group investments remained largely unchanged.

Net unrealized gains/losses on investments included in total equity have increased by USD 983 million since December 31, 2010, mainly driven by higher net unrealized gains on debt securities of USD 1.8 billion as interest rates have continued to fall. Though yields on government bonds fell in both periods, credit spreads widened significantly compared with the same period of 2010 and partially offset the positive impact of falling yields. Net unrealized gains on equity securities decreased by USD 870 million since December 31, 2010. This reduction was driven by the realization of gains on the sale of shares in New China Life Insurance Co., Ltd. in the first six months of 2011 and by deteriorating equity markets in the three months ended September 30, 2011.

Total return, net of investment expenses, on average Group investments was 4.4 percent, a decrease of 1.7 percentage points compared with the same period of 2010. This decrease was mainly due to lower net unrealized gains on debt securities. Debt securities, which are invested to match the Group's insurance liability profiles, returned positive 4.6 percent, equity securities returned negative 2.2 percent and other investments, mainly real estate and mortgages, returned positive 5.9 percent.

Operating and financial review *continued*

Performance of unit-linked investments	in USD millions, for the nine months ended September 30		
	2011	2010	Change
Net investment income	1,344	1,141	18%
Net capital (losses)/gains on investments and impairments	(8,750)	4,123	nm
Net investment result, net of investment expenses ¹	(7,406)	5,264	nm
Average investments	104,112	101,007	3%
Total return on unit-linked investments²	(7.1%)	5.2%	(12.3 pts)

¹ After deducting investment expenses of USD 446 million and USD 385 million for the nine months ended September 30, 2011 and 2010, respectively.

² Total return is not annualized.

Total return on unit-linked investments was a negative 7.1 percent compared with a gain of 5.2 percent in the same period of 2010. The movement in the total return was due to net capital losses in 2011 compared with gains during the same period of 2010, mostly driven by lower equity markets. Net investment income increased by USD 203 million or by 18 percent in U.S. dollar terms and 10 percent on a local currency basis.

Insurance and investment contract liabilities

Reserves for losses and loss adjustment expenses

The majority of the Group's reserves for losses and loss adjustment expenses are attributable to General Insurance. The remaining reserves mostly relate to Farmers Re and Non-Core Businesses.

in USD millions	Total Group		of which General Insurance	
	2011	2010	2011	2010
As of January 1				
Gross reserves for losses and loss adjustment expenses	68,107	68,126	63,864	63,517
Reinsurers' share	(12,093)	(12,182)	(11,192)	(10,963)
Net reserves for losses and loss adjustment expenses	56,014	55,944	52,672	52,554
Net losses and loss adjustment expenses incurred	16,728	17,756	15,696	14,744
Current year	17,699	18,605	16,612	15,553
Prior years	(972)	(850)	(916)	(809)
Total net losses and loss adjustment expenses paid	(16,938)	(17,178)	(14,978)	(14,237)
Current year	(6,558)	(7,045)	(5,417)	(5,057)
Prior years	(10,380)	(10,134)	(9,561)	(9,180)
Acquisitions/(divestments)	36	(6)	38	6
Foreign currency translation effects	(10)	(469)	28	(432)
As of September 30				
Net reserves for losses and loss adjustment expenses	55,829	56,046	53,455	52,636
Reinsurers' share	(12,558)	(11,890)	(11,284)	(10,920)
Gross reserves for losses and loss adjustment expenses	68,387	67,936	64,739	63,556

As of September 30, 2011, the Group **net reserves for losses and loss adjustment expenses** decreased by USD 185 million to USD 55.8 billion compared with December 31, 2010. This decrease was mostly driven by the implementation of a reinsurance contract related to the run-off insurance business of Zurich Specialties London Limited, in anticipation of a portfolio transfer to be executed when regulatory approval is received. Prior years favorable reserve development amounted to USD 972 million. Further details of reserve developments are shown in note 4 of the unaudited Consolidated financial statements.

Operating and financial review *continued*

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 in other segments relate predominantly to companies that are in run-off or are centrally managed, and are included only 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		Total Group	
		2011	2010	2011	2010	2011	2010
		Net reserves as of January 1	187,196	180,145	17,331	17,655	204,527
Movements in net reserves	(4,970)	3,427	728	190	(4,242)	3,617	
Net reserves as of September 30	182,226	183,572	18,059	17,845	200,285	201,417	

The following provides further detail on the development and composition of reserves and liabilities in the Global Life business.

Global Life – Development of reserves and liabilities	in USD millions	Unit-linked insurance and investment contracts ¹		Other life insurance liabilities ²		Total reserves and liabilities	
		2011	2010	2011	2010	2011	2010
		As of January 1					
Gross reserves	100,891	92,841	88,299	89,452	189,189	182,293	
Reinsurers' share	–	–	(1,993)	(2,148)	(1,993)	(2,148)	
Net reserves	100,891	92,841	86,306	87,304	187,196	180,145	
Premiums	11,596	11,026	6,805	7,137	18,401	18,163	
Claims	(10,367)	(7,965)	(7,150)	(7,362)	(17,517)	(15,328)	
Fee income and other expenses	(1,343)	(1,398)	(1,747)	(1,504)	(3,089)	(2,902)	
Interest and bonuses credited to policyholders	(6,916)	5,054	2,427	2,569	(4,489)	7,623	
Change in assumptions	–	–	80	136	80	136	
(Divestments)/acquisitions and transfers	22 ³	(1,340)	(35) ³	(251)	(13)	(1,592)	
(Decreases)/increases recorded in other comprehensive income	(3)	7	565	1,682	561	1,689	
Foreign currency translation effects	427	(2,717)	668	(1,646)	1,095	(4,363)	
As of September 30							
Net reserves	94,308	95,508	87,918	88,065	182,226	183,572	
Reinsurers' share	–	–	(2,085)	(1,986)	(2,085)	(1,986)	
Gross reserves	94,308	95,508	90,004	90,051	184,312	185,558	

¹ Includes reserves for unit-linked contracts, the net amounts of which were USD 46.5 billion and USD 48.2 billion, and liabilities for investment contracts, the net amounts of which were USD 47.8 billion and USD 47.3 billion as of September 30, 2011 and 2010, respectively

² Includes reserves for future life policyholders' benefits, the net amounts of which were USD 73.7 billion and USD 72.7 billion and policyholders' contract deposits and other funds, the net amounts of which were USD 14.2 billion and USD 15.4 billion as of September 30, 2011 and 2010, respectively

³ The 2011 movement mainly relates to a transfer of USD 28 million related to the shift of other life insurance liabilities to liabilities for investment contracts following a review of contract classifications (see note 1 of the unaudited Consolidated financial statements).

Total reserves and liabilities for insurance and investment contracts, net of reinsurance, decreased by USD 5.0 billion or by 2.7 percent in U.S. dollar terms, and 3.1 percent on a local currency basis compared with December 31, 2010. This was mainly a consequence of the weakening of financial markets at the end of September 2011 which decreased unit-linked fund values.

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

in USD millions, as of

	Unit-linked insurance and investment contracts		Other life insurance liabilities		Total reserves and liabilities	
	09/30/11	12/31/10	09/30/11	12/31/10	09/30/11	12/31/10
North America	877	845	5,196	5,107	6,074	5,952
Latin America	447	505	1,981	2,042	2,428	2,547
Europe	81,493	87,287	79,097	77,507	160,590	164,794
<i>of which:</i>						
<i>United Kingdom</i>	50,193	54,757	4,896	4,792	55,089	59,549
<i>Germany</i>	9,409	10,666	42,115	41,347	51,523	52,013
<i>Switzerland</i>	656	650	19,502	18,688	20,158	19,339
<i>Ireland</i>	10,478	10,430	1,525	1,318	12,003	11,748
<i>Spain</i>	5,282	5,352	6,430	6,783	11,712	12,134
<i>Rest of Europe</i>	5,476	5,432	4,629	4,579	10,105	10,011
Asia-Pacific and Middle East	9,819	10,701	1,353	1,378	11,172	12,080
Other	1,672	1,552	288	267	1,960	1,819
Eliminations	–	–	2	4	2	4
Total	94,308	100,891	87,918	86,306	182,226	187,196

Unit-linked insurance and investment contracts, net of reinsurance, decreased by USD 6.6 billion compared with December 31, 2010, or by 7 percent in both U.S. dollar terms and on a local currency basis. This is largely the result of the effect on fund values from investment value reductions.

Other life insurance liabilities, net of reinsurance, increased by USD 1.6 billion compared with December 31, 2010, or by 2 percent in U.S. dollar terms and 1 percent on a local currency basis. In local currency, the increase was driven by guarantee credits to policyholders and the low interest rate environment which increases reserves that flow directly through shareholders' equity.

Operating and financial review *continued*

Indebtedness

in USD millions, as of	Repurchase agreements		Collateralized loans		Senior debt		Subordinated debt		Total	
	09/30/11	12/31/10	09/30/11	12/31/10	09/30/11	12/31/10	09/30/11	12/31/10	09/30/11	12/31/10
	Operational debt	1	1	241	743	870	865 ²	–	–	1,110
Financial debt					4,983 ³	5,588 ³	5,597	5,004	10,580	10,592
Total	–	–	241	743	5,853	6,453	5,597	5,004	11,690	12,200

¹ Moody's issued a new guideline on operational debt in May 2011 and confirmed to the Group in August 2011 that they will exclude the Group's repurchase agreement obligations from their total leverage calculation. As a consequence amounts relating to repurchase agreement obligations have now been excluded from operational debt and therefore are shown as zero in the table. Repurchase agreement obligations were USD 3.3 billion and USD 2.1 billion as of September 30, 2011 and December 31, 2010, respectively. Standard & Poor's had already previously excluded these obligations from operational debt.

² Operational senior debt includes the book value of the USD 750 million in senior debt issued under the EMTN Programme by Zurich Finance (Luxembourg) S.A. in September 2009, which was loaned directly to the Group's banking activities. This issue has been recognized as operational debt by Moody's but not by Standard & Poor's. In addition, operational senior debt includes an adjustment of USD 100 million for non-recourse debt.

³ Financial senior debt contains the book value of USD 400 million that was previously presented in a separate column, "Capital markets."

Total operational and financial debt, as revised for the exclusion of repurchase agreement obligations, decreased by USD 510 million to USD 11.7 billion or by 4 percent.

Operational debt, as revised for the exclusion of repurchase agreement obligations, decreased by USD 499 million to USD 1.1 billion since December 31, 2010, or by 31 percent due to the repayment of USD 502 million in collateralized loans.

Financial debt remained broadly flat at USD 10.6 billion, but decreased 1 percent on a local currency basis. Changes in the Group's financing consisted of the repayment in July 2011 of commercial paper of USD 400 million, the repayment on maturity of a CHF 1.0 billion senior bond and the issuance of two senior notes totaling CHF 750 million under the Euro Medium Term Note Programme (EMTN Programme). In addition a new subordinated note of CHF 500 million was issued in March 2011 under the EMTN Programme to refinance the early redemption of hybrid debt that was classified as "Preferred Securities" in shareholders' equity as of December 31, 2010.

In March 2011, Moody's Investor Service upgraded Zurich Insurance Company Ltd's financial strength rating by one notch to Aa3 from A1. Debt ratings were also upgraded by one notch, resulting in its senior debt ratings moving to A1, subordinated to A2(hyb) and preferred to A3(hyb).

Details of debt issuances are set out in note 11 of the unaudited Consolidated financial statements.

Capitalization

in USD millions	Shareholders' equity	Non- controlling interests	Total equity
As of December 31, 2010, as previously reported	31,984	1,337	33,321
Adjustment due to the restatement ¹	(79)	(1)	(80)
As of December 31, 2010, as restated	31,905	1,336	33,241
Proceeds from issuance of share capital	207	–	207
Proceeds from treasury share transactions	20	–	20
Dividends	(1,916)	(21)	(1,937)
Redemption of preferred securities	(476)	–	(476)
Share-based payment transactions	(38)	–	(38)
Total comprehensive income	2,172	36	2,209
Net income after taxes	3,210	45	3,254
Net other recognized income and expenses	(1,038)	(8)	(1,046)
Net changes in capitalization and non-controlling interests	–	42	42
As of September 30, 2011	31,874	1,394	33,267

¹ See note 1 of the unaudited Consolidated financial statements.

Total equity increased by USD 26 million to USD 33.3 billion, or by 0.1 percent. The net growth in equity was after the deduction of USD 2.7 billion for the dividend of CHF 17.00 per share, which was approved at the Annual General Meeting on March 31, 2011, and was paid out from the newly created capital contribution reserve. Dividend of USD 1.9 billion has been shown and USD 795 million has been included in the cumulative foreign currency translation adjustments. The early redemption of preferred securities further decreased equity by USD 476 million and was funded mainly by the issuance of CHF 500 million under the EMTN Programme in March 2011. Net income after tax of USD 3.3 billion fully offset the dividend and capital redemption.

The Swiss Solvency Test (SST) has become fully effective and mandatory as of January 1, 2011. Under SST, the Group is required to use a company-specific internal model to calculate risk-bearing and target capital. The Group is required to file the SST on a biannual basis. For June 30, 2011, the Group filed on a consolidated basis an SST capitalization ratio of 225 percent compared with 223 percent as of December 31, 2010. The ratio is subject to the regulator's review, as well as its approval of the Group's internal model.

The Group also continues to be subject to Solvency I requirements based on the Swiss Insurance Supervisory Law. The Solvency I ratio as of September 30, 2011, increased to 256 percent compared with 242 percent as of June 30, 2011, and 232 percent as of December 31, 2010.

Operating and financial review *continued*

Cash flows

Summary of cash flows	in USD millions, for the nine months ended September 30	
	2011	2010
Net cash provided by operating activities	4,434	1,382
Net cash used in investing activities	(202)	(78)
Net cash used in financing activities	(3,368)	(1,903)
Foreign currency translation effects on cash and cash equivalents	232	(426)
Change in cash and cash equivalents excluding change in cash received as collateral for securities lending	1,095	(1,025)
Cash and cash equivalents as of January 1 ¹	9,726	10,749
Cash and cash equivalents as of September 30 ¹	10,821	9,724
Changes in cash received as collateral for securities lending	–	(302)
Cash and cash equivalents as of January 1 ²	9,726	11,241
Cash and cash equivalents as of September 30²	10,821	9,914

¹ Excluding cash received as collateral for securities lending

² Including cash received as collateral for securities lending

Net cash provided by operating activities, which included cash movements in and out of, as well as within, total investments, was USD 4.4 billion for the nine months ended September 30, 2011. Net cash used in investing activities of USD 202 million was primarily related to net cash outflows from the net purchases and sales of property and equipment of USD 111 million and the acquisition of Malaysian Assurance Alliance Berhad for USD 110 million. Net cash outflows from financing activities of USD 3.4 billion were primarily related to the payment of dividends and the early redemption of preferred securities for USD 476 million. Repayments of debt outstanding were largely offset by issuances of new debt (see Indebtedness section).

Details of acquisitions are set out in note 2 of the unaudited Consolidated financial statements.

Currency translation impact

The Group operates worldwide in multiple currencies and seeks to match foreign exchange exposures on an economic basis. Details of principal exchange rates are set out in note 1 of the unaudited Consolidated financial statements.

As the Group has chosen the U.S. dollar as its presentation currency, differences arise when functional currencies are translated into the Group's presentation currency. The table below shows the effect of foreign currency rates on the translation of selected line items.

Selected Group income statement line items	variance over the prior period, for the nine months ended September 30, 2011	in USD	
		millions	in %
	Gross written premiums and policy fees	2,182	6%
	Insurance benefits and losses, gross of reinsurance	(1,779)	(7%)
	Net income attributable to shareholders	138	4%
	Business operating profit	105	3%

The income statements are translated at average exchange rates. In the first nine months of 2011, the U.S. dollar has on average been weaker against the euro and British pound, and significantly weaker against the Swiss franc, compared with the first nine months of 2010. The net result has been an increase in U.S. dollar terms in gross written premiums and policy fees which was partially offset by an increase in U.S. dollar terms in insurance benefits and losses.

Selected Group balance sheet line items	variance over December 31, 2010, as of September 30, 2011	in USD	
		millions	in %
	Total investments	1,125	–
	Reserves for insurance contracts, gross	1,035	–
	Cumulative translation adjustment in shareholders' equity	(1,218)	(4%)

The balance sheets are translated at end-of-period rates. The U.S. dollar has weakened against the Swiss franc, but remained relatively stable against the euro and British pound as of September 30, 2011, compared with December 31, 2010, resulting in a marginal increase in U.S. dollar terms in total investments and reserves for insurance contracts. The decrease in the cumulative translation adjustment in shareholders' equity includes USD 795 million relating to the dividend and underlying currency translation losses of USD 426 million.

Operating and financial review *continued*

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