

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 balance sheet items	variance over December 31, 2005, as of December 31, 2006	
	in USD millions	in %
Total investments	24,543	9%
Reserves for insurance contracts	17,344	8%
Cumulative translation adjustment in total equity	1,052	5%

The weakening of the US dollar from December 31, 2005 to December 31, 2006 had a positive effect on balance sheet positions in US dollar terms, which are translated at closing exchange rates.

For the year ended December 31, 2006, the impact of foreign currency translation on the consolidated income statements was not significant.

Balance sheet highlights

in USD millions, as of	12/31/06	12/31/05	Change
Group investments	195,676	183,455	7%
Investments for unit-linked products	114,327	93,838	22%
Total investments	310,003	277,293	12%
Reserves for losses and loss adjustment expenses	64,535	60,425	7%
Reserves for unearned premiums	14,668	13,531	8%
Other reserves for insurance contracts, excluding unit-linked products	95,437	90,277	6%
Reserves for unit-linked contracts	66,008	55,691	19%
Reserves for insurance contracts	240,648	219,924	9%
Liabilities for investment contracts (primarily unit-linked)	50,705	40,999	24%
Financial debt	7,713	7,540	2%
Total equity	27,056	23,240	16%
Total financial debt and equity	34,769	30,780	13%

Total investments increased by USD 32.7 billion, while on a local currency basis they increased by USD 8.2 billion, or 3 percent. Similarly, total reserves for insurance contracts increased by 9 percent, but on a local currency basis by 2 percent. Liabilities for investment contracts increased by 24 percent in reporting currency and 10 percent on a local currency basis. As of December 31, 2006, financial debt remained flat on a local currency basis compared with December 31, 2005, while total equity increased by 16 percent primarily due to the contribution of net income after taxes.

Investments

Total investments as presented in the consolidated balance sheets include Group investments, where we bear part or all of the investment risk, and investments for unit-linked products, where policyholders bear the investment risk. Investments for unit-linked products include investments held for liabilities related to insurance and investment contracts except for investment policies with discretionary participation features where the investments are managed as part of Group investments.

Breakdown of Investments

in USD millions, as of

	12/31/06		12/31/05	
	Group investments	Unit-linked investments	Group investments	Unit-linked investments
Cash and cash equivalents	17,438	5,684	18,723	4,759
Equity securities:	18,339	90,666	15,550	74,764
Common stocks, including equity unit trusts	11,461	84,824	9,413	69,898
Unit trusts (debt securities, real estate and short-term investments)	3,014	5,842	2,420	4,866
Common stock portfolios backing participating with-profit policyholder contracts	1,604	–	1,691	–
Trading equity portfolios in capital markets and banking activities	2,260	–	2,026	–
Debt securities	126,435	8,922	118,011	7,286
Real estate held for investment	6,921	8,360	6,314	6,388
Mortgage loans	10,806	–	9,307	–
Policyholders' collateral and other loans	12,634	2	11,984	3
Investments in associates	153	–	580	–
Other investments	2,950	693	2,986	638
Subtotal	195,676	114,327	183,455	93,838
Total investments	310,003		277,293	

Total investments increased by USD 32.7 billion, or 12 percent, to USD 310.0 billion as of December 31, 2006. After adjusting for foreign currency translation effects, total investments increased by USD 8.2 billion as a result of increased inflows of funds into investments and positive revaluations of equities and real estate held for investment. These effects were partially offset by negative revaluations on our debt securities due to higher interest rates compared with 2005.

Net purchases of debt securities of USD 2.6 billion for the year ended December 31, 2006, were mostly offset by negative revaluations resulting in a net increase of USD 809 million after adjusting for foreign currency movements of USD 9.3 billion.

The total increase of equity securities of USD 18.7 billion was attributable to net purchases of USD 147 million, value appreciation in local currency and foreign currency movements of USD 9.8 billion.

All other positions remained broadly flat or slightly increased after adjusting for foreign currency movements.

Development of Reserves for Losses and Loss Adjustment Expenses

We establish reserves for losses and loss adjustment expenses, which are estimates of future payments of reported and unreported claims for losses and related expenses, with respect to insured events that have occurred. These estimates are based on assumptions regarding the development of reserved claims, which may be different from the actual development of claims over time. Any changes in estimates are reflected in the income statement of the period in which estimates are changed.

in USD millions	2006	2005	Change
As of January 1			
Gross reserves for losses and loss adjustment expenses	60,425	57,765	
Reinsurers' share	(14,231)	(14,278)	
Net reserves for losses and loss adjustment expenses	46,194	43,487	
Net losses and loss adjustment expenses incurred			
Current period	21,447	22,465	(5%)
Prior years	(218)	141	nm
Total	21,229	22,606	(6%)
Total net losses and loss adjustment expenses paid	(18,907)	(17,200)	10%
Divestments of companies and businesses, including transfer to liabilities held for sale	(66)	(37)	nm
Currency translation effects	2,363	(2,662)	nm
As of December 31			
Net reserves for losses and loss adjustment expenses	50,813	46,194	
Reinsurers' share	(13,722)	(14,231)	
Gross reserves for losses and loss adjustment expenses	64,535	60,425	

The gross reserves for losses and loss adjustment expenses balance includes the Group's loss reserves, the majority of which are included within the General Insurance segment.

Gross reserves for losses and loss adjustment expenses increased by USD 4.1 billion, and 2 percent on a local currency basis from January 1, 2006, to December 31, 2006. Net losses and loss adjustment expenses incurred in the current period declined predominantly due to lower catastrophe losses in 2006 compared with 2005. Overall, prior accident year loss development was favorable at USD 218 million. Payments in 2006 were impacted by the large catastrophes which occurred in 2005.

Development of cumulative net loss ratios

	2001	2002	2003	2004	2005	2006
In the year	81.4%	70.6%	67.1%	68.3%	73.3%	69.6%
One year later	85.7%	72.0%	66.1%	64.2%	68.1%	
Two years later	85.8%	72.3%	65.4%	63.5%		
Three years later	87.4%	74.5%	65.5%			
Four years later	88.5%	74.7%				
Five years later	90.2%					

The loss ratios within the triangle reflect both a steady improvement in underwriting quality and the more conservative reserving position.

Development of Reserves for Life Insurance Contracts

in USD millions

	Future life policyholders' benefits		Policyholders' contract deposits and other funds		Reserves for unit-linked contracts	
	2006	2005	2006	2005	2006	2005
As of January 1						
Gross reserves	71,292	81,350	18,985	22,763	55,691	51,920
Reinsurers' share	(1,305)	(1,418)	(3,504)	(3,594)	–	–
Net reserves	69,987	79,932	15,481	19,169	55,691	51,920
Premiums and claims	(4,763)	(3,952)	(1,164)	(4,009)	(382)	913
Interest and bonuses credited to policyholders	2,973	2,708	876	1,217	6,184	6,897
Change in assumptions	293	585	(4)	(4)	(17)	7
Acquisitions/(divestments)	(37)	(150)	–	4	–	43
(Decrease)/increase recorded in shareholders' equity	(494)	30	(622)	422	–	–
Foreign currency translation effects	7,059	(9,166)	1,109	(1,318)	4,532	(4,089)
As of December 31						
Net reserves	75,018	69,987	15,676	15,481	66,008	55,691
Reinsurers' share	1,485	1,305	3,258	3,504	–	–
Gross reserves	76,503	71,292	18,934	18,985	66,008	55,691

Net reserves for future life policyholders' benefits increased by 7 percent from January 1, 2006, primarily due to foreign currency translation; however, after adjusting for this effect, they decreased by 3 percent due to the transfer of group life contracts to independent foundations in Switzerland and maturities of traditional products in Germany.

After adjusting for foreign currency translation effects, net reserves for policyholders' contract deposits and other funds decreased by 4 percent primarily due to the continued decline of endowments in Germany as those products are no longer tax deductible. In addition, net unrealized gains on investments charged to shareholders' equity decreased.

After adjusting for foreign currency translation effects, our unit-linked contracts reserves increased by 8 percent due to an increase in unit-linked business, as well as gains on unit-linked investments being credited to policyholders, particularly in the UK due to the strength of the equity market.

Liabilities for Investment Contracts

in USD millions	2006	2005
As of January 1	40,999	39,260
Premiums and claims	(595)	(296)
Interest and bonuses credited to policyholders	5,115	5,832
Change in assumptions	–	(1)
Divestments/transfers	(4)	–
Increase/(decrease) recorded in shareholders' equity	(31)	8
Foreign currency translation effects	5,221	(3,804)
As of December 31	50,705	40,999

Liabilities for investment contracts have increased on a local currency basis by 10 percent as of December 31, 2006, mainly due to the growth of the business, especially in Ireland, the Isle of Man and the UK, but also as a result of equity market increases, particularly in the UK.

Capitalization and Indebtedness

in USD millions, as of	12/31/06	12/31/05	Change
Collateralized loans	2,427	3,056	(21%)
Debt related to capital markets and banking activities	1,889	2,139	(12%)
Obligation to repurchase securities	6,144	5,295	16%
Total operational debt	10,460	10,490	(0%)
Senior debt	2,905	2,933	(1%)
Subordinated debt	4,808	4,607	4%
Total financial debt	7,713	7,540	2%
Shareholders' equity	26,531	22,426	18%
Minority interests	525	814	(36%)
Total equity	27,056	23,240	16%
Total financial debt and equity	34,769	30,780	13%

Total operational debt remained flat at USD 10.5 billion. The decrease in our collateralized loans balance resulted from maturities of the mortgage loans securing them. In addition, debt related to capital markets and banking activities decreased by USD 250 million. These decreases offset the USD 849 million increase in our obligation to repurchase securities related to investment management activities in our UK businesses.

The Group's Euro Medium Term Note (EMTN) Programme allows for the potential issuance of up to USD 6 billion of senior and subordinated notes, of which USD 3.7 billion was issued as of December 31, 2006 and 2005.

The Group has access to a syndicated revolving credit facility of USD 3 billion that terminates in 2011. Zurich Group Holding, together with Zurich Insurance Company and Farmers Group, Inc., are guarantors of the facility and can draw up to USD 1.25 billion, USD 1.5 billion and USD 250 million, respectively. No borrowings were outstanding under this facility as of December 31, 2006.

Dunbar Bank has access to various committed credit facilities totaling GBP 430 million. No borrowings were outstanding under these facilities as of December 31, 2006.

Total Equity

Rollforward of total equity

in USD millions	Shareholders' equity	Minority interests	Total equity
As of December 31, 2005	22,426	814	23,240
Change in net unrealized gains on investments excluding translation adjustments	(415)	(6)	(421)
Change in currency translation adjustments	1,029	23	1,052
Issuance of share capital	104	–	104
Distributions to shareholders	(745)	(6)	(751)
Nominal value reduction of share capital	(177)	–	(177)
Dividends	(568)	(6)	(574)
Redemption of preferred securities	(425)	(355)	(780)
Share-based payment transactions	29	–	29
Treasury share transactions	1	–	1
Net income after taxes	4,527	98	4,625
Net changes in capitalization and minority interests	–	(43)	(43)
As of December 31, 2006	26,531	525	27,056

Total equity increased primarily as a result of net income after taxes of USD 4.6 billion, which more than offset redemptions of preferred securities, distributions to shareholders and net reductions of unrealized gains caused by higher interest rates.

Distributions to shareholders totaled USD 745 million, of which USD 701 million was distributed to common shareholders and USD 44 million to preferred shareholders. The distributions to common shareholders of CHF 7.00 per share comprised a gross dividend of CHF 4.60 per share and a payout of CHF 2.40 per share in the form of the nominal value reduction of each registered share. The total payout of CHF 7.00 per share was approved at the Annual General Meeting on April 20, 2006, and was paid to shareholders on July 4, 2006. The nominal value reduction was subject to the fulfillment of the necessary requirements and the registration of the share capital reduction in the Commercial Registrar of the Canton of Zurich. The nominal value of each registered share reduced from CHF 2.50 to CHF 0.10.

On March 30, 2006, and April 11, 2006, we redeemed the Series I and Series III of Trust Capital Securities (Zurich RegCaPS), respectively. The liquidation amounts totaled USD 425 million in aggregate.

On March 16, 2006, we redeemed 12,000,000 Series A Preference Shares issued by Zurich Financial Services (Jersey) Ltd., with a par value of EUR 25 per security for a total of USD 355 million, reducing minority interests.

In March 2006 we listed one million shares of contingent capital on the SWX Swiss Exchange (742,444 of which were issued as of December 31, 2006) to fulfill obligations under employee share and option plans. Proceeds from shares issued as of December 31, 2006 totaled USD 104 million.

For the year ended December 31, 2006, we recorded net unrealized losses on investments of USD 421 million, excluding translation adjustments, in total equity driven by lower values of debt securities due to an overall increase in interest rates in 2006 compared with 2005.