Half year results 2013

Remarks by Martin Senn (slides 3 and 4), CEO, and Pierre Wauthier (slides 5 to 17), CFO of Zurich Insurance Group

August 15, 2013

Slide 3: Key Messages

Welcome to Zurich Insurance Group's results presentation for the first half of 2013.

Business operating profit for the six months was 2.3 billion U.S. dollars down 9 percent from the same period in 2012. Net income attributable to shareholders declined by 17 percent to 1.9 billion dollars.

Earnings were affected by significant weather-related losses during the second quarter and by a marked decline in investment income. This decline is due to continued low interest rates, but it also reflects our disciplined investment approach as we continue to focus on maintaining the strength of our balance sheet and managing risks and return relative to liabilities.

These results hide many positive developments in our business over the period including an improved underlying underwriting performance in both General Insurance and Farmers Re and good growth in our General Insurance and Global Life target markets.

In addition, despite the challenging background in which we have been operating we continue to generate strong cash flows and to preserve our excellent capital position with solvency well within our double-A target range.

These positive factors show that we continue to make progress on the strategy we set in 2010, which we translated at the time into very ambitious targets for 2013 at the Group level and for each of our business segments.

In terms of our progress towards these targets, it is clear that if we were to stop the clock at the end of June 2013, we would be on track to achieve some of these goals, such as those set for Global Life and our expense savings, while others such as in GI and in Farmers remain more challenging. We are continuing to pursue our strategy and our targets with discipline and focus. This has helped us drive the business forward in the last three years and it has given us a strong platform on which we can build.

As part of our ongoing planning process we are developing the strategy for the next phase of our journey to build on our strengths and to address areas of improvement in order to continue delivering sustainable value.

We will update you on our progress as a business, on how we delivered against our 2013 targets, and on our strategic direction for the next three years at our Investor Day on December 5.

Slide 4: Financial Highlights

To put our business operating profit and net income numbers into perspective, the Group's total net investment income for the period fell 289 million dollars, or 8 percent, to 3.2 billion dollars. At the same time, insured losses net of reinsurance in General Insurance rose by 3 percent or 312 million dollars in part due to the flooding in Central and Eastern Europe, and an unusual number of mid-sized weather-related events in the U.S., Canada and Europe.

Despite these headwinds, General Insurance maintained its focus on disciplined underwriting and expense management and delivered growth in gross written premiums and policy fees in all business areas except Europe. The underlying loss ratio narrowed to 60.4 percent over the half-year and the expense ratio fell by 0.3 percentage points which helped mitigate the impact from weather-related losses resulting in a Combined Ratio of 95.6 percent.

The Global Life business delivered strong growth in new business value which rose 53 percent in dollar terms to 647 million dollars driven by growth in its target markets and the protection business, and the inclusion of Zurich Santander.

Farmers business operating profit increased by 99 million dollars, or 17 percent, to 696 million dollars, due to an improved underwriting result in Farmers Re while Farmers Management Services revenues declined slightly.

Shareholders' equity decreased 10 percent from the start of the year to 30.9 billion dollars after deducting 2.7 billion dollars for the dividend of 17 Swiss francs per share and unrealized losses on fixed income investments due to higher interest rates and changes in credit spreads. The annualized return on common shareholders' equity for the half year based on net income attributable to shareholders was 11.3 percent and the return on the business operating profit after tax was 10.8 percent.

Let me reiterate: while overall we see improvements in our underlying operating performance it is clear from the headline numbers that we can do better and more has to be done. We remain committed to our strategy and targets with discipline and focus.

In closing, I would like to thank all my colleagues around the world, for their commitment and dedication, and I would also like to thank our customers and shareholders for their continued trust and support.

Slide 5: BOP by segment

Good morning and good afternoon ladies & gentlemen.

There are a number of positive developments in what is a mixed set of results with our overall business operating profit down 9% compared to last year.

- In General Insurance, business operating profit is down 28% for the discrete second quarter, and down 16% year-to-date. While the underlying loss ratio continues to improve, this has been more than offset by lower investment income and higher weather and large losses.

- The Global Life BOP for the discrete Q2 is down 4%, while flat year-to-date. In relation both to the half year and Q2 figures, improved expense and risk margins, and an increased contribution from Zurich Santander, were offset by reductions in the investment margin and a lower level of special operating items.

- Farmers BOP increased 21% for the discrete second quarter and 17% year-to-date, driven by Farmers Re's improved underlying loss ratio, while we experienced a high level of weather losses in the second quarter, roughly comparable to last year.

- The Other Operating Businesses loss was 232 million dollars for the discrete second quarter, 5% better for the quarter and 4% better year-to-date. The improvement is mainly due to lower net headquarters expenses, some of which is timing related and which we expect to catch-up in the second half.

- Non-Core Businesses reported a loss of 21 million in the second quarter, down from last year due to small movements on life run-off books.

Turning to net income for the quarter, the result of 789 million is down 27% compared to prior year driven by the lower business operating profit, lower realized investment gains and a 77 million dollar realised currency translation loss. These two last items had no impact on shareholders equity.

Slide 6: General Insurance – key performance indicators

The key highlights for General Insurance can be summarized as follows.

- We continued with our pricing and underwriting discipline, reflected in another quarter of robust rate increases, as well as portfolio management actions. We saw continued growth in our targeted markets with overall gross written premium in local currency 4 percent higher than last year.

- We delivered a combined ratio of 95.6 percent for the half year, despite an elevated level of weather and large losses in the second quarter.

- If we look at our net non-technical expenses, there are significant movements between the first and second quarter. While the first quarter benefitted from a number of significant positive one-offs, the discrete second quarter result of 266 million dollars was slightly above our expected quarterly run rate, due mostly to 20 million dollars of foreign exchange losses.

- All this and the continued pressure on net investment income, down by roughly 100 million dollars per quarter in comparison to first and second quarter 2012, impacted our BOP, which ended at 1.4 billion dollars, 16 percent below last year.

Slide 7: General Insurance – Rate change monitor and GWP performance

As in the previous quarter we achieved robust rate increases of 3.7% in the first half of 2013 and 4.2% for the second quarter. We increased rates across the segments, especially in our Global Corporate business.

Our gross premiums grew by 4% in the first half and 6% in the second quarter, on a local currency basis. At a regional level the growth picture remained the same as in the previous quarters, with growth in International Markets , North America Commercial and Global Corporate more than compensating the decline in the European personal and commercial business.

In the second half of the year we expect our growth in gross written premium to be impacted by a reduction of around 300 million dollars for our North America Commercial business, as a result of lower crop volumes and discontinuing a large fronting contract. The second item will have no impact on net earned premiums or on the bottom line.

Slide 8: General Insurance – Comparison of loss ratio

In the first half of 2013 we improved the underlying loss ratio to 60.4% or 1.2 percentage points better than in the first half of 2012, with the quarter on quarter underlying loss ratio also improving by 0.5 percentage points to 60.2%.

This improvement was achieved mainly by our North American and European operations as re-underwriting, portfolio management and rate tiering actions in the current and prior periods continue to deliver.

In relation to prior year development, the level of reserve releases in the first half of 2013 was broadly consistent with the first half of 2012, and we continued to see favorable development across several regions. Although the pattern of releases between the first and second quarter was not even, this reflects quarterly fluctuations which are not unexpected given the size and diversity of our book and our policy to recognize adverse trends early. In the context of comparatively benign industry-wide claims trends, we would not see the level of releases in our first half year results as an unusual number.

Taking major catastrophes and large losses together, the impact on the first half loss ratio was 10.5 percentage points, or 1.8 percentage points worse than in 2012. As is well known, the second quarter witnessed an unusual number of mid-sized weather related events in the US, Canada and Europe, and we were also impacted by a number of large individual industrial losses. Two such claims cost us 100 million dollars in the second quarter.

Slide 9: General Insurance – expense ratio walk

Our Expense ratio improved further to 27.0%.

Our other technical expenses, which is the element of the expense ratio that we can influence most actively, improved by 0.7 percentage points compared to last year, with a 0.8 percentage point improvement in mature markets more than compensating for a continued business shift into International Markets, which tend to run at a higher expense ratio.

While some of this improvement was due to positive one-offs, there is an underlying improvement as well, which reflects our continued focus on expense management, in particular our expense saving program which is delivering results as planned.

The lower other technical expense ratio was partly off-set by an increase in the commission ratio which is up 0.4 percentage points, mainly driven by the changing mix of business.

Slide 10: General Insurance – BOP and CoR by business

Global Corporate delivered a strong combined ratio at 90 percent despite the impact of the European Floods.

Our European business reported a combined ratio of 95.3 percent, even with the impact of the European Floods, as well as further weather-related events and some significant large losses.

The combined ratio of North America commercial includes an improvement in the underlying loss ratio of 2.2 percentage points which was off-set by the prior year reserve adjustments reported last quarter and the weather events in the second quarter.

The combined ratio of International Markets of 100.3 percent has been heavily impacted by the floods in Queensland in Australia which contributed roughly 2 percentage points.

So let me summarize our half-year performance in General Insurance:

- Although our results were adversely affected by an above average level of weather and large losses, our underlying loss ratio improved further by 1.2 percentage points to 60.4 percent and our combined ratio excluding CAT losses slightly improved by 0.2 percentage points.

- Two, we continue to see written rate increases overall to exceed our current estimate of loss cost inflation which remains subdued

- Third, the contribution from prior year releases is broadly in line with the first half of 2012.

- And fourth, Investment income continues to be impacted by low reinvestment rates, with a decline of roughly 100 million dollars per quarter in comparison to 2012.

Slide 11: Global Life – Key performance indicators

Global life results continue to reflect the positioning of the business towards fee based and protection products while reducing our reliance on interest rate sensitive traditional business. As we execute on our strategy we may see some reduction in topline in exchange for an increase in new business margins as we grow our protection business. Nonetheless, the reduction in gross premiums and the net outflows shown on this slide mainly reflect the fact that we have stopped selling a particular type of investment bond in the UK. This impact was anticipated and had minimal impact on new business value.

APE and NBV grew strongly both in the HY and the 2nd quarter, largely due to the exclusion of Zurich Santander in 2012. The existing business outside of Zurich Santander still delivered new business value growth of 21% to the half year.

The emphasis on profitability over volume is evidenced in the 7.5% improvement in new business margins. This is explained by the inclusion of Zurich Santander, and the shift in business mix on the existing portfolio towards more protection which also benefits from the low rates used to discount new business cash flows.

The translation from our new business success into business operating profits will take time, however the signs of this transition are starting to show through and I will look at this in more detail in the profit by source slide.

Slide 12: Global Life – Business Operating Profit: Profit by Source

The headline business operating profit was flat year over year. Within this there are two positives and two main offsetting factors.

- Firstly, and reflecting the focus on fee based and protection products, the combined expense and risk margins increased by 89 million dollars, or 59 million dollars when including the change in acquisition deferrals. Part of this improvement is due to our expense program in Europe.

- Secondly, we have a growing contribution from Zurich Santander shown here in other profit margins. This business contributed 218m before non-controlling interests, or 95 million after non-controlling interests, to our first half 2013 life BOP. This represented an increase of 65 million dollars compared to the first half of 2012. We are very pleased with our progress here, although you should note that the results for the first half of 2013 include 24 million of positive one-off items.

- Partially offsetting these favorable developments was a 73 million dollar reduction in the investment margin as persisting low yields continued to affect spread business and returns on capital, with the largest reduction of 33m coming from Germany. In addition, the contribution from special operating items also decreased by 30 million compared to prior year.

Overall, both with and without the two one-off items I have just referred to, our life BOP in the first half of 2013 is consistent with the quarterly run rate of 300 to 330 million dollars that we expect to see.

In summary we are pleased with our new business progress while BOP delivery has been essentially maintained despite the low interest rate environment.

Slide 13: Farmers – key performance indicators

Early in July we reported that two severe tornados hitting Oklahoma City in May caused unusually high losses for the Farmers Exchanges and Farmers Re. Further weather events such as a major wildfire in Colorado in June added to these losses and made this year's second quarter as challenging in terms of cat impact as the comparable quarter in the two preceding years.

While this was the driver of the 73 million business operating loss at Farmers Re in the second quarter, the performance of this division is moving in the right direction, as both the underlying and the reported combined ratio were some five percentage points better than in the first half of 2012. In addition, recent rate and underwriting actions are continuing to roll through the book up for renewal.

From a Farmers Management Services perspective, new business continued to decline in the second quarter, albeit at a modestly lower pace than in the 1st quarter. This negatively impacted new business policy fees and was only partially offset by higher management fees. This, in combination with lower investment income, resulted in a 3% year on year decline in Farmers Management Services business operating profit.

The Managed Gross Earned Premium margin declined to 7.1%, which is marginally above the 7% we expect over the long term.

Slide 14: Farmers Exchanges - key performance indicators

Farmers Exchanges Gross Written Premium declined 1% compared to last year. The trends seen in the first quarter continued through the second. Non-standard Auto and Independent Agent Business Insurance overall lost 200 million in volume in the first half – only partly offset by good growth in Homeowners and Specialty. In addition, while the year on year rate of decline of new business has improved, rolling out rate and other underwriting actions across the in-force book is having a negative impact on their retentions.

However these actions are having, and are expected to continue to have, a positive impact on the Farmers Exchanges combined ratio which improved by about 5 points in both the 1st half and the 2nd quarter 2013.

Finally, even with another tough period of weather-related losses, the Farmers Exchanges surplus ratio at 38.4% is at the same level as of the beginning of the year and remains at the upper end of the Farmers Exchanges' target range.

Slide 15: Investment performance of Group investments

Net investment income decreased by 8 percent both in US dollars and local currency reflecting the persisting low yield environment. The marked rise in yields towards the end of the second quarter increased our new money yield by some 30 basis points to roughly 2.5%. While this is a positive development, there continues to be a gap of over 80 basis points to our running yield of around 3.3%.

Net realized capital gains also decreased significantly compared to the first half of 2012. The three main drivers are first, losses on hedging positions and bond holdings that are marked to market through Profit and Loss, in our non-core business and largely offset by mark to market gains on the related liabilities, with limited overall impact on our earnings. Second, losses on hedging derivative positions put in place to protect the balance sheet and third, active sale of debt and equity securities generating capital gains primarily benefitting policyholders.

Rising government bond yields and widening credit spreads in the US impacted net unrealized gains largely driving the negative movement of 4.3 billion in the first half of 2013 and 3.4 billion in the quarter. The reduction of unrealized gains included in shareholders' equity was 2.2 billion in the first half and 1.8 billion in the discrete quarter.

Slide 16: Development of shareholders' equity

Our shareholders' equity reduced by just under 4 billion dollars in the quarter to 30.9 billion with the dividend payment of 2.7 billion and a net change in unrealized losses of 1.8 billion being partially offset by the discrete quarter net income of 0.8 billion. This resulted in a return on common shareholders' equity of 11.3% and a Business operating profit after tax ROE of 10.8%.

Although our shareholders' equity has declined, our economic position is largely unchanged, and our ZECM ratio remains very comfortable.

Also worth noting is that our cash remittances remained strong in the first half. A detailed update will be provided at the end of the year.

Slide 17: Summary

In conclusion, while this is a mixed set of results, let me emphasize a few things:

- In GI, we improved our underlying loss ratio and expense ratio and continue to drive rate increases while improving retention.

- In Global Life, new business value growth continued, both organically in our target markets and from the acquisition of Zurich Santander, with underlying BOP results reflecting the delivery of our strategy.

- And in Farmers, the rate and underwriting actions taken by the Farmers Exchanges are continuing to improve their combined ratio, as well as that of Farmers Re, albeit with a trade off in relation to new business volumes and retentions.

- Lastly, our capital position and cash flows remain very strong.

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