

## **Q1 Results 2014**

Remarks by George Quinn (slides 2, 11 and 12), Chief Financial Officer, and Vibhu Sharma (slides 3 to 10), Group Controller of Zurich Insurance Group.

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### **Slide 2: Key messages**

Good morning or good afternoon, my name is George Quinn and I am the Chief Financial Officer of Zurich Insurance Group, and I would like to welcome you to our Q1 results presentation.

I will make a few short introductory remarks on our results, before I hand over to Vibhu Sharma, who will take you through the details. So, let me summarize the main points.

First, we see this as a solid start to the year across our GI, Life and Farmers businesses. Compared to the first quarter of 2013, our Business Operating Profit is up 2 percent and Net Income Attributable to Shareholders is up by 20 percent.

Our annualized BOPAT ROE in Q1 2014 was 13.4 percent, which is towards the higher end of our 12 to 14 percent range, although this includes a number of favorable factors which we would not extrapolate over the remainder of the year.

Second, we have reported a good GI combined ratio, of 93.9 percent for Q1, although this has been helped by a one-time pension curtailment gain in Switzerland and by low levels of catastrophe losses. Our focus continues to be on improving our accident year profitability and we have a number of actions under way to achieve this.

Third, Farmers gross written premiums are still under some pressure, which is as we expected, but the quarter on quarter picture has clearly improved and we see some early positive signals that this trend will continue.

And last, our Z-ECM capital ratio has increased and is now above the top-end of our expected range at 127 percent. We are deploying additional risk capital in the business, and expect this to lead to the ratio moving back towards the 120 percent level over the course of 2014.

With that I will hand you over to Vibhu, who will take you through the details of our results.

### **Slide 3: Group – Business operating profit and NIAS**

Good morning or good afternoon, I will cover the operating performance of GI, Life and Farmers shortly, but I will briefly highlight three points on this slide.

First, in relation to the pension curtailment gain mentioned by George, this arises from changes to the employee pension scheme in Switzerland, with a positive impact of 130 million dollars, 72 million dollars in GI, 40 million dollars in OOB and 18 million dollars in Global Life.

Second, within group BOP, our OOB result is influenced by very low headquarters expenses, which benefitted from the one-off pension gain, as well as from lower marketing and other costs in the first quarter in comparison to what we expect for the rest of the year. And our non-core result was impacted by a roughly 35 million dollar loss on a specific contract in our Centrally Managed Businesses, which we consider to be a one-off.

And third, in the walk we show from BOP to NIAS on this slide, the main point to highlight is a high level of realized gains, with only a very small level of restructuring costs.

Over Q4 2013 and Q1 2014 we have incurred around 350 million dollars of the 600 million dollars in accounting and restructuring charges we announced at the investor day. This leaves roughly 250 million dollars remaining, and as we see it now, we expect this to come through in the second quarter. The only change to what we have said before is that we expect almost all of these costs to be outside of BOP.

#### **Slide 4: General Insurance – Topline**

Gross written premiums are flat in local currency, and would have been 1 percent higher if we exclude the discontinued large fronting contract that we have referred to in the last few quarters. Our top-line was also modestly negatively impacted by some timing effects in Global Corporate, as well as a planned re-underwriting in Brazil.

We continue to see good rate increases across the book, with a 3 percent increase on renewed business overall, broadly consistent with what we experienced in Q1 2013, and slightly lower than in Q4 2013, as expected given seasonality effects, with higher renewal volumes in Europe in the first quarter.

Within Global Corporate and NAC, we continue to see positive momentum in casualty and specialty risks, although we are experiencing some market pressure in US property lines. We have also written much less new captive business in Q1 2014 in comparison to what was a particularly strong prior period. However, our retentions have been good and we expect to see moderate growth in these two businesses over the year.

In our European business, which now includes Middle East and Africa, we saw top-line pressures in some countries, such as Italy, but growth in UK commercial and personal lines in Switzerland. While

gross premiums declined in local currency by 1 percent, this is an improvement to what we saw through most of 2013.

For International markets, premiums increased by roughly 8 percent in local currency, adjusted for a carve out of certain Global Corporate business, and 3 percent in local currency on a reported basis. While we are still expanding the business, our underlying growth rate has slowed in comparison to recent years, partially driven by our decision to focus more on profitability in certain books in Latin America.

#### **Slide 5: General Insurance – Combined ratio**

We reported a combined ratio of 93.9 percent for the first quarter of 2014, 1 percent better than in the first quarter of last year.

As you can see from this slide, we have changed the way we analyze the main components of our combined ratio, focusing now on three metrics: the accident year ex-catastrophe combined ratio, the impact of mid-size and major cat events, and then prior year development. I will talk about each of these three components briefly.

First, as you can see from this slide, our accident year ex-cat combined ratio was 93.2 percent in Q1 2014. This includes 63 million dollars of the pension gain I mentioned earlier. Excluding this one-off item, the accident year ex-cat combined ratio would have been 94 percent, compared to 93.6 percent in the prior period, albeit that this masks an improved result on a like for like basis.

In terms of the drivers of our accident year results, the ex-cat loss ratio improved by roughly 1 percent compared to the prior period, even with a 20 basis point impact from non-cat weather in the US in Q1 2014.

Large individual non-cat losses, which we had previously split out separately and are now included within the accident year combined ratio, were at similar levels in both quarters, and broadly in line with expectations.

Offsetting the improvement in the loss ratio, our expense ratio increased by 40 basis points including the pension gain, or 120 basis points if this is excluded. The biggest drivers of the increase are a reallocation of costs from Life to GI in Germany, and a positive one-off within the prior period results.

Taking all of these factors in combination, we do continue to see better underlying profitability in NAC and in Europe but we are well aware that we need to improve our accident year results, and this is a key priority for us in 2014.

Moving back to the slide, in terms of the impact from catastrophes, this was 1.9 percent in Q1 2014, mainly due to claims relating to the US freeze and UK floods. The first quarter for both years has seen relatively little in the way of catastrophe losses, and clearly on a low level compared to the average of the last two years, which is slightly over 3.5 percent.

Lastly, prior year development continues to be favorable, with a 1.2 percent positive impact on the combined ratio, higher than in Q1 2013, which was impacted by negative experience on some books of business in NAC.

Looking at recent years, Q1 has tended to see relatively low levels of reserve releases than later quarters, and this may prove to be the case in 2014 as well. That said, we would assume that future reserve releases are likely to be at a lower level compared to past experience, as the positive impact of a low inflation environment has largely worked its way through our results. Using the terminology we adopted in relation to reserve releases last year, the 1.2 percent positive contribution from PYD in Q1 2014 is not an “unusual number” in this steady state low inflation environment.

Looking at the performance by business, all of our regions had a combined ratio well below 100 percent in Q1 2014.

Global Corporate reported a low combined ratio for Q1, albeit benefitting from a virtually loss free quarter in terms of catastrophe claims. Compared to the very strong Q1 2013 result, we experienced a higher level of property losses and a lower level of positive prior year development.

NAC results on an accident year basis improved mainly due to a small improvement in underlying profitability.

Our European business was impacted by much higher catastrophe claims in the quarter compared to Q1 2013 but continues to show good underlying margin improvement despite a higher expense ratio, if we adjust to exclude the one-off pension gain. We are also pleased that our business in Germany is back to reporting good results again.

And in our International business, we reported a significant improvement in our LatAm expense ratio, and lower catastrophe losses in Asia Pacific.

#### **Slide 6: General Insurance – BOP components**

Business operating profit for our General Insurance business increased in the first quarter by 5 percent in US dollars and in local currency.

The underwriting result improved by 89 million dollars for the reasons I previously explained.

In terms of investment income, as expected, this is starting to show signs of flattening out, with a decline of only 15 million dollars compared to the prior year. Also as we expected, we have reported a lower contribution from our hedge fund investments in the first quarter, which declined by roughly 25 million dollars.

The non-technical result of 150 million dollars is on a similar level as last year and benefitted from currency translation gains of roughly 70 million dollars, or 50 million dollars after minority interests, mainly arising from the depreciation of the Argentinian and Venezuelan currencies, as well as some further one-offs such as part of the pension gain. The prior year also benefitted from a one-off factor, namely, a 50 million dollar gain on the sale of own-use property in Taiwan.

The positive items in Q1 are likely to be non-recurring, and so we would expect to see much higher non-technical costs in the remainder of the year. However, as mentioned with our full year results, starting with Q2 reporting, we will show the majority of non-technical expenses within our reported expense and combined ratios. This will, of course, have absolutely no impact on our overall GI BOP, but it is expected to lead to a roughly 2 percentage point increase in our combined ratio.

To summarize on our General Insurance business, we are making progress, and the majority of our portfolio is in good shape but we also recognize that more needs to be done if we are to achieve our goals.

#### **Slide 7: Global Life – New business**

APE increased 7 percent, mainly driven by the UK, together with solid growth in Ireland, Spain and Italy.

In the UK, we experienced good inflows to the corporate savings platform, while the retail wealth business significantly increased sales through advisor networks.

From an APE perspective, these positives more than offset three factors.

First, lower European protection volumes, following an exceptionally strong Q1 2013.

Second, a reduction in unit-linked sales, following a lower than expected take up of investment products around the UK tax year end.

And third, negative currency translation impacts in Latin America, with an increase on a local currency basis.

Net inflows for the quarter also returned to the positive, at 0.6 billion dollars, as surrenders of the last tranches of a discontinued bond in the UK were more than offset by sizable inflows in Switzerland and Zurich Santander Brazil.

In terms of new business value, we have started showing this metric net of minorities, and have restated the comparatives accordingly.

For Q1 2014, the shift in mix from higher margin protection to lower margin corporate pensions, and a revision to new business assumptions in Latin America, had a negative impact on the new business margin. This led to an 10 percent decline in new business value compared to an exceptionally strong prior period.

#### **Slide 8: Global Life – BOP by region**

For this quarter we will focus on the global life business operating profit development by region. This will be replaced by the introduction of “Sources of Earnings” reporting along with our half year results.

Moving to the slide.

Within the 9 percent improvement in business operating profit over the prior year there are a few moving parts, and several one-off items that essentially offset each other.

Starting with Europe, the increase of 57 million dollars is primarily driven by a 40 million dollar tax related gain in the UK and Global Life’s share of the pension gain.

The increase in Latin America is mainly driven by positive claims experience, increased investment income and a small currency gain.

Going the other way, results for North America were impacted by a 56 million dollar charge following the impacts of the transfer of a closed portfolio to non-core businesses, highlighting the continued focus on improving the returns in our manage for value businesses.

Overall, we would characterize this as a solid start to the year for our life business, and we continue to expect an increase in risk margins over and above the likely decline in investment result over the course of 2014.

On the next slide I will give you an update on the Farmers Exchanges, which we do not own but are relevant to the performance of our Farmers business segment.

## Slide 9: Farmers Exchanges

Farmers Exchanges Gross Written Premiums declined by roughly 2 percent in Q1 2014 in comparison to the prior year period. This is a clear improvement in comparison to Q4 2013, when the Farmers Exchanges reported a decline in gross written premiums of nearly 4 percent when measured against Q4 2012.

The main driver of the decline is Farmers Auto business, where gross premiums declined by 5 percent. Within this, the fall in premiums was far more pronounced in the direct channel, due to the shift from the 21st Century to the Farmers brand, whereas the quarter on quarter decline in the exclusive agent channel has slowed.

The fall in premiums in Auto was partially offset by continued strong growth in Specialty lines, and a return to growth in Farmers Home and in Business Insurance sold through exclusive agents. In addition, although Bristol West Gross Written Premiums declined, vehicles-in-force counts increased during the first quarter.

As well as an improving trend in Gross Written Premiums, we see other metrics pointing in a more positive direction too. The positive momentum in new business continued quarter on quarter, and retention is largely flat while premium per policy is improving. Net promoter scores, which tend to be a leading indicator of higher retention, have improved. While no one can be satisfied with a continued decline in premiums or policy count, these early positive signals give us confidence that we will see further improvement in the Farmers Exchanges top-line performance as the year progresses.

In terms of profitability, the Farmers Exchanges combined ratio slightly deteriorated due to higher cat losses, and higher expenses. The ex-catastrophe loss ratio improved by 0.6 points to 60.8 percent.

Continued good profitability enabled the Farmers Exchanges to generate surplus of 133 million dollars in Q1 2014. The surplus ratio thus further increased to around 38 percent, exceeding the 33-36 percent near term target.

Clearly, Q1 tends to be relatively benign in term of cat losses and in recent years it was mainly Q2 that was most affected by natural catastrophe events. So far experience has been within the range of expectations, with the Farmers Exchanges reporting losses of roughly 125 million dollars in relation to two weather events in April. Given where the surplus ratio was at the end of March, and absent major cat losses in the remainder of the year, this means that the Farmers Exchange reliance on capital support through Quota Share reinsurance should reduce over time.

### **Slide 10: Farmers**

At Farmers Management Services, “management fees and other related revenues” declined by 1.5 percent, in line with a 2 percent decline in the Gross Earned Premiums of the Farmers Exchanges.

However, this was compensated by lower expenses, enabling FMS to report stable earnings compared to Q1 2013, and with a slight improvement in the managed gross earned premium margin to 7.3 percent.

Farmers Re gross written premiums declined by 4 percent due to the reduction in Quota Share reinsurance treaty participation as well as the top-line decline at the Farmers Exchanges. The combined ratio and BOP contribution in Q1 2014 were broadly stable compared to Q1 2013, although as mentioned before, we need to bear in mind that Q1 tends to be relatively benign in terms of catastrophe losses.

I will now hand back to George, who will take you through our Group balance sheet and capital, and summarize our Q1 results.

### **Slide 11: Group – Balance sheet and capital**

Shareholders’ equity increased by just over 2 billion dollars in the quarter, driven by 1.3 billion dollars of net income and 0.9 billion dollars of unrealized gains, mainly on our fixed income securities. Our dividend was paid in early April and will be reflected in our second quarter results.

In terms of the economic capital position, this remains very strong, with the Z-ECM and SST ratios increasing to 127 percent and 217 percent, respectively, at the end of December.

Focusing on the Z-ECM ratio first, the increase of 6 percentage points from the half year is mainly due to modelling refinements. The biggest impact was from improving our approach to foreign exchange, moving to a basket of currencies as a benchmark to measure the currency risk of the Group, as opposed to using the US dollar.

The SST ratio improved by 11 points from the half-year results, with the majority due to business profits and market movements.

It is important to consider here that, while the Z-ECM ratio is above the target range, it is mainly due to model improvements that do not have an equal impact on other binding capital constraints. In addition, and all things being equal, we expect that the ratio will move back to around the 120 percent level over the course of 2014, as we deploy additional risk capital in the business.

**Slide 12: Summary**

Before I wrap up, I want to thank Vibhu for leading Zurich's finance team through a very challenging time. He has done an outstanding job, and I very much look forward to working with him, and all my new colleagues as we look to take the company forwards.

So, in summary, we would see this as a solid start to the year across the business.

We have reported a good combined ratio, which benefited from the pension gain and a low level of catastrophe losses. We continue to work on improving our accident year profitability and this will be a key focus for the remainder of 2014.

While still early days, we see positive signals in the Farmers Exchanges top-line.

And we are deploying additional risk capital in the business, leveraging off a Z-ECM ratio which is now above the top-end of our target range.

We will give you a more complete update on strategic execution with our half year results, when we will publish the first of our report cards.

Thank you for your time.



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