Zurich Insurance Group

Operating and financial review (unaudited) 2016

Annual results 2016

Operating and financial review

The operating and financial review is the management analysis of the business performance of Zurich Insurance Group Ltd and its subsidiaries (collectively the Group) for the years ended December 31, 2016, compared with 2015.

Contents

The information contained within the operating and financial review is unaudited and is based on the consolidated results of the Group for the years ended December 31, 2016 and 2015. All amounts are shown in U.S. dollars and rounded to the nearest million unless otherwise stated, with the consequence that the rounded amounts may not always add up to the rounded total. All ratios and variances are calculated using the underlying amounts rather than the rounded amounts. This document should be read in conjunction with the annual results 2016 of the Group and, in particular, with its consolidated financial statements and embedded value report for the year ended December 31, 2016.

In addition to the figures stated in accordance with International Financial Reporting Standards (IFRS), the Group uses business operating profit (BOP), new business measures and other performance indicators to enhance the understanding of its results. Details of these additional measures are set out in the separately published glossary. These should be viewed as complementary to, and not as substitutes for the IFRS figures. For a reconciliation of BOP to net income attributable to shareholders (NIAS), see table 27.2 in note 27 of the consolidated financial statements.

On June 10, 2016, Zurich announced a planned change in the structure of the Group, effective July 1, 2016, which will lead to a simpler, more customer-oriented structure and reduced complexity. The new business structure will be focused on geographic regions in our core businesses of Property and Casualty (P&C) and Life – Asia Pacific, Europe, Middle East and Africa (EMEA), Latin America and North America – as well as Farmers, Group Functions and Operations and Non-Core Businesses. On September 20, 2016, Zurich announced further changes to the business structure of the Group by creating a new unit, called Commercial Insurance, which will combine its Corporate and Commercial business into a single global business. The new reporting structure will be reflected in the consolidated financial statements in 2017.

Financial highlights

in USD millions, for the years ended December 31, unless otherwise stated	2016	2015	Change[1]
Business operating profit	**4,530**	2,916	55%
Net income attributable to shareholders	**3,211**	1,842	74%
General Insurance gross written premiums and policy fees	**33,122**	34,020	(3%)
Global Life gross written premiums, policy fees and insurance deposits	**30,347**	29,037	5%
Farmers Management Services management fees and other related revenues	**2,867**	2,786	3%
Farmers Re gross written premiums and policy fees	**1,587**	2,145	(26%)
General Insurance business operating profit	**2,435**	864	182%
General Insurance combined ratio	**98.4%**	103.6%	5.1 pts
Global Life business operating profit	**1,344**	1,300	3%
Global Life new business annual premium equivalent (APE)[2]	**4,779**	4,772	–
Global Life new business margin, after tax (as % of APE)[2]	**21.0%**	21.6%	(0.6 pts)
Global Life new business value, after tax[2]	**866**	912	(5%)
Farmers business operating profit	**1,520**	1,421	7%
Farmers Management Services gross management result	**1,367**	1,338	2%
Farmers Management Services managed gross earned premium margin	**7.0%**	7.1%	(0.1 pts)
Average Group investments	**190,523**	198,049	(4%)
Net investment result on Group investments	**7,045**	7,462	(6%)
Net investment return on Group investments[3]	**3.7%**	3.8%	(0.1 pts)
Total return on Group investments[3]	**4.3%**	1.7%	2.6 pts
Shareholders' equity[4]	**30,660**	31,178	(2%)
Z-ECM[5]	**122%**	121%	1.0 pts
Diluted earnings per share (in USD)	**21.36**	12.33	73%
Diluted earnings per share (in CHF)	**21.04**	11.86	77%
Book value per share (in CHF)[4]	**208.44**	209.27	–
Return on common shareholders' equity (ROE)[6]	**11.8%**	6.4%	5.4 pts
Business operating profit (after tax) return on common shareholders' equity (BOPAT ROE)[6]	**11.6%**	6.4%	5.2 pts

[1] Parentheses around numbers represent an adverse variance.
[2] Details of the principles for calculating new business are included in the embedded value report in the annual results 2016. New business value and new business margin are calculated after the effect of non-controlling interests, whereas APE is presented before non-controlling interests.
[3] Calculated on average Group investments.
[4] As of December 31, 2016 and December 31, 2015, respectively.
[5] Ratios as of December 31, 2016 and December 31, 2015, respectively. Ratio for December 31, 2016 reflects midpoint estimate with an error margin of +/- 5ppts.
[6] Shareholders' equity used to determine ROE and BOPAT ROE is adjusted for net unrealized gains/(losses) on available-for-sale investments and cash flow hedges.

Operating and financial review (continued)

Performance overview

The Group's business operating profit of USD 4.5 billion increased by USD 1.6 billion, or 55 percent in U.S. dollar terms and 62 percent on a local currency basis compared with 2015, as underlying performance in all core businesses improved. The General Insurance result progressed favorably following the impact of re-underwriting and pricing actions initiated in the second six months of 2015. The result also benefited from lower catastrophe losses and weather related events, as well as favorable prior year development. Global Life achieved a strong result and continued to grow, while maintaining its focus on priority markets and on extracting value from in-force business. Farmers Management Services also continued its positive momentum from premium growth, though Farmers Re incurred higher losses, mainly as a result of higher catastrophe events.

Net income attributable to shareholders of USD 3.2 billion increased by USD 1.4 billion, or by 74 percent in U.S dollar terms and 82 percent on a local currency basis. The increase arose mainly from the increase in business operating profit, as well as the impairment of goodwill in 2015 and lower restructuring charges.

The Group's capital and solvency positions remained strong and enabled the Board of Directors to propose a dividend of CHF 17 per share. Solvency measured on an economic basis as determined under the Zurich Economic Capital Model (Z-ECM) was estimated at 122 percent as of December 31, 2016, above the target range of 100 to 120 percent and remained stable. Shareholders' equity decreased by USD 518 million to USD 30.7 billion during 2016. This decrease resulted from the cost of the dividend approved in March 2016, net actuarial losses on pension plans and negative currency translation adjustments, partly offset by the net income and net unrealized gains on investments.

Business operating profit increased by USD 1.6 billion to USD 4.5 billion, or by 55 percent in U.S. dollar terms and increased 62 percent on a local currency basis.

- **General Insurance** business operating profit increased by USD 1.6 billion to USD 2.4 billion, resulting mainly from an improvement in the net underwriting result of USD 1.4 billion across all regions.
- **Global Life** business operating profit increased by USD 44 million to USD 1.3 billion, or 3 percent in U.S. dollar terms and 9 percent on a local currency basis. Improvements on a local currency basis in Latin America, EMEA and Asia Pacific were offset by a lower contribution from North America. Lower overall costs net of deferrals and improvements in investment margin were partly offset by a deterioration in the technical margin.
- **Farmers** business operating profit increased by USD 99 million to USD 1.5 billion, or by 7 percent. **Farmers Management Services** business operating profit increased by USD 118 million to USD 1.5 billion, driven by growth in gross earned premiums of the Farmers Exchanges[1] and a one-time USD 86 million favorable impact as a result of a pension plan curtailment gain. **Farmers Re** business operating profit decreased by USD 19 million to USD 42 million, due to a lower underwriting result compared with 2015.
- **Other Operating Businesses** reported a business operating loss of USD 758 million, compared with a loss of USD 720 million in 2015. The increased loss was primarily due to the impact of less favorable foreign exchange movements and several one-off items in both 2016 and 2015.
- **Non-Core Businesses** reported a business operating loss of USD 11 million compared with a profit of USD 51 million in 2015. This deterioration resulted from a higher release of long-term reserves in 2015 compared with 2016, as a consequence of a buy-back program for a variable annuity product in the U.S.

[1] The Farmers Exchanges are owned by their policyholders. Farmers Group Inc., a wholly owned subsidiary of the Group, provides certain non-claims administrative and management services to the Farmers Exchanges as attorney-in-fact and receives fees for its services.

Business volumes for the core business segments, comprising gross written premiums, policy fees, insurance deposits and management fees, decreased by USD 65 million to USD 67.9 billion, broadly flat in U.S. dollar terms, but increased 4 percent on a local currency basis.

- **General Insurance** gross written premiums and policy fees decreased by USD 898 million to USD 33.1 billion, or 3 percent in U.S. dollar terms, but remained flat on a local currency basis. 2016 includes the acquisition of Rural Community Insurance Services (RCIS) in North America Commercial beginning April 1, 2016. Excluding RCIS, gross written premiums decreased by 4 percent on a local currency basis, with decreases across all regions except Latin America.
- **Global Life** gross written premiums, policy fees and insurance deposits increased by USD 1.3 billion to USD 30.3 billion, or 5 percent in U.S. dollar terms and 10 percent on a local currency basis. The increase on a local currency basis occurred predominantly in EMEA, driven by higher sales of Corporate Life & Pensions and individual savings business, and in Latin America, which included the effect of a large corporate contract in Chile.
- **Farmers Management Services** management fees and other related revenues increased by USD 81 million to USD 2.9 billion, or 3 percent, due to growth in gross earned premiums of the Farmers Exchanges. **Farmers Re** gross written premiums and policy fees decreased by USD 558 million to USD 1.6 billion, or by 26 percent, due to lower reinsurance assumed from the Farmers Exchanges.

The **net investment result on Group investments**, before allocations to policyholders, of USD 7.0 billion decreased by USD 417 million, or by 6 percent in U.S. dollar terms and 3 percent on a local currency basis, resulting in a **net investment return on average Group investments** of 3.7 percent compared with 3.8 percent in 2015. **Net investment income**, predominantly included in the core business results, of USD 5.5 billion decreased by USD 87 million, or 2 percent in U.S. dollar terms, but was 1 percent higher on a local currency basis. **Net capital gains on investments and impairments** included in the net investment result decreased by USD 330 million to USD 1.6 billion, mainly due to lower realizations compared with 2015. **Total return on average Group investments** was 4.3 percent, compared with 1.7 percent for 2015. Total return includes the net investment return and the favorable impact from net unrealized investment gains before allocations to policyholders, of USD 1.1 billion compared with losses of USD 4.1 billion in 2015, neither of which flow through net income. This improvement arose mainly as a result of positive equity market performance in 2016 and falling bond yields compared with rising bond yields during 2015.

The U.S. dollar, on average, strengthened during 2016 compared with 2015 against all of the Group's major trading currencies. The translation effect of the strengthening of the U.S. dollar during 2016 affected many line items in both the consolidated income and cash flow statements, and reduced business operating profit by USD 197 million. As of December 31, 2016 compared with December 31, 2015, the U.S. dollar was stronger against major currencies in particular the British pound, which weakened 16 percent following the EU membership referendum vote, and affecting most line items in the balance sheet.

The **shareholders' effective tax rate** decreased to 30.7 percent for the period ended December 31, 2016 compared with 36.6 percent for 2015. The decrease of 5.9 percentage points reflects changes in the geographical profit mix and the effect of several non-recurring charges in 2015, which did not attract tax relief.

ROE increased by 5.4 percentage points to 11.8 percent, largely due to the increase in net income attributable to shareholders. **BOPAT ROE** increased by 5.2 percentage points to 11.6 percent as a result of the increase in business operating profit. **Diluted earnings per share** in Swiss francs increased by 77 percent to CHF 21.04 compared with CHF 11.86 in 2015. Diluted earnings per share in U.S. dollars increased by 73 percent to USD 21.36 compared with USD 12.33 in 2015.

Operating and financial review (continued)

General Insurance

in USD millions, for the years ended December 31	2016	2015	Change
Gross written premiums and policy fees	33,122	34,020	(3%)
Net earned premiums and policy fees	26,102	28,051	(7%)
Insurance benefits and losses, net of reinsurance	17,394	20,152	14%
Net underwriting result	412	(1,002)	nm
Net investment result	2,086	2,002	4%
Net non-technical result (excl. items not included in BOP)	70	(29)	nm
Non-controlling interests	133	108	(23%)
Business operating profit	**2,435**	**864**	**182%**
Loss ratio	66.6%	71.8%	5.2 pts
Expense ratio	31.8%	31.7%	(0.1 pts)
Combined ratio	**98.4%**	**103.6%**	**5.1 pts**

in USD millions, for the years ended December 31	Business operating profit (BOP)		Combined ratio	
	2016	2015	2016	2015
Global Corporate	322	(345)	104.2%	113.9%
North America Commercial	973	768	96.1%	98.2%
Europe, Middle East & Africa (EMEA)	1,016	403	95.4%	101.3%
International Markets	364	82	95.4%	103.3%
GI Global Functions including Group Reinsurance	(240)	(45)	nm	nm
Total	**2,435**	**864**	**98.4%**	**103.6%**

Business operating profit increased by USD 1.6 billion to USD 2.4 billion, resulting mainly from an improvement in the net underwriting result of USD 1.4 billion across all regions. The non-technical result improved largely due to foreign exchange gains and the sale of own-use real estate in Germany. The net investment result benefited from higher hedge fund gains compared with 2015, mostly in North America.

Gross written premiums and policy fees decreased by USD 898 million to USD 33.1 billion, or 3 percent in U.S. dollar terms, but remained flat on a local currency basis. Excluding RCIS in the North America Commercial result, gross written premiums overall decreased by 4 percent on a local currency basis, with decreases across all regions except Latin America. The decreases were a result of the focus on profitability, the impact of soft market conditions and exiting business in South Africa and Morocco. Overall, rates rose by around 2 percent in 2016.

The **net underwriting result** improved by USD 1.4 billion to USD 412 million, with an overall combined ratio of 98.4 percent, an improvement of 5.1 percentage points from 2015. The loss ratio improved by 5.2 percentage points reflecting lower catastrophe and weather events, and an improvement in large and underlying loss experience across most regions. The result also reflects favorable development in loss reserves established in prior years compared with negative development in 2015. The favorable development in 2016 was due to reductions in most regions, partly offset by Group Reinsurance. The expense ratio remained at prior year levels, reflecting a lower expense base as a result of initiatives to reduce costs across all regions and the effect of positive non-recurring items in 2016, offset by lower premium volumes.

Global Corporate

in USD millions, for the years ended December 31	2016	2015	Change
Gross written premiums and policy fees	7,681	8,670	(11%)
Net underwriting result	(209)	(835)	75%
Business operating profit	**322**	**(345)**	**nm**
Loss ratio	80.8%	91.2%	10.4 pts
Expense ratio	23.4%	22.7%	(0.7 pts)
Combined ratio	**104.2%**	**113.9%**	**9.7 pts**

Business operating profit increased by USD 667 million to USD 322 million, mainly due to the improvement in the net underwriting result.

Gross written premiums and policy fees of USD 7.7 billion decreased by USD 989 million, or 11 percent in U.S. dollar terms and 8 percent on a local currency basis. This reflected the outcome of re-underwriting measures taken to restore profitability in both existing books and new business. Rates overall increased by 1 percent in 2016, despite continued rate pressure, particularly in North America.

The **net underwriting result** improved by USD 626 million to an underwriting loss of USD 209 million, reflected in the improvement of 9.7 percentage points in the combined ratio to 104.2 percent. The improvement in the loss ratio of 10.4 percentage points was mainly attributable to positive development of reserves established in prior years compared with negative development in 2015, as well as lower catastrophe and weather related losses in Asia Pacific, EMEA and North America. The expense ratio increased by 0.7 percentage points, mainly as a result of lower premium volumes despite reduced costs and the effect of positive non-recurring items in 2016.

Operating and financial review (continued)

North America Commercial

in USD millions, for the years ended December 31	2016	2015	Change
Gross written premiums and policy fees	11,917	10,742	11%
Net underwriting result	311	146	nm
Business operating profit	**973**	**768**	**27%**
Loss ratio	65.4%	67.0%	1.6 pts
Expense ratio	30.7%	31.2%	0.4 pts
Combined ratio	**96.1%**	**98.2%**	**2.0 pts**

Business operating profit increased by USD 205 million to USD 973 million, or by 27 percent, due to the improved net underwriting result and a higher net investment result mainly driven by hedge-fund gains.

Gross written premiums and policy fees increased by USD 1.2 billion to USD 11.9 billion, or by 11 percent. This increase was driven by the completion of the acquisition of RCIS on March 31, 2016 with its results included as of April 1, 2016. RCIS is a provider of agricultural insurance in the U.S. through a federal crop insurance program and other private crop insurance products. Excluding RCIS, gross written premiums and policy fees decreased by 2 percent as a result of underwriting measures. The rate environment remained positive with overall rates increased by 1 percent.

The **net underwriting result** increased by USD 165 million to USD 311 million, reflected in the 2.0 percentage points improvement in the combined ratio to 96.1 percent. Despite higher loss ratio pertaining to the RCIS business, the overall ratio decreased by 1.6 percentage points, mainly attributable to an improvement in the underlying losses. In addition, the result benefited from positive development of reserves established in prior years compared with negative development in 2015. This was partly offset by an increase in catastrophe and weather related losses. The expense ratio improved by 0.4 percentage points, as a result of initiatives to reduce costs, the effect of positive non-recurring items in 2016 and the inclusion of RCIS. This was partly offset by higher commissions due to change in business mix in the non RCIS book.

Europe, Middle East & Africa

in USD millions, for the years ended December 31	2016	2015	Change
Gross written premiums and policy fees	10,162	10,955	(7%)
Net underwriting result	458	(138)	nm
Business operating profit	**1,016**	**403**	**nm**
Loss ratio	64.0%	69.1%	5.2 pts
Expense ratio	31.4%	32.1%	0.7 pts
Combined ratio	**95.4%**	**101.3%**	**5.9 pts**

Business operating profit increased by USD 613 million to USD 1.0 billion, as a result of an improvement in the net underwriting result, supported by an improved non-technical result.

Gross written premiums and policy fees decreased by USD 793 million to USD 10.2 billion, or by 7 percent in U.S. dollar terms and 4 percent on a local currency basis. This reflects the outcome of re-underwriting measures taken to restore profitability from both existing books and new business and the exit of business in South Africa and Morocco in the fourth quarter of 2016. Premiums written declined in some markets where competitive pressure remained.

The **net underwriting result** improved by USD 595 million to USD 458 million, reflected in the positive development in the combined ratio of 5.9 percentage points to 95.4 percent. The loss ratio improved by 5.2 percentage points resulting from a lower current accident year loss ratio. The expense ratio improved by 0.7 percentage points, as a result of initiatives to reduce costs and the effect of positive non-recurring items in 2016.

Operating and financial review (continued)

International Markets

in USD millions, for the years ended December 31	2016	2015	Change
Gross written premiums and policy fees	3,556	3,894	(9%)
Net underwriting result	145	(112)	nm
Business operating profit	**364**	**82**	**nm**
Loss ratio	49.2%	56.5%	7.4 pts
Expense ratio	46.3%	46.8%	0.5 pts
Combined ratio	**95.4%**	**103.3%**	**7.9 pts**

Business operating profit increased by USD 282 million to USD 364 million. The increase resulted from improvements in the net underwriting result and the non-technical result. The latter was mainly a result of foreign exchange gains.

Gross written premiums and policy fees decreased by USD 337 million to USD 3.6 billion, or 9 percent in U.S. dollar terms, but remained flat on a local currency basis. On a local currency basis, gross written premiums grew by 5 percent in Latin America due to the impact of inflation in the region, mainly in Argentina. Despite growth in some areas of Asia Pacific, premiums decreased overall by 6 percent on a local currency basis due to the impact of underwriting actions taken in Australia. Overall, International Markets achieved average rate increases of 1 percent in 2016.

The **net underwriting result** improved by USD 257 million to USD 145 million, reflected in the 7.9 percentage points improvement in the combined ratio to 95.4 percent. The loss ratio improved by 7.4 percentage points, mainly as a result of an improvement in the current accident year loss ratio, as well as higher levels of favorable development of loss reserves established in prior years compared with 2015. The expense ratio improved by 0.5 percentage points as a result of initiatives to reduce costs and the effect of positive non-recurring items in 2016.

Global Life

in USD millions, for the years ended December 31	2016	2015	Change
Insurance deposits	14,817	14,591	2%
Gross written premiums and policy fees	15,530	14,446	7%
Net investment income on Group investments	3,244	3,320	(2%)
Insurance benefits and losses, net of reinsurance	(11,510)	(8,612)	(34%)
Business operating profit	**1,344**	**1,300**	**3%**
Net policyholder flows[1]	8,338	7,200	16%
Assets under management[2, 3]	255,722	254,210	1%
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts (net reserves)[3]	209,118	207,542	1%

[1] Net policyholder flows are defined as the sum of gross written premiums and policy fees and deposits, less policyholder benefits.
[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 fees are earned.
[3] As of December 31, 2016 and December 31, 2015, respectively.

New business – highlights

in USD millions, for the years ended December 31	2016	2015	Change
New business annual premium equivalent (APE)[1]	**4,779**	**4,772**	**–**
New business margin, after tax[2]	**21.0%**	**21.6%**	**(0.6 pts)**
New business value, after tax[3]	**866**	**912**	**(5%)**

[1] APE is shown gross of non-controlling interests.
[2] New business margin is calculated using new business value as a percentage of APE based on figures net of non-controlling interests for both metrics.
[3] New business value is calculated on embedded value principles net of non-controlling interests.

Source of earnings[1]

in USD millions, for the years ended December 31	2016	2015	Change
Loadings and fees	3,620	3,829	(5%)
Investment margin	571	511	12%
Technical margin	927	1,122	(17%)
Operating and funding costs	(1,539)	(1,776)	13%
Acquisition costs	(2,509)	(2,763)	9%
Impact of deferrals	274	376	(27%)
Business operating profit	**1,344**	**1,300**	**3%**

[1] Each line represents the Group's interest after deducting non-controlling interests, amounting in total to USD 255 million in 2016 and USD 223 million in 2015 in business operating profit.

Operating and financial review (continued)

Business operating profit increased by USD 44 million to USD 1.3 billion, or 3 percent in U.S. dollar terms and 9 percent on a local currency basis. Improvements on a local currency basis in Latin America, EMEA, and Asia Pacific were partly offset by a lower contribution from North America. In EMEA, the main improvement on a local currency basis arose through the investment margin and lower overall costs. This improvement was partly offset by a deterioration in the technical margin from higher claims and lower fees due to lower volumes and change in mix of business. Asia Pacific benefited from growth, including the contribution of recent acquisitions, and the transition to run-off of the Singapore business, with a corresponding transfer to Non-Core Businesses. In Latin America, higher volumes, increased investment returns and overall favorable claims experience were the main contributors on a local currency basis. North America was mainly affected by an adverse variance resulting from a review of expected persistency in certain universal life books of business.

Loadings and fees deteriorated by USD 209 million to USD 3.6 billion, or by 5 percent in U.S dollar terms, but remained flat on a local currency basis. In local currency, volume growth in Latin America and the positive contribution from the recent acquisitions in Asia Pacific, both MAA Takaful Berhad insurance company in Malaysia and the retail life insurance protection business of Macquarie Group in Australia, were offset by lower fees in EMEA largely from lower single premium business in Germany and changes in mix of business in the UK.

Investment margin improved by USD 60 million to USD 571 million, or 12 percent in U.S. dollar terms, and 18 percent on a local currency basis. The improvement largely occurred in EMEA and Latin America. In EMEA the increase arose mainly from lower policyholder crediting rates in Switzerland and in Germany, consistent with market conditions, and higher asset bases in Spain and Italy, where business has been growing. In Latin America, local currency improvements were driven by higher investment returns, mostly in Brazil and Mexico.

Technical margin deteriorated by USD 194 million to 927 million, or by 17 percent in U.S dollar terms and 14 percent on a local currency basis. This deterioration was predominantly driven by adverse claims experience in EMEA and the International Group Risk (IGR) business, where higher than expected levels of large losses occurred.

Operating and funding costs improved by USD 237 million to USD 1.5 billion, or by 13 percent in U.S dollar terms, and 9 percent on a local currency basis. In local currency, the positive impact of disciplined central expense management, expense reductions across EMEA and a one-off benefit relating to unit-linked funds in the UK were partly offset by project costs for growth initiatives in other regions.

Acquisition costs decreased by USD 253 million to USD 2.5 billion, or by 9 percent in U.S dollar terms, and by 5 percent on a local currency basis. The decrease on a local currency basis reflected lower volumes of business, particularly in Germany, and changes in business mix in the rest of EMEA and in North America. The contribution from the **impact of deferrals** decreased by USD 102 million to USD 274 million, or by 27 percent both in U.S. dollar terms and on a local currency basis. The negative effect arose mainly in North America, resulting from the review of expected persistency in certain universal life books of business and changes in product mix, and in EMEA, also impacted by changes in product mix.

Insurance deposits increased by USD 227 million to USD 14.8 billion, or 2 percent in U.S. dollar terms and 8 percent on a local currency basis. On a local currency basis, increases occurred in EMEA driven by Corporate Life & Pensions products in the UK, partly offset in Ireland, where a small number of large contracts boosted volumes in 2015.

Gross written premiums and policy fees increased by USD 1.1 billion to USD 15.5 billion, or by 7 percent in U.S. dollar terms and 11 percent on a local currency basis. The increase on a local currency basis arose predominantly in EMEA and Latin America, from higher sales of individual savings products in Spain, individual protection products in Zurich Santander and a large corporate contract in Chile, with a partial offset due to lower sales of single premium products in Germany.

Net policyholder flows were positive at USD 8.3 billion and USD 1.1 billion higher compared with 2015. The majority of the improvement occurred in the retail business in EMEA, driven by individual savings business in Spain, with a partial offset in Germany due to lower single premium business. **Assets under management** increased by 1 percent in U.S. dollar terms and 7 percent on a local currency basis compared with December 31, 2015. The increase was driven by positive net policyholder flows and favorable market movements. In U.S. dollar terms, this increase was offset by the impact of the weaker British pound against the U.S. dollar on investments denominated in British pounds. **Net reserves** increased by 1 percent in U.S. dollar terms, and by 8 percent on a local currency basis compared with December 31, 2015, substantially reflecting movements similar to those in the related assets.

NBV, APE, NBM and BOP by region

in USD millions, for the years ended December 31	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[2]		New business margin, after tax (as % of APE) (NBM)[3]		Business operating profit (BOP)	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
North America	110	100	156	179	70.7%	56.1%	118	178
Latin America	126	125	1,231	957	14.7%	21.1%	250	195
of which:								
Zurich Santander	*103*	*99*	*752*	*726*	*26.8%*	*26.8%*	*217*	*184*
Europe, Middle East & Africa (EMEA)	501	526	3,191	3,422	17.2%	16.3%	911	892
United Kingdom	*193*	*200*	*1,105*	*1,242*	*17.5%*	*16.1%*	*161*	*173*
Germany	*32*	*19*	*279*	*406*	*11.7%*	*4.9%*	*233*	*220*
Switzerland	*77*	*70*	*346*	*335*	*22.3%*	*21.0%*	*209*	*229*
Ireland	*40*	*57*	*383*	*443*	*10.5%*	*13.0%*	*68*	*58*
Spain	*86*	*90*	*589*	*378*	*28.0%*	*44.4%*	*57*	*50*
Italy	*(1)*	*–*	*241*	*234*	*(0.3%)*	*0.2%*	*50*	*41*
Zurich International Life	*69*	*84*	*210*	*349*	*32.9%*	*23.9%*	*76*	*70*
Rest of EMEA	*4*	*5*	*37*	*34*	*10.8%*	*13.6%*	*57*	*50*
Asia Pacific	88	112	155	157	57.8%	72.1%	92	43
Other	40	49	47	57	86.5%	85.1%	(26)	(8)
Total	**866**	**912**	**4,779**	**4,772**	**21.0%**	**21.6%**	**1,344**	**1,300**

NBV, APE and NBM by pillar

in USD millions, for the years ended December 31	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[2]		New business margin, after tax (as % of APE) (NBM)[3]	
	2016	2015	**2016**	2015	**2016**	2015
Bank Distribution	238	241	1,714	1,599	22.4%	22.7%
Other Retail	308	353	1,278	1,472	24.1%	24.0%
Corporate Life & Pensions	320	318	1,787	1,701	18.0%	18.8%
Total	**866**	**912**	**4,779**	**4,772**	**21.0%**	**21.6%**

[1] New business value is calculated on embedded value principles net of non-controlling interests.
[2] APE is shown gross of non-controlling interests.
[3] New business margin is calculated using new business value as a percentage of APE based on figures net of non-controlling interests for both metrics.

APE remained flat at 4.8 billion in U.S. dollar terms, but increased 7 percent on a local currency basis. Latin America increased by 42 percent on a local currency basis mostly due to the effect of a large corporate contract in the Zurich operations in Chile and higher sales of individual protection products in Zurich Santander Brazil. The improvement in Spain resulted from increased sales in Bank Distribution. These improvements were partly offset by lower new business sales in the rest of EMEA, particularly in Germany and Zurich International Life, and in North America.

New business value decreased by USD 45 million to USD 866 million, or 5 percent in U.S. dollar terms, but remained flat on a local currency basis. On a local currency basis, favorable product mix across EMEA, in spite of overall lower sales, and a refinement in the modeling of policyholder participation in Switzerland, led to an improvement in the region. Higher sales resulted in the improvement in Latin America and positive changes to persistency assumptions led to higher new business value in North America. These positive effects were offset by adverse impacts in Asia Pacific, primarily due to lower swap rates in Japan, only partly offset by improved business mix in Australia.

New business margin decreased by 0.6 percentage points to 21 percent. Improvements in North America and EMEA were mainly due to product mix, in spite of Spain being negatively impacted by higher sales of lower margin individual savings products. These improvements were more than offset by a decrease in Latin America, mainly attributable to the effect of a large corporate contract in the Zurich operations in Chile, and in Asia Pacific, due to the adverse impact of lower swap rates in Japan.

On a **pillar basis**, the new business results were as follows:

In Bank Distribution, NBV decreased by USD 3 million to USD 238 million, or by 1 percent in U.S. dollar terms, but increased 4 percent on a local currency basis. The increase on a local currency basis largely resulted from higher margins in the Zurich Santander operations in Mexico, together with higher sales in Zurich Santander Brazil.

In Other Retail, NBV decreased by USD 45 million to USD 308 million, or by 13 percent in U.S. dollar terms and 10 percent on a local currency basis. The decrease on a local currency basis arose mainly in Japan and Switzerland, both negatively impacted by lower interest rates, partly offset by improved business mix in North America.

In Corporate Life & Pensions, NBV increased by USD 2 million to USD 320 million, or by 1 percent in U.S. dollar terms and 9 percent on a local currency basis, largely benefiting from improved business mix in the UK and a refinement in the modeling of policyholder participation in Switzerland.

Farmers

Farmers business operating profit increased by USD 99 million to USD 1.5 billion. This was due to an increase of USD 118 million in Farmers Management Services, which was partly offset by a reduction in business operating profit of USD 19 million in Farmers Re.

Farmers Management Services

in USD millions, for the years ended December 31	**2016**	2015	Change
Management fees and other related revenues	2,867	2,786	3%
Management and other related expenses	(1,500)	(1,448)	(4%)
Gross management result	1,367	1,338	2%
Other net income	112	22	nm
Business operating profit	**1,478**	**1,360**	**9%**
Managed gross earned premium margin	7.0%	7.1%	(0.1 pts)

Business operating profit increased by USD 118 million to USD 1.5 billion driven by growth in gross earned premiums of the Farmers Exchanges and a one-time USD 86 million favorable impact as a result of a pension curtailment gain from changes to the Farmers pension plan, effective December 31, 2018.

Management fees and other related revenues of USD 2.9 billion increased USD 81 million, or 3 percent, due to growth in gross earned premiums of the Farmers Exchanges across most lines of business. **Management and other related expenses** of USD 1.5 billion grew 4 percent. **Other net income** of USD 112 million increased USD 89 million primarily due to the favorable impact of a pension curtailment gain from changes to the Farmers pension plan.

The **managed gross earned premium margin** was 7.0 percent compared with 7.1 percent for 2015.

Operating and financial review (continued)

Farmers Re

in USD millions, for the years ended December 31	**2016**	2015	Change
Gross written premiums and policy fees	1,587	2,145	(26%)
Net underwriting result	(51)	(26)	(93%)
Business operating profit	**42**	**61**	**(32%)**
Loss ratio	71.3%	70.1%	(1.2 pts)
Expense ratio	32.0%	31.1%	(0.9 pts)
Combined ratio	**103.3%**	**101.2%**	**(2.2 pts)**

Business operating profit decreased by USD 19 million to USD 42 million due to the deterioration of underwriting results compared with 2015.

Gross written premiums and policy fees decreased by USD 558 million to USD 1.6 billion, or by 26 percent, as a result of lower participation in the reinsurance agreements with the Farmers Exchanges. Participation in the All Lines quota share reinsurance agreement was reduced from 10 percent to 8 percent, effective December 31, 2015. The Auto Physical Damage (APD) quota share reinsurance agreement was terminated effective January 1, 2016.

The **net underwriting result** deteriorated by USD 24 million to a loss of USD 51 million reflected in the 2.2 percentage points deterioration in the combined ratio. The **loss ratio** increased by 1.2 percentage points as a result of higher catastrophe losses, mainly related to Texas storms. The **expense ratio**, based on ceded reinsurance commission rates payable to Farmers Exchanges, increased 0.9 percentage points due to the termination of the APD quota share reinsurance agreement which had a lower ceding commission rate.

Farmers Exchanges

Financial information about the Farmers Exchanges, which are owned by their policyholders, is proprietary to the Farmers Exchanges, but is provided to support an understanding of the performance of Farmers Group, Inc. and Farmers Re.

The Farmers Exchanges are owned by their policyholders. Farmers Group Inc., a wholly owned subsidiary of the Group, provides certain non-claims administrative and management services to the Farmers Exchanges as attorney-in-fact and receives fees for its services.

in USD millions, for the years ended December 31	**2016**	2015	Change
Gross written premiums	19,714	19,077	3%
Gross earned premiums	19,528	18,885	3%

Gross written premiums in the Farmers Exchanges increased by USD 637 million to USD 19.7 billion, or by 3 percent. Growth in most lines of business from continuing operations was partially offset by decreases in discontinued 21st Century operations.

Gross earned premiums in the Farmers Exchanges increased by USD 643 million to USD 19.5 billion, or by 3 percent.

Other Operating Businesses

in USD millions, for the years ended December 31	2016	2015	Change
Business operating profit:			
Holding and Financing	(528)	(520)	(2%)
Headquarters	(230)	(200)	(15%)
Total business operating profit	**(758)**	**(720)**	**(5%)**

Holding and Financing business operating loss of USD 528 million increased by USD 8 million, or by 2 percent in U.S. dollar terms and 5 percent on a local currency basis. This was primarily driven by less favorable foreign exchange impacts, which were higher in 2015 partly as a result of the Swiss National Bank action to discontinue the link of the Swiss franc to the euro, partly offset by reductions in external debt expense.

Headquarters business operating loss of USD 230 million increased by USD 30 million compared with 2015, or by 15 percent in U.S. dollar terms and 18 percent on a local currency basis. Underlying expense savings were offset by several one-off items in both 2015 and 2016, including higher performance remuneration costs compared with 2015.

Non-Core Businesses

in USD millions, for the years ended December 31	2016	2015	Change
Business operating profit:			
Zurich Legacy Solutions	(21)	(50)	58%
Other run-off	10	101	(90%)
Total business operating profit	**(11)**	**51**	**nm**

Zurich Legacy Solutions, which comprise run-off portfolios managed with the intention of proactively reducing risk and releasing capital, reported a business operating loss of USD 21 million. The improvement of USD 29 million arose primarily from the one-off impacts of successful exit strategies partly offset by reduced investment income following capital repatriation.

Other run-off, which largely comprises U.S. life insurance and annuity portfolios, reported a business operating profit of USD 10 million, a decrease of USD 91 million. This deterioration resulted from a higher release of long-term reserves in 2015 compared with 2016, as a consequence of a buy-back program for a variable annuity product in the U.S.

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