Zurich Insurance Group

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Operating and financial review (unaudited) 2018

Results for the six months to June 30, 2018

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 six months ended June 30, 2018, compared with the same period of 2017.

Contents

The information contained within the operating and financial review is unaudited and is based on the consolidated results of the Group for the six months ended June 30, 2018 and 2017. 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 2017 of the Group and, in particular, with its consolidated financial statements and embedded value report for the year ended December 31, 2017.

In addition to the figures stated in accordance with International Financial Reporting Standards (IFRS), the Group uses business operating profit (BOP), new business metrics 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 note 14 (table 14.4) of the unaudited consolidated financial statements for the six months ended June 30, 2018.

Certain comparatives have been revised as a result of reclassifications and other adjustments. For details refer to note 1 of the unaudited consolidated financial statements for the six months ended June 30, 2018.

Financial highlights

in USD millions, for the six months ended June 30, unless otherwise stated	2018	2017	Change[1]
Business operating profit	**2,422**	2,167	12%
Net income attributable to shareholders	**1,791**	1,503	19%
P&C business operating profit	**1,137**	1,020	11%
P&C gross written premiums and policy fees	**18,543**	18,005	3%
P&C combined ratio	**97.5%**	99.5%	2.0 pts
Life business operating profit	**760**	650	17%
Life gross written premiums, policy fees and insurance deposit	**16,966**	14,361	18%
Life new business annual premium equivalent (APE)[2]	**2,291**	2,275	1%
Life new business margin, after tax (as % of APE)[2]	**26.4%**	25.3%	1.0 pts
Life new business value, after tax[2]	**522**	503	4%
Farmers business operating profit	**808**	794	2%
Farmers Management Services management fees and other related revenues	**1,445**	1,438	–
Farmers Management Services managed gross earned premium margin	**7.0%**	7.0%	0.0 pts
Farmers Re gross written premiums and policy fees	**97**	772	(87%)
Farmers Life new business annual premium equivalent (APE)[2]	**45**	46	(3%)
Average Group investments[3]	**192,606**	187,372	3%
Net investment result on Group investments	**3,139**	3,091	2%
Net investment return on Group investments[4]	**1.6%**	1.6%	(0.0 pts)
Total return on Group investments[4]	**0.2%**	1.7%	(1.5 pts)
Shareholders' equity[5]	**29,729**	33,062	(10%)
Z-ECM[6]	**134%**	132%	2.0 pts
Return on common shareholders' equity (ROE)[7]	**12.5%**	11.3%	1.2 pts
Business operating profit (after tax) return on common shareholders' equity (BOPAT ROE)[7]	**12.3%**	11.0%	1.3 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 Report 2017. 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 Including investment cash.
4 Calculated on average Group investments.
5 As of June 30, 2018 and December 31, 2017, respectively.
6 Ratios as of June 30, 2018 and December 31, 2017, respectively. Ratio for June 30, 2018 reflects midpoint estimate with an error margin of +/- 5 pts.
7 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.

Performance overview

The Group's business operating profit of USD 2.4 billion increased by USD 255 million or 12 percent in U.S. dollar terms and 11 percent on a local currency basis, as underlying performance in all core businesses developed positively. Life continued to deliver strong results, predominantly in Europe, Middle East & Africa (EMEA) and Latin America while Property & Casualty (P&C) showed improvements in the underwriting result. Farmers benefited from an improvement in the combined ratio at Farmers Re. The result included the impact of USD 70 million for measures related to restructuring activities within the Group.

Net income attributable to shareholders of USD 1.8 billion increased by USD 288 million, or by 19 percent in both U.S. dollar and local currency terms. The increase reflected the combination of higher business operating profit and lower income tax expenses, largely resulting from the U.S. corporate tax reform that was enacted at the end of 2017.

Shareholders' equity decreased by USD 3.3 billion to USD 29.7 billion during the first six months of 2018, following the dividend payout of USD 2.8 billion and anti-dilution measures amounting to USD 925 million. Higher unrealized losses on investments and negative currency translation adjustments caused by the strengthening of the U.S. dollar relative to the main currencies of the Group, contributed to the decrease, partially offset by the net income for the period and net actuarial gains on pension plans.

Business operating profit of USD 2.4 billion increased USD 255 million with improvements in all businesses other than Group Functions and Operations.

- → **P&C** business operating profit improved by USD 117 million to USD 1.1 billion, benefiting from improvements in current accident year losses across the segments and higher favorable development of reserves established in prior years. These were partly offset by a reduction in the investment result and higher non-technical expenses including the impact of measures related to the Group's restructuring.
- → **Life** business operating profit increased by USD 109 million to USD 760 million, or 17 percent in U.S. dollar terms and 12 percent on a local currency basis**.** On a local currency basis, business operating profit benefited from higher loadings and fees resulting from increased volumes, as well as improvements in the investment margin. In addition, operating costs also improved when adjusting for the impact of measures related to the Group's restructuring and one-time benefits incurred in the first six months of 2017.
- → **Farmers** business operating profit increased by USD 14 million to USD 808 million. This was primarily due to an increase in Farmers Re benefiting from lower catastrophe and weather-related losses.
- → **Group Functions and Operations (GF&O)** business operating loss increased to USD 334 million due to lower recharges to business units and one-off expenses partially offset by lower financing costs and foreign exchange gains.
- → **Non-Core Businesses** business operating profit increased by USD 48 million to USD 51 million as a result of reserve releases in run-off books.

The Group further progressed against its financial targets in 2018:

BOPAT ROE increased to 12.3 percent, mainly as a result of higher business operating profit and the improved shareholders' effective tax rate. The Group's capital and solvency positions remained strong. Solvency measured on an economic basis as determined under the **Zurich Economic Capital Model (Z-ECM)** was estimated at 134 percent as of June 30, 2018, above the target range of 100–120 percent, and increased by 2 percentage points from January 1, 2018.

Building on accumulated expense savings of USD 700 million achieved in 2016 and 2017, the Group has made further progress toward meeting its 2019 expense target of USD 1.5 billion against the 2015 baseline, with cumulative net savings of approximately USD 900 million achieved to date and further savings expected to be delivered over the remainder of 2018.

Cash remittances in excess of USD 9.5 billion over the cycle, are on track to be delivered.

The **net investment result on Group investments** before allocations to policyholders of USD 3.1 billion increased by USD 49 million, or by 2 percent in U.S. dollar terms and decreased by 4 percent on a local currency basis, resulting in a **net investment return on average Group investments** of 1.6 percent, in line with the same period of 2017. **Net investment income**, mainly included in the core business results, of USD 2.7 billion increased by USD 139 million, or 5 percent in U.S. dollar terms, and 1 percent on a local currency basis, as a result of rising yields in U.S. **Net capital gains on investments and impairments** included in the net investment result decreased by USD 91 million to USD 398 million, mainly due to the impact of rising interest rates and volatile equity markets on the investment portfolio measured at fair value through profit and loss. **Total return on average Group investments** was 0.2 percent (not annualized), compared with 1.7 percent in the same period of 2017. Total return includes the net investment result, net capital gains and the unfavorable impact from net unrealized capital gains before allocations to policyholders reported in shareholders' equity. These net unrealized capital gains were a negative USD 2.7 billion compared with positive USD 134 million in the same period of 2017. This decline was mainly due to rising European government bond yields and widening credit spreads in 2018, after falling yields in the same period of 2017.

The **shareholders' effective tax rate** decreased to 26.8 percent for the period ended June 30, 2018 compared with 32.5 percent for the same period of 2017. The decrease was driven primarily due to the U.S. corporate tax reform enacted at the end of 2017, under which U.S. profits are now taxed at a 21.0 percent, compared with 35.0 percent in previous years. In addition, results for the first six months of 2017 were affected by several non-recurring charges, particularly the one related to the Ogden[1] discount rate change in the UK (Ogden), which had an unfavorable impact on the shareholders' effective tax rate.

NIAS ROE improved by 1.2 percentage points to 12.5 percent due to the improvement in net income attributable to shareholders.

[1] The discount rate reflected in the Ogden tables defined by the Lord Chancellor of the UK Ministry of Justice is used to calculate personal injury and accident claims in the UK. On February 27, 2017 this rate was changed from 2.5 percent to minus 0.75 percent.

Operating and financial review (continued)

Property & Casualty (P&C)

in USD millions, for the six months ended June 30	Total			Of which Commercial[1]		
	2018	2017	Change	**2018**	2017	Change
Gross written premiums and policy fees	18,543	18,005	3%	8,209	8,222	–
Net earned premiums and policy fees	13,041	12,498	4%	5,279	5,414	(3%)
Insurance benefits and losses, net of reinsurance	8,477	8,389	(1%)	3,947	4,000	1%
Net underwriting result	325	62	n.m.	(71)	(148)	52%
Net investment result	991	1,026	(3%)	602	644	(7%)
Business operating profit	**1,137**	**1,020**	**11%**	**471**	**506**	**(7%)**
Loss ratio	65.0%	67.1%	2.1 pts	74.8%	73.9%	(0.9 pts)
Expense ratio	32.5%	32.4%	(0.1 pts)	26.6%	28.8%	2.3 pts
Combined ratio	**97.5%**	**99.5%**	**2.0 pts**	**101.3%**	**102.7%**	**1.4 pts**

[1] Excluding Group Reinsurance and intersegment eliminations.

BOP by Segment

in USD millions, for the six months ended June 30	Business operating profit (BOP)			Net underwriting result		
	2018	2017	Change	**2018**	2017	Change
Europe, Middle East & Africa (EMEA)	498	316	58%	274	52	n.m.
North America	635	564	13%	172	10	n.m.
Asia Pacific	74	114	(35%)	19	89	(79%)
Latin America	60	133	(55%)	(6)	43	n.m.
Group Reinsurance[1]	(130)	(107)	(21%)	(135)	(133)	(1%)
Total	**1,137**	**1,020**	**11%**	**325**	**62**	**n.m.**

[1] Including intersegment elimination.

Business operating profit increased by USD 117 million to USD 1.1 billion, driven by an improvement in the underwriting result stemming from favorable development of reserves established in prior years and lower underlying losses across the segments with EMEA and Group Reinsurance affected by a reserve strengthening of USD 209 million in the first six months of 2017 due to the change in the Ogden rate in the UK. This was partly offset by lower hedge fund gains, mainly in North America, measures related to the Group's restructuring amounting to USD 59 million and lower foreign exchange gains compared with the first six months of 2017.

EMEA business operating profit increased by USD 182 million, with the same period of 2017 affected by Ogden. This, together with an improvement in the current accident year loss ratio, was partly offset by higher catastrophe and weather-related losses and by the impact of measures related to the Group's restructuring. In **North America,** business operating profit increased by USD 71 million, driven by a higher underwriting result and higher investment income, partly offset by lower hedge fund gains and by foreign currency losses in the first six months of 2018 compared with gains in the first six months of 2017. In **Asia Pacific,** business operating profit decreased by USD 40 million, as the same period of 2017 benefited from higher favorable development of loss reserves established in prior years. This was only partly offset by higher fee income from Cover-More and lower one-off costs compared to the first six months of 2017. **Latin America** declined by USD 73 million, with the first six months of 2017 benefiting from higher favorable development of reserves established in prior years, a one-time settlement of premium taxes in Brazil and higher foreign exchange gains in Venezuela. The decrease in **Group Reinsurance** was due mainly to higher foreign currency losses.

Commercial Insurance business operating profit decreased by USD 35 million as an improved underwriting result was more than offset by lower hedge fund gains as well as lower foreign currency gains in North America and Venezuela. The underwriting result benefited from higher favorable development of reserves established in prior years and lower operating expenses, which were only partly offset by an increase in catastrophe and weather-related losses, as well as in the underlying losses.

Gross written premiums and policy fees increased by USD 538 million or 3 percent in U.S. dollar terms and remained broadly flat on a local currency basis. Growth in Asia Pacific and Latin America was mostly offset by a decrease in North America, while EMEA remained in line with the first six months of 2017. In Asia Pacific, growth was driven by the travel solutions business in Australia, motor and personal accident in Japan, and takaful business in Malaysia. The improvement in Latin America was mainly due to inflation in Argentina, growth in mass-consumer business in Brazil and commercial and motor insurance in Mexico. North America's crop and large commercial books showed decreases, with the latter affected by portfolio rebalancing initiatives. Overall, rates rose by around 3 percent in the first six months of 2018.

The **net underwriting result** increased by USD 263 million to USD 325 million, with a combined ratio of 97.5 percent, 2 percentage points lower than in the first six months of 2017. The increase in the underwriting result was driven by higher favorable development of loss reserves established in prior years and an improvement in underlying losses across the segments. Catastrophe and weather-related losses were in line with the same period in 2017. The expense ratio increased slightly, with improvements resulting from initiatives to reduce costs offset by increased commissions across the segments, reflecting changes in the business mix.

The net underwriting result in **EMEA** increased by USD 222 million, mainly due to higher favorable development of reserves established in prior years, as 2017 was affected by Ogden. This was partly offset by an increase in catastrophe and weather-related losses. The current accident year loss ratio improved due to lower underlying loss experience, and the expense ratio also improved slightly. **North America** increased by USD 162 million, mainly due to lower catastrophe and weather-related losses, after severe hail storms in the first six months of 2017. Favorable development of loss reserves established in prior years was in line with the first six months of 2017. The current accident year loss ratio decreased due to an improved underlying loss experience. The expense ratio also improved as a result of lower staff costs and other expenses, and lower premium taxes benefiting from one-off adjustments. An increase in commissions due to changes in business mix partly offsets these favorable factors. **Asia Pacific** was USD 71 million lower than the first six months of 2017, with prior year benefiting from more favorable development of loss reserves established in prior years. **Latin America** declined by USD 49 million, as a result of lower favorable development of reserves established in prior years and the inclusion in prior year of a one-time settlement of premium taxes in Brazil. Commissions increased, reflecting changes in business mix, and were partly offset by an improvement in underlying loss experience. **Group Reinsurance** remained broadly flat with higher assumed losses partly offset by lower unfavorable development of reserves established in prior years.

Operating and financial review (continued)

Life

in USD millions, for the six months ended June 30	**2018**	2017	Change
Insurance deposits	8,985	7,313	23%
Gross written premiums and policy fees	7,980	7,048	13%
Net investment income on Group investments	1,575	1,449	9%
Insurance benefits and losses, net of reinsurance	(5,554)	(4,932)	(13%)
Business operating profit	**760**	**650**	**17%**
Net policyholder flows[1]	4,330	2,715	60%
Assets under management[2, 3]	264,353	269,836	(2%)
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts (net reserves)[3]	209,747	215,424	(3%)

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 on balance sheet Group investments and unit-linked investments plus assets that are managed by third parties, on which fees are earned.
3 As of June 30, 2018 and December 31, 2017, respectively.

BOP by segment

in USD millions, for the six months ended June 30	**2018**	2017	Change
Europe, Middle East & Africa (EMEA)	524	438	20%
North America	(17)	(16)	(3%)
Asia Pacific	78	78	(1%)
Latin America	173	149	16%
Group Reinsurance[1]	2	1	n.m.
Total	**760**	**650**	**17%**

1 Including intersegment elimination.

Business operating profit increased by USD 109 million to USD 760 million, or 17 percent in U.S. dollar terms and 12 percent on a local currency basis. On a local currency basis, the majority of the increase occurred in **EMEA** and **Latin America.** The improvement In Latin America resulted from higher technical margins on corporate protection business and gains related to the devaluation of the Argentinian peso, and in **EMEA** it was largely due to lower discretionary policyholder dividends, favorable experience variances and reductions in operating costs. These improvements were partially offset by a deterioration in the technical margin and lower fee revenue in Germany. In **Asia Pacific**, continued growth across the region was offset by less favorable market movements in Hong Kong. In **North America,** growth in the corporate business, partly due to transferring that business from the Non-Core segment at the end 2017, was offset by the impairment of a software asset.

Gross written premiums, policy fees and insurance deposits increased by USD 2.6 billion to USD 17 billion, or by 18 percent in U.S. dollar terms and 10 percent on a local currency basis. On a local currency basis, improvements occurred across all segments, particularly in EMEA, where Italy, Switzerland and the UK were the main contributors, and in North America.

Assets under management decreased by 2 percent in U.S. dollar terms, but increased by 1 percent on a local currency basis compared with December 31, 2017. The local currency increase was driven by favorable market movements and positive net policyholder flows. In U.S. dollar terms, the U.S. dollar's strengthening against European and Latin American currencies led to a decline compared with December 31, 2017. **Net policyholder flows** of USD 4.3 billion increased by 60 percent in U.S. dollar terms compared with June 30, 2017, with the largest contributions from Switzerland, the joint-venture with Banco de Sabadell, S.A. in Spain and Italy.

Source of earnings[1]

in USD millions, for the six months ended June 30	**2018**	2017	Change
Loadings and fees	1,753	1,641	7%
Investment margin	339	248	37%
Technical margin	521	510	2%
Operating and funding costs	(673)	(641)	(5%)
Acquisition costs	(2,064)	(1,202)	(72%)
Impact of deferrals	885	96	n.m.
Business operating profit	**760**	**650**	**17%**

[1] Each line represents the Group's interest after deducting non-controlling interests, amounting in total to USD 139 million in 2018 and USD 145 million in 2017 in business operating profit.

Viewed in terms of profit sources and on a local currency basis, business operating profit benefited from higher volumes resulting in higher loadings and fees, as well as improvements in the investment margin. Acquisitions costs and the impact of deferrals were affected by the reinsurance contract entered into with OnePath Life in anticipation of its acquisition.

Loadings and fees improved by 7 percent in U.S dollar terms and 2 percent on a local currency basis. Growth in Asia Pacific, higher volumes in Latin America and increased fee income in North America, the latter partly from a transfer of the corporate protection business from the Non-Core segment at the end 2017, were the main drivers. These positive factors were partially offset by lower fee revenue in Germany due to a decrease in business volume. The **investment margin** improved by 37 percent in U.S. dollar terms and 35 percent on a local currency basis. EMEA made the biggest contribution with reserve releases in accordance with interest rate changes in Switzerland and reduced discretionary policyholder dividends. In addition, foreign currency gains in Latin America also contributed to the improvement. The **technical margin** increased by 2 percent in U.S dollar terms and decreased 1 percent on a local currency basis, mainly driven by disability benefits in Switzerland, where the first six months of 2017 were exceptionally good. This was partly offset by improved margins on corporate protection business in Latin America and the growing portfolios of individual protection business in Asia Pacific.

Operating and funding costs increased by 5 percent in U.S dollar terms and were flat on a local currency basis. In local currency, the positive impact of expense reductions across EMEA was offset by higher costs in Asia Pacific, largely related to the integration of recently acquired businesses and a negative impact in Latin America from a one-time settlement of premium taxes in Brazil in the first six months of 2017. **Acquisition costs** increased by 72 percent in U.S dollar terms and 67 percent on a local currency basis, mostly as a result of a reinsurance contract with OnePath Life. This also drove the improvement in the **impact of deferrals.**

Operating and financial review (continued)

NBV, APE and NBM by Segment

in USD millions, for the six months ended June 30	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[2]		New business margin, after tax (as % of APE) (NBM)[3]	
	2018	2017	**2018**	2017	**2018**	2017
Europe, Middle East & Africa (EMEA)	345	328	1,615	1,596	23.0%	21.6%
North America	8	17	43	25	18.9%	67.5%
Asia Pacific	93	78	113	87	83.5%	90.9%
Latin America	76	80	521	566	23.6%	22.4%
Total	**522**	**503**	**2,291**	**2,275**	**26.4%**	**25.3%**

NBV, APE and NBM by line of business

in USD millions, for the six months ended June 30	New business value, after tax (NBV)[1]		New business annual premium equivalent (APE)[2]		New business margin, after tax (as % of APE) (NBM)[3]	
	2018	2017	**2018**	2017	**2018**	2017
Protection	406	389	919	787	54.3%	63.5%
Corporate Pensions	35	49	371	632	9.6%	7.8%
Unit Linked	85	78	627	607	14.7%	14.2%
Annuities and Savings	(5)	(14)	374	250	(1.7%)	(7.1%)
Total	**522**	**503**	**2,291**	**2,275**	**26.4%**	**25.3%**

[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 improved by USD 16 million to USD 2.3 billion, or 1 percent in U.S. dollar terms. On a like-for-like basis, adjusted by USD 317 million for the disposal of the UK workplace pensions and saving business to Lloyds Banking Group (LBG) and on a local currency basis, APE improved by USD 219 million or 11 percent. The largest improvement occurred in EMEA. The joint venture with Banco de Sabadell, S.A. in Spain, saving products in Italy and corporate savings in Switzerland and the UK were the main contributors. The UK also benefited from a single large corporate protection sale. In Asia Pacific, all countries contributed to the growth, while North America saw the volume of corporate protection business improving from a low base in 2017. In Latin America, continued growth in Brazil was more than offset by Chile, where the first six months of 2017 included the effect of a large corporate protection contract.

New business value increased by USD 19 million to USD 522 million, or 4 percent in U.S. dollar terms. On a like-for-like basis, adjusted by USD 18 million for the disposal of the UK workplace pensions and saving business to Lloyds Banking Group (LBG) and on a local currency basis, new business value increased by USD 13 million or 3 percent. New business value benefited from higher volumes, positive economic variances in Latin America and EMEA and from a modelling refinement in Germany. These positive effects were partially offset by adverse product mix, especially in Asia Pacific and North America, and unfavorable operating assumption updates.

As a result, the overall **new business margin** improved by 1 percentage points to 26 percent, with improvements in EMEA and Latin America, and decreases in Asia Pacific and North America. The latter was driven by growth in lower-margin corporate protection business.

Farmers

in USD millions, for the six months ended June 30	2018	2017	Change
Farmers Management Services (FMS)	702	700	–
Farmers Re	25	6	n.m.
Farmers Life	81	87	(7%)
Total business operating profit	**808**	**794**	**2%**

Farmers business operating profit increased by USD 14 million to USD 808 million, or by 2 percent. **Farmers Management Services** business operating profit increased by USD 1 million to USD 702 million. **Farmers Life** business operating profit decreased by USD 6 million to USD 81 million reflecting higher claims experience, partially offset by higher operating income from growth of Life insurance in-force. **Farmers Re** business operating profit increased by USD 19 million to USD 25 million due to a 6.8 percentage point improvement in the combined ratio, partially offset by lower investment and other income.

Farmers Management Services

in USD millions, for the six months ended June 30	2018	2017	Change
Management fees and other related revenues	1,445	1,438	–
Management and other related expenses	747	750	–
Gross management result	698	688	1%
Managed gross earned premium margin	7.0%	7.0%	0.0 pts

Management fees and other related revenues of USD 1.4 billion increased USD 7 million due to growth in gross earned premiums of the Farmers Exchanges.[2] **Management and other related expenses** slightly decreased to USD 747 million.

The **managed gross earned premium margin** remained unchanged at 7.0 percent.

Farmers Re

in USD millions, for the six months ended June 30	2018	2017	Change
Gross written premiums and policy fees	97	772	(87%)
Net underwriting result	4	(23)	n.m.
Loss ratio	64.1%	71.0%	6.9 pts
Expense ratio	32.2%	32.0%	(0.2 pts)
Combined ratio	**96.3%**	**103.0%**	**6.8 pts**

Gross written premiums and policy fees decreased by USD 675 million to USD 97 million, or by 87 percent, as a result of the reduced participation in the All Lines quota share reinsurance agreement with the Farmers Exchanges from 8.0 percent to 1.0 percent effective December 31, 2017.

The **net underwriting result** improved by USD 27 million to USD 4 million, driven by a 6.8 percentage point improvement in the combined ratio. The **loss ratio** decreased 6.9 percentage points primarily as a result of lower catastrophe events. The **expense ratio** increased slightly to 32.2 percent.

[2] 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.

Operating and financial review (continued)

Farmers Life

in USD millions, for the six months ended June 30	2018	2017	Change
Insurance deposits	79	80	(1%)
Gross written premiums and policy fees	447	438	2%
New business annual premium equivalent (APE)	45	46	(3%)
New business value (NBV)	64	49	31%
Assets under management[1, 2]	5,354	5,415	(1%)
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts (net reserves)[2]	4,731	4,659	2%

[1] Assets under management comprise on balance sheet Group investments and unit-linked investments plus assets that are managed by third parties, on which fees are earned.
[2] As of June 30, 2018 and December 31, 2017, respectively.

Insurance deposits decreased by USD 1 million to USD 79 million. **Gross written premiums and policy fees** increased by USD 9 million to USD 447 million, mainly due to growth of insurance in-force.

APE remained in line with prior year. **NBV** increased despite lower sales, due mainly to higher margins from lower acquisition expenses, a favorable sales mix and the U.S. corporate tax rate reduction, partially offset by the negative effect of higher interest rates on certain individual protection business.

Assets under management remained essentially flat and **total reserves** increased by USD 72 million.

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 six months ended June 30	2018	2017	Change
Gross written premiums	10,335	10,047	3%
Gross earned premiums	9,965	9,846	1%

Gross written premiums in the Farmers Exchanges increased by USD 288 million to USD 10.3 billion, or by 3 percent. Continuing operations[3] were up 4.7 percent, driven primarily by the addition of the Commercial Auto Rideshare business in March as well as growth in all books of business. Growth was partially offset by the run-off in discontinued operations.

Gross earned premiums in the Farmers Exchanges increased by USD 119 million to USD 10.0 billion, or by 1 percent.

[3] Continuing operations exclude Independent Agent Business Insurance, 21st Century outside of California and Hawaii and other discontinued operations.

Group Functions and Operations

in USD millions, for the six months ended June 30	**2018**	2017	Change
Holding and Financing	(191)	(217)	12%
Headquarters	(143)	(84)	(71%)
Total business operating profit	**(334)**	**(301)**	**(11%)**

Holding and Financing business operating loss of USD 191 million improved by USD 26 million or 12 percent in U.S. dollar terms and 15 percent on a local currency basis. The main factors driving the improvement were lower financing costs and higher foreign exchange gains than in the same period in 2017.

Headquarters recorded a business operating loss of USD 143 million, USD 59 million higher compared with the same period of 2017 or 71 percent in U.S. dollar terms and 66 percent in local currency. Underlying expense savings were more than offset by lower recharges to business units.

Non-Core Businesses

in USD millions, for the six months ended June 30	**2018**	2017	Change
Zurich Legacy Solutions	37	(44)	n.m.
Other run-off	14	47	(71%)
Total business operating profit	**51**	**3**	**n.m.**

Zurich Legacy Solutions, which is predominantly comprised of P&C run-off portfolios, reported a business operating profit of USD 37 million, an improvement of USD 81 million primarily due to favorable transaction gains in the first six months of 2018 and a reserve increase of USD 80 million related to the Ogden rate change in 2017.

Other run-off, which is largely comprised of U.S. life insurance and annuity portfolios, reported a USD 34 million decrease in business operating profit compared with the same period of 2017 when the business benefited from the release of long-term reserves as a consequence of in-force management activities in a closed life book. The decline was partly offset by releases of reserves following a settlement.

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