Q2 Results 2014

Remarks by Martin Senn, Chief Executive Officer (slides 3 to 8), and George Quinn (slides 10 to 21), Chief Financial Officer of Zurich Insurance Group.

August 7, 2014

Slide 3: Key financials

Welcome to Zurich Insurance Group’s results presentation for the first half of the 2014 financial year.

I am pleased to report encouraging progress across the Group. I will make a few comments on our financial performance before turning to an update on our strategy execution.

First, our financial performance.

Business operating profit for the first six months of 2014 is 2.6 billion US dollars, up 15 percent from the prior year period. Net income attributable to shareholders is up 14 percent at 2.1 billion dollars.

While still early in our three year plan we are on track against our 2014 to 2016 targets.

Business operating profit after tax return on equity of 12.5 percent, is within our target range of 12 to 14 percent.

Zurich remains very well capitalized with solvency currently considerably above our double A-target range. Our Z-ECM ratio was 128 percent at the end of March, but is likely to have moved closer to the top end of the target range as we allocated more risk capital to investment management in the second quarter.

Cash flows have remained strong and we project that full-year cash remittances will be in excess of 3.5 billion dollars, ahead of 2013.

In terms of implementing the plans we set out at the investor day, naturally, most of the actions we have taken in the last six months are laying the groundwork for the next few years.

Nonetheless, we have provided some additional information on how volumes and profitability break down by our priority markets, as well as extra data relating to the Farmers Exchanges, which we do not own, and we will evolve what we disclose over time, as our actions start to ‘move the needle’ on our financial metrics.

Coming back to our progress to date, we have made an encouraging start to our plan across each of our three strategic cornerstones.
The process of prioritizing investment in distinctive positions is at an early stage. Nevertheless, we have completed much of the preparation for future investment in priority markets in each of our customer segments. To give you some examples.

In Corporate, we have established consistent customer segmentation across Global Corporate and Corporate Life & Pensions. We are well on track to meeting our plan of 100 new common customers across these two businesses by year-end. We have also implemented regional initiatives to increase product density levels in Global Corporate.

In North America Commercial, we have completed a ‘big data’ pilot to generate new insights, developed two new predictive models, segmented the customer base in what we believe is an industry first in the commercial mid-market space and achieved higher conversion rates based on a new broker model. We are now transferring this knowledge to our commercial business in Australia, with other markets to follow.

In the retail space, we have completed our customer segmentation across five European markets so that we better understand customer needs. We are aligning our business plans with these needs to ensure we make the right investments in 2015. We have also extended our exclusive distribution agreement with Banco Sabadell in Spain.

As we showed at the investor day, the majority of our capital is allocated to businesses which are generating a good return. Our priority here is to build on strong and profitable positions.

However, around one third of our capital is allocated to our manage for value businesses, which for various reasons have lower profitability. Over time we aim to change this picture, improving profitability and reprioritizing capital deployment.

As we expected, manage for value returns in the first half of this year are not that different to what we showed at the investor day. However, as I will explain shortly, we have taken a number of important steps in our GI business and in evaluating our options in Global Life. It has to be our aim here to show tangible progress in our financial KPIs over the three year plan period.

In relation to growing our operating earnings, we largely completed the streamlining of our organizational structure above the business unit level in July. This process is intended to speed up our decision making and optimize our governance but is also expected to deliver annual cost savings of 250 million dollars by the end of 2015.
And as part of our initiatives to enhance investment returns, Investment Management has completed the objective of deploying additional risk capital in the second quarter and we also have already invested or committed to invest 1 billion dollars in illiquid assets so far this year.

Turning to progress in each of our three segments, starting with General Insurance.

**Slide 5: Report card – General Insurance**

Gross written premiums in our priority markets grew by 4 percent in US dollars and 3 percent in local currency, adjusted for a non-renewed fronting contract.

Despite some evidence of increasing competitive pressures, we saw good growth in Global Corporate, as well as in our Commercial insurance operations in the US and the UK. Gross written premiums in our priority retail markets were broadly flat, with growth in some markets, but with overall volumes impacted by some re-underwriting in Brazil.

As you can see from this slide, our priority markets continue to account for the majority of our GI operating earnings. We reported good growth in BOP in these markets, with a marked improvement in our accident year combined ratio. And while the year-on-year comparison benefits from the Swiss pension credit in Q1 and low catastrophe losses, we continue to see strong overall profitability in these markets, particularly in our Q2 results.

Besides the groundwork we have completed on prioritizing investment we have also made good progress in the General Insurance businesses that we are managing for value.

Measures include the sale of the Russian retail business and exit from Zurich-branded aggregator distribution in the UK.

Our current primary objectives are to drive further improvement in accident year profitability, complete turnaround actions in several markets, and prioritize growth initiatives where we enjoy distinctive positions.

**Slide 6: Report card – Global Life**

In Global Life, Annual Premium Equivalent in our priority markets is up by about 15 percent, with strong growth in our Corporate Life and Pensions business in the UK, and successful execution of growth strategies in bank distribution and our IFA distribution business in the US.
New Business Value is up 3 percent in priority markets, adjusted to be on a like for like basis, good performance given that our first half new business last year was boosted by particularly strong sales of protection products. Overall, we are pleased with our progress here.

In terms of manage for value operations, we have exited marginal positions in Taiwan, Corporate Life & Pensions Australia and Luxembourg.

We have also developed a holistic approach to in-force management in the UK, Germany and the US, which we anticipate could contribute additional BOP of towards the upper end of the 50 million to 100 million dollars range that we mentioned at the investor day.

We are in the process of improving our Global Life financial reporting. The first step is the implementation of sources of earnings reporting. Next year, we will better align our reporting with our strategy for each component of our diverse business, identifying markets where cash extraction is the priority and enabling us to better articulate our growth plans.

As you know from the Investor Day, we have not set segment-level targets, nor do we intend to. However, I have included here a bit more colour on what is behind our confidence that our Life business can get to a BOP level above 350 million dollars per quarter by 2016. Naturally, there are many moving parts here, but we are on track to deliver.

We will give you a comprehensive update on our life business at the investor day we plan to hold in May 2015.

**Slide 7: Report card – Farmers**

We have also seen some encouraging signs of progress at the Farmers Exchanges.

While gross written premiums at the Farmers Exchanges declined by 1 percent in the second quarter, this compares to a decline of 2 percent in Q1 and 4 percent in Q4 2013. In addition, excluding 21st Century and Business Insurance sold through Independent Agents, both gross written premiums and policies in force have grown in the last four months.

This is best evidenced in an improvement in both retentions and new business, as well as in customer satisfaction, as measured by Net Promoter Score. The Farmers Exchanges have also seen growth in the total number of agents, driven by a significant reduction in agent attrition.

This suggests that the Farmers Exchanges’ go-to-market strategy is beginning to pay off, although, obviously, there is still much to do.
Slide 8: Key messages

In summary, in General Insurance, we have made good progress on our strategy to turn around or exit underperforming businesses and deliver an improved accident year combined ratio.

Global Life is implementing its in-force management initiatives and progressing its priority market growth strategy.

And we see further positive trends from the Farmers Exchanges, with improved customer satisfaction and agent retention.

At the same time, we continue to generate strong cash remittances, which underpin our attractive and sustainable dividend.

There is still much work to be done. Nevertheless, we are pleased with the progress we have made to date and remain confident that we are on track to fulfill our ambitions for 2014 to 2016.

Thank you for your attention and your continued trust and support.

Slide 10: Group – Business operating profit

Good morning or good afternoon, my name is George Quinn and I am Zurich's Chief Financial Officer. In a few moments, I will take you through our second quarter results in a little more detail.

Before I get into the detail, I'd like to make a few broader comments. As you've heard from Martin, we see this is a good set of results, with encouraging progress across the group. Having said this, we all recognize that there is a lot more to do and this will be our focus for the next 30 months. The targets are our top priority. We expect to make investments to support future growth but, at the same time, we won't hesitate to take capital from businesses that cannot meet our expectations. Finally we intend to take full advantage of our operating leverage to grow operating earnings.

I will cover the operating performance of our segments shortly, but I will briefly highlight two points on this slide.

First, as you can see in the BOP to NIAS reconciliation, we have a high tax rate for the second quarter, of around 32 percent. We now expect the full year tax rate to be around 27.5 percent, driven by some charges, such as Russia, that do not attract tax relief. This does not change our view of our longer term effective tax rate of around 23.5 percent.
Second, also in the BOP to NIAS reconciliation for the second quarter, we show restructuring and accounting charges of 98 million dollars. With an additional 24 million dollars of charges within our life BOP, we have incurred accounting and restructuring costs of roughly 120 million dollars in the second quarter, and 470 million dollars in total since Q4 2013. There are some additional costs to incur, with a further 50 million dollars in charges in Q3 and Q4 this year. The final total relating to what we signaled at the investors day last year will be around 520 million dollars.

A significant portion of the restructuring costs in the second quarter relate to the streamlining of the businesses above the business unit level, which is largely completed and affects around 670 positions globally. We expect to deliver savings of 75 million dollars this year, a further 150 million dollars next year, and the full 250 million dollar effect by the beginning of 2016. From a financial perspective, the benefit of these savings will be reflected in lower charges to the segments. While some of the cost savings will be reinvested in priority markets to help drive our growth ambitions, we continue to look for further ways to simplify and improve efficiency and I have no doubt that we will find them.

**Slide 11: General Insurance – Topline**

Q2 Gross written premiums are up 3 percent in local currency. Excluding the impact of a large discontinued fronting contract, premiums in local currency are up 4 percent for Q2 and 2 percent for the first half.

Rate increases across the book are 2 percent for the quarter. Rates are generally adequate for most of our business lines but we see some market pressure, mainly in the US property lines, as we highlighted already at Q1. Overall claims inflation remains subdued and the benefits of improvement in rate continues to find its way to the bottom line.

Within Global Corporate and NAC, we continue to see growth in casualty and specialty risks and some other priority areas. Our new business increased in the second quarter while retention was slightly down, mainly driven by our efforts to deal with underperforming parts of the portfolio.

Our European business grew top-line by 1 percent in local currency. We are cautiously optimistic here as we are seeing some growth momentum in some key markets such as in the UK and personal lines in Switzerland and Germany. Elsewhere there was top-line pressure, for example in Italy, where the market is shrinking.

In International markets, premiums increased by roughly 2 percent in local currency, adjusting for the carve out of certain Global Corporate business, and decreased 5 percent in local currency on a reported basis. We are still expanding the business but our underlying growth rate has slowed, mainly due to some selective re-underwriting in Latin America and market softening in Australia.
As we flagged at Q1, we have shifted most of our non-technical expenses into the reported expense ratio. On this new basis we reported a good combined ratio of 95.7 percent for the second quarter, more than 3 percentage points better than the same quarter last year. Excluding the non-technical shift, our combined ratio would have been 93.1 percent for Q2, compared to 96.2 percent in the prior year quarter.

You can find further details on the shift of non-technical expenses in the appendix to our results presentation.

Our accident year ex-cat combined ratio was 93.5 percent for the second quarter. Again, this is a good result, 4 percentage points better than in the prior year and roughly 3 percentage points better than in the first quarter, adjusting for the Swiss pension gain.

The improvement is mainly related to the accident year ex-cat loss ratio. Here, we have benefitted from favorable large loss experience but we have also seen further improvement in our underlying loss ratio, especially in NAC and Europe.

Our overall expense ratio for the quarter is flat compared to Q2 2013 but is around 1 percent lower than the adjusted Q1 figure. There are some non-recurring benefits of around 50 basis points in the Q2 results, and we’d expect the second half expense ratio to be slightly higher, due to investments that we are making in priority markets.

The impact from catastrophes was 2.3 percent in Q2 mainly due to claims relating to US weather and hail storms in Europe. This is below the average of the last couple of quarters and significantly better than last year’s second quarter, which was impacted by some severe US tornadoes and the European floods.

In terms of PYD, we have a zero result for the quarter. We saw generally favorable experience in many areas, particularly in Europe, but this was more than offset by adverse development on a number of large individual claims in Global Corporate. There will be fluctuations in PYD and we see the Q2 result as driven by some identifiable and specific factors. There is no change to our prior guidance of 1-2%.

In Global Corporate we experienced lower catastrophe and fewer large losses in the current year, and our underlying loss ratio also improved. The uptick in the combined ratio was driven by the development of the large individual prior year claims I’ve just mentioned.
Both NAC and EMEA have significantly decreased the accident year ex-cat combined ratio, by 2 and 3 percentage points respectively, and also benefitted from lower catastrophe losses compared to the second quarter of last year. While it’s partly a function of fewer large losses in the quarter, we continue to see some encouraging improvement in the underlying performance of these businesses, driven by ongoing underwriting actions and the earn through of rate increases.

And lastly in our International business we start to see improvement in our Latin American business which was off-set by a lower level of prior year releases in our Asia pacific region.

**Slide 13: General Insurance – BOP components**

GI BOP was 807 million dollars in the second quarter, up over 40 percent, driven by the improved underwriting result.

Investment income was essentially flat in comparison to the prior period, and we continue to see signs of the ‘flattening out’ we've mentioned in previous quarters. Our hedge fund investments also contributed positively to the result.

The non-technical result of 104 million dollars for the second quarter is roughly 50 million dollars worse than last year. This is mainly as a result of roughly 40 million dollars of higher currency losses and a few non-recurring factors.

We expect the main recurring item in the non-technical result to be the interest expense, which will be around 30 million dollars per quarter. Other items that will be included here are some small ongoing non-operational costs, currency gains and losses, and one-offs related to non-business transactions. We expect some volatility between quarters, mainly due to the currency component.

To summarize, our General Insurance business delivered a good set of results, driven by the improved accident year result.

**Slide 14: Global Life – New business**

The main focus of our life business is growth in our priority markets, which include bank distribution, Corporate life and pensions, and select retail markets such as the UK and the US.

Overall APE in Q2 was 22 percent higher than in the prior period, with net inflows in the quarter, and good progress in our target markets.

In bank distribution we built on the positive momentum from the first quarter. Zurich Santander Brazil continues to deliver strong growth in protection sales, with overall APE up 37 percent in local currency
and 26 percent on a reported basis. Within Europe, bank distribution volumes in Spain increased by roughly 150 percent following successful sales campaigns in individual protection and savings products.

In the UK, APE growth of 51 percent was mainly driven by corporate savings, as we continued to experience good inflows on to the corporate savings platform, together with growth in corporate protection.

And in North America, we are now starting to see some traction in individual protection through the growing IFA channel, with volumes doubling compared to Q2 2013.

Our overall new business value was flat year on year, mainly due to the impact of expense allocation and lapse assumption changes in North America and Latin America, masking an improving picture on a like for like basis.

**Slide 15: Global Life – BOP**

Q2 business operating profit reduced by 37 million dollars to 315 million dollars, mainly due to two factors.

First, the prior period quarter benefitted from around 30 million dollars in positive one-offs relating to an actuarial model change in Hong Kong and a positive earnout adjustment in Zurich Santander.

Second, within Q2 2014, there is a software write off of 24 million dollars, which is part of the 120 million dollars of accounting and restructuring charges I referred to earlier.

The recently announced changes in German regulation had a negative impact of 37 million dollars on Q2 BOP, as we recognized the impact of new rules relating to policyholder sharing in the risk result. However, this was offset by the positive impact of a model update, also in our German life business.

There is not much to say in this quarter about the realized impact of managing for value on our in-force. This does not mean that this is not a priority for us or that there is any lack of activity. It is a priority and the team are working hard and we hope to have to more report on this over the course of the next few quarters.

**Slide 16: Global Life – Sources of Earnings**

As you can see, we have replaced the profit by source reporting with a new sources of earnings approach, with data here shown for the first half of 2014.
The sources of profit remain unchanged, and continue to be net of policyholder participation. As we have talked about in the past, we have a very different business to our peers. We write a lot less spread business, with more focus on underwriting returns coming through the technical margin, as you can see on this slide.

Note that the data is net of non-controlling interests and that we have removed the concept of special operating items, although we will continue to make reference to exceptional items that distort the results.

Over time, these changes will make it easier to follow the drivers of earnings in the life business while providing a clearer link with our product strategy and allowing for more meaningful KPIs.

While simpler in approach from the previous disclosure, we appreciate that there is a lot to digest here. To help you with this we have provided a briefing document that explains our approach and how this links to our products and KPIs. We have also provided data going back to the beginning of 2013, identifying the impact of one-off items, and that should give you a better sense of the trends in our results.

I'd like to make 3 key points about this analysis:

First, in terms of revenues in the first half, as expected, our investment margin, excluding the impact of discretionary policyholder dividends, is broadly flat compared to the prior year. The growth in the business is evident in loadings and fees, up 3 percent and, adjusted for one-off items, growth in our technical margin of 7 percent.

Second, in terms of expenses, and again adjusted for one-off items, our operating expenses increased by 7 percent, with an increase in our overall acquisition costs of 4 percent. This reflects the investments we are making in our priority businesses, both in terms of operating costs and commissions to our distributors.

Third, while we have seen modest underlying growth in our profitability in the first half, a key financial goal for the next two years is to improve our operating leverage by focusing on in-force management initiatives in manage for value markets, growing our bank distribution earnings and getting to scale in our priority retail markets.

Overall, we think this new basis of reporting is a good step forward. At the same time, we recognize that we need to continue evolving our life disclosures to improve investor and analyst understanding of the business and where we are headed. As Martin mentioned earlier, there is still much to do on disclosure. We plan to sub-segment the business to make it easier to understand and explain,
highlighting the different way we view the component parts of the life business. Some of them will focus on cash extraction which can include structural levers, others on BOP and ROE and some on EV. Today’s disclosure is a first step, but you can expect more on this in the next year.

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 17: Farmers Exchanges**

As Martin has already highlighted, the positive signs seen at Farmers Exchanges in the first quarter have continued into the second.

The quarterly trend has improved from a roughly 4 percent decline in Q4 2013 to 2 percent down in Q1 2014, and now around a 1 percent decline in Q2.

If you zoom in and look at the ‘core’ book of business – excluding direct auto, independent agent business insurance and discontinued operations – the Exchanges gross premiums increased by 1.5 percent, mainly due to strong growth in Specialty and increasing momentum in Homeowners and Exclusive Agent Business Insurance.

While standard auto sold through Exclusive Agents is still decreasing, this is at a much slower pace than in the previous quarters and non-standard auto returned to growth.

Looking at policies-in-force tells the same story. While overall the Farmers Exchanges lost some 50,000 policies in the second quarter, the number of policies in the ‘core’ business increased by 25,000.

This is all driven by a steady improvement in the KPIs you saw on the report card; growth in new business counts and improving retention, a now growing Exclusive agent force, and other leading indicators such as the Net Promoter Score.

Overall, there is no denying that much remains to be done to reposition the business and return to growth, but we are confident that the business is on the right track.

In terms of profitability, the second quarter has proven to be the most catastrophe prone in recent years, and this may well prove to be the case in 2014. This year’s second quarter saw 13 catastrophe events for the industry. Three of those events generated losses in excess of 50 million dollars for the Farmers Exchanges, or 265 million dollars in total. In addition, while there were fewer extreme events in comparison to Q2 2013, we also saw a larger number of small events than last year. For example, hail losses were a bigger factor in 2014, as can be seen in the auto loss ratios for the second quarter.
As we cautioned in May, Farmers Exchanges surplus generation is sensitive to the catastrophe experience in the second and third quarter, and cat losses in Q2 mean that the surplus is now roughly back where it started the year.

Nonetheless, the Farmers Exchanges’ surplus position continues to exceed the 33 to 36 percent near term target and the expectation that the Exchanges will reduce reliance on capital support through Quota Share reinsurance is unchanged.

**Slide 18: FMS and Farmers Re**

Farmers Management Services revenues slightly declined, as you would expect given the small decrease in the Exchanges earned premiums. However, this decline was more than offset by lower labour costs and around 20 million dollars of positive one-off items, relating to employee benefits and a gain on the sale of own use property.

For Q2 stand alone, the Managed Gross Earned Premium margin increased to 7.4 percent. However, this was helped by the positive employee benefit impact I just referred to, and we continue to see 7 percent as a more sustainable figure over the longer term.

Finally, as a result of the high level of catastrophe losses, Farmers Re posted a BOP loss for the third consecutive second quarter.

While the Farmers Re combined ratio was around 105 percent for Q2, this is still around 5 points better than in the prior period quarter. Roughly half of this was due to lower catastrophe losses, with the remainder due to underlying improvements and favorable prior-year development.

**Slide 19: Group – Balance sheet and capital**

Shareholders’ equity decreased by just under 1 billion dollars in the quarter, with net income of 0.8 billion dollars and unrealized gains of 1 billion dollars offset by the payment of our 2.8 billion dollar dividend in April.

Our economic capital position remains very strong, with the Z-ECM ratio broadly flat at 128 percent at the end of March. The one point increase is driven by 7 points of business profits and positive market movements, offset by 2 points for the regular dividend accrual and after a reduction of 4 points from deploying additional risk capital in our investment portfolio.

As Martin mentioned, we continued to deploy risk capital into the investment portfolio in the second quarter, with most of the new strategic asset allocation now executed. All things being equal, we would expect this to have reduced the Z-ECM ratio by 3 to 5 points.
For the half year we have also updated the free capital generation analysis we disclosed for the first time at our investor day in December last year.

Our approach to free capital generation is a little different to the information disclosed by some of our peers, as it is built up from local statutory data. Our aim is to show how IFRS earnings convert into deployable regulatory capital, and how it then translates into net cash remittances to the centre.

We have now updated this exercise for 2013. The left hand chart shows the walk from IFRS earnings to statutory earnings to free capital generation. The right hand chart shows the walk from free capital generation to cash remittances.

There are three points I want to make here.

First, we told you at the investor day that we expected to see a significant uplift from the 2012 operating capital generation of 2.4 billion dollars, a year that was impacted by challenges in our German GI business, as well as claims from storm Sandy, and when we also had an increase in Farmers Re capital requirements. And I’m pleased to say that these figures bear this out, with GI and Farmers operating capital generation increasing by 0.6 billion dollars and 0.3 billion dollars, respectively.

Second, as we showed you last year, a very high percentage of our operating earnings turn into operating capital generation. For 2013, we reported post-tax BOP of 3.5 billion dollars and this chart shows how this translated into 3.2 billion dollars of operating capital generation, a ratio above 90 percent.

Third, our flexible capital structure enables us to facilitate a high rate of conversion of operating free capital generation into net cash remittances. Most of our cash generation comes from a fairly small number of operations that are close to the central holding companies, and we have a policy of pooling risks as close to the centre as possible. This helped our businesses deliver 2.9 billion of cash remittances in 2013, and we expect to achieve in excess of 3.5 billion dollars in 2014.

As you would expect, we are benefitting from some one-off effects in 2014. As a result, you should not extrapolate our cash remittance expectations for this year into the future. But we are pleased with our progress to date.

Looking forwards, growth in earnings should continue to convert into higher free capital generation, potentially also with some increases in capital requirements, depending of course on our ability to deploy additional capital at profitable levels. However, the combination of a very robust capital
position, stable leverage and excellent cash generation means that we are in a very strong overall financial position on all relevant capital metrics.

**Slide 21: Summary**

So, let me move to the summary.

In general insurance we’ve reported a good combined ratio for Q2 and see an improving trend in our accident year profitability. We are not complacent about the competitive environment but we can drive further improvement by reinforcing our underwriting disciplines, executing our turnaround and exit plans, pursuing further efficiencies and selectively growing the portfolio.

In our life business, in-force management actions are underway, and we continue to make good progress in growing our priority markets.

Farmers Exchanges have reported two consecutive quarters of improving top-line trends, with key metrics for new business, retentions and customer satisfaction pointing to further recovery in the second half.

We expect our full year cash remittances to be well ahead of what we achieved in 2013, fully underpinned by very strong operating free capital generation.

Overall, we have made a good start to the year and are on track with where we expected to be, but there is much still to do to deliver on our three year targets.

Thank you for watching.
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