Comments on Q2-16 results

Slide 4: Key messages

Zurich’s underlying results continued to improve in the second quarter as a result of management actions outlined previously. The Q2-16 result also benefited from some currency gains, reported in the GI non-technical result, and other one-time effects.

General Insurance (GI) is showing underlying improvement throughout the first half of 2016 driven by the actions taken on the portfolio, with further improvement expected as the year progresses.

Global Life (GL) continues to deliver consistent results in line with previous guidance.

The Farmers Exchanges, which are owned by their policyholders, have continued to deliver growth, with this reflected in fee income at Farmers Management Services.

The Group has made progress on simplifying the group organizational structure, while reducing costs leading to an improved GI expense ratio. The Group has announced exits from Morocco, Taiwan and South Africa as well as the completion of the acquisition of Rural Community Insurance Services (RCIS), MAA Takaful Berhad and the announced acquisition of Macquarie Group’s retail life protection business.

The Group’s capital position remains resilient, with the Z-ECM ratio comfortably within the target range at the end of the second quarter.

In summary, this result confirms the start of the turnaround in operating performance with further improvement expected over the remainder of the year.

Slide 5: Key financials

Q2-16 Business operating profit (BOP) for the Group was USD 1.1bn and net income attributable to shareholders (NIAS) was USD 0.7bn, with BOP in line with the first quarter despite higher levels of natural catastrophes, and well ahead of the run rates achieved in the second half of 2015.

Lower levels of realized gains combined with higher restructuring charges relating to the Group’s profit improvement plans and a higher effective tax rate account for the 22% decline in NIAS year to date.

These results demonstrate that execution of the plans for 2016 are well underway, with further underlying improvement expected for the second half of the year as the measures taken earn fully into results.
The capital position of the Group remains resilient, with the Z-ECM ratio at the end of June estimated to be around 107%.

In addition to the usual financials, the Group has today disclosed a supplemental pack providing additional detail on non-life reserves on both a line of business and regional level. Management continues to view the Group as adequately reserved. A separate Q&A call relating to this new disclosure will be held on Friday 12th August at 1pm CET.

**Slide 6: Report card – General Insurance**

In GI good progress has been made in executing on the actions taken in the second half of last year to restore profitability. Results are visible in the HY-16 figures.

GWP is up 2% in local currency compared to HY-15, due to the inclusion of RCIS. Excluding this acquisition the premium level has reduced, driven by profitability actions especially in Global Corporate. BOP is up significantly, especially compared to the second half of last year. The actions taken – mainly centered around restoring technical excellence, enhancing governance and acceleration of the expense program – are reflected in the bottom line already in the first half of this year.

Additionally, decisions were taken during the year to improve the Group’s footprint. This included the sale of the retail and commercial business in South Africa, Morocco and Taiwan. These transactions, together with the previously announced sale of the Middle East GI business, are expected to close by Q4-16, subject to regulatory approvals.

The Group remains committed to further improvement in the performance of GI. This will be achieved through further management actions together with the investments made in the priority markets, the Zurich brand, people and platforms.

**Slide 7: Report card – Global Life**

Global Life continued to deliver underlying growth for the first half of 2016, despite market headwinds and the challenges of a low yield environment.

The increase in new business value of 28% in local currency reflects profitable growth in most areas, including success in bank joint ventures and the improved business mix of Corporate Life and Pensions business in the UK.

Business Operating Profit increased by 7% in local currency, driven by bank joint ventures, which continue to show steady growth, and emerging markets, which benefitted from improved results in the Zurich branded businesses in Latin America.
The Global Life retail footprint has been strengthened through the announced purchase of the Macquarie Life in-force book in Australia as well as the completion of the acquisition of MAA Takaful Berhad, which will further contribute to Global Life results in the coming quarters.

While the macro environment continues to prove challenging, the life business has delivered on expectations with further progress expected in the second half of 2016.

**Slide 8: Report card – Farmers Exchanges**

The Farmers Exchanges continue to show progress in the execution of their strategy with further improvement in the Net Promoter score and continued growth in the agency force laying the foundation for future premium growth.

Retention overall has remained flat over recent quarters, despite ongoing rate increases to restore the profitability of the Farmers Auto book, while new business production picked up over the first half reflecting the ongoing roll-out of Farmers new Auto and Home products. These products are designed for the target customer – the confident planner – and provide greater flexibility to account for individual needs.

**Slide 10: Group – BOP and NIAS**

Q2-16 BOP is up 17% compared to Q2-15 driven mainly by GI, while for the first half BOP declined slightly with growth in GI and FMS offset principally by lower results at Farmers Re and an increased loss in OOB.

Lower levels of realized gains coupled with higher levels of restructuring charges relating to the Group’s profit improvement plans and a higher effective tax rate account for the 22% decline in NIAS year to date.

As previously communicated restructuring charges are expected to be skewed to the second half of the year, with FY-16 restructuring charges expected to be within the previously communicated USD 500m guidance.

The shareholders’ effective tax rate for the half year was 29.9% with the full year tax rate expected to be around this level.

**Slide 11: General Insurance – Topline**

In Q2-16 the topline for GI increased because of the first-time inclusion of RCIS. The acquisition of RCIS, which closed on March 31, added USD 1.1bn of GWP in Q2-16 to GI in total and North America Commercial (NAC). Further details on the RCIS impact on the results can be found in the appendix.
Excluding RCIS, Q2-16 GWP declined by 1% in local currency and by 4% for the HY-16, in line with the Q1-16 trend and driven by ongoing focus on profitability and the impact of the broader soft market conditions. Rate increases on renewal business were 2% with increases across all regions. Retention and new business development remained in line with Q1-16.

Global Corporate’s gross written premiums were down 13% in local currency for Q2-16 and 12% for HY-16. This decline is largely a result of actions taken to improve performance as well as lower new business volumes, and is expected to continue throughout the year.

For NAC, and excluding RCIS, gross written premiums increased in local currency for Q2-16, driven largely by growth in captives and some timing effects in the existing crop business. Excluding these the premium level declined 2% as a result of tiering actions and broad market conditions.

Gross written premiums for EMEA declined 4% in local currency for Q2-16, driven by the competitive environment mainly in the UK and the sale of the retail business in the Netherlands.

In International Markets premiums for Q2-16 increased by 11% in local currency. Growth in Latin America was partly offset by the exit of lines of business in Australia that did not meet the required profitability levels.

**Slide 12: General Insurance – Tiering results**

Updated tiering results for the Group continue to be encouraging. Overall rate increases on renewal business were 2% for HY-16, with substantial variation in the level of increases achieved across the various tiers of the portfolio. The focus on the lowest tier has produced double-digit rate increases with a significant reduction in retention. Similar results are seen across most regions and are in line with the plans set at the end of last year.

This demonstrates good progress has been made in terms of the actions taken last year, with results already visible in HY-16, and gives confidence for further combined ratio improvements in the upcoming quarters.

**Slide 13: General Insurance – Loss ratio over time**

The actions taken since the end of last year have continued to lead to improvement in the development of the underlying loss ratios. The accident year (AY) loss ratio excluding catastrophes for Q2-16 improved to 64.4%, 2.1 percentage points lower than in Q1-16.

The AY loss ratio excluding catastrophes for HY-16 was 65.4%, 2.0 percentage points better than FY-15. The reduction has been driven by management actions and is split roughly equally across both the attritional and the large loss ratios, with improvements across all regions.
The Q2-16 loss ratio returned to levels seen in 2014.

**Slide 14: General Insurance – Combined ratio details**

Looking at the loss ratio in more detail, large man-made losses in Q2-16 were 0.5 percentage points lower than in Q2-15 and 1.7 percentage points better than in Q1-16. The HY-16 position is 1.0 percentage point lower than FY-15. Non-catastrophe large losses in Q2-16 were broadly in line with expectations.

Actions implemented towards the end of last year delivered a 1.0 percentage point improvement in the attritional loss ratio compared to FY-15, with reductions in all regions. The Q2-16 discrete attritional loss ratio is 0.4 percentage points better than in Q1-16. Adjusting for the inclusion of RCIS, which runs at a higher loss ratio and a lower expense ratio, the improvement would have been roughly 1 percentage point.

Natural catastrophes and other weather events contributed 5.8 percentage points to the combined ratio in Q2-16, significantly more than the normal yearly run-rate and above Q1-16 and Q2-15. The main events were the Canadian wildfires, European floods and hail storms in Texas, and altogether these equated to approximately USD 200m in the Q2-16 result.

Prior year reserves developed favorably in all major regions, with the 1.5 percentage point reduction in the combined ratio in line with the expected range of 1-2%.

The expense ratio of 30.3% for Q2-16 benefits from the inclusion of RCIS by roughly 0.5 percentage points, as well as from some positive one-offs in the order of USD 30m (0.4ppts) as well as some underlying improvement in the quarter.

Underlying expenses are expected to continue to reduce over the second half of the year, with the HY-16 expense ratio of 31% more indicative of the level expected for the second half of the year.

**Slide 15: General Insurance – Regional combined ratios**

GI’s combined ratio (CR) was 99.0% in the discrete second quarter, with the AY CR excluding natural catastrophes at 94.7%. This represents a 3.4 percentage point improvement over Q1-16 and is more than 4 percentage points lower than the FY-15.

The combined ratio is in-line with expectations and reflects strong execution of the plans in GI. In the second half of the year more improvement is expected.

Looking at the performance by region it makes more sense to compare the HY-16 combined ratio vs. FY-15.
Global Corporate’s combined ratio of 99.0% for HY-16 is significantly lower than for FY-15. This is mainly driven by a favorable impact from prior year reserves and some improvement in both the expense and attritional loss ratios. The higher level of natural catastrophes in Q2-16 is more than offset by more benign large losses.

NAC’s combined ratio increased by 0.9 percentage points compared to FY-15. Favorable prior year reserve development is more than offset by higher catastrophe related losses and an uptick in large losses.

The reduction in EMEA’s combined ratio of more than 7 percentage points is driven by a sharp improvement in the AY combined ratio ex-cat and lower catastrophe losses.

In International Markets, the reduction in the combined ratio of 9.5 percentage points compared to FY-15 is mainly driven by improved attritional loss ratios in Latin America and Asia Pacific, a higher level of favorable PYD and lower expenses as Latin America had some non-recurring items in 2015.

**Slide 16: General Insurance – BOP components**

The GI BOP for the quarter was USD 663m, a sharp improvement compared to the material losses in Q3-15 and Q4-15 and USD 542m of BOP in Q1-16.

Compared to Q2-15, the increase in the GI underwriting result is reflected in the decrease of the combined ratio by 1.0 percentage point.

Investment income is up 4% on a reported basis and up 8% in local currency compared to the prior year, mainly as a result of higher allocation to equities and less liquid assets. In Q2-16 hedge fund investments generated a gain of USD 39m after a loss of USD 63m in Q1-16 which resulted from high market volatility.

The non-technical result excluding FX movements of USD 21m was slightly below the guidance given. The Q2-16 result includes a currency benefit of USD 99m for Q2-16, with a related and partly offsetting impact on the non-controlling interests. This benefit results mainly from the devaluation of the Venezuelan Bolivar and the Group’s prudent approach of investing in USD assets to back insurance liabilities in countries with high levels of inflation.

**Slide 17: Global Life – New business & Net inflows**

Q2-16 Global Life new business APE volumes were flat in local currency compared to the prior year quarter, with increases in Latin America offset by a decrease in EMEA. By line of business, protection, unit linked and corporate pensions business accounted for 78% of new business sales as the Group continues to have limited exposure to guarantee products.
The new business value increased 21% in local currency year on year, driven by a 5.3 percentage point increase in the new business margin on a reported basis, compared to the prior year quarter.

In EMEA local currency new business value increased by 35% year on year. Benefits from mix shifts in the UK and modeling refinements in Switzerland for Corporate Life and Pensions business, combined with higher sales of protection products in the joint venture with BancSabadell more than offset the overall decrease in volumes in the region.

Latin America new business value increased 10% in local currency, with positive contributions from both Zurich Santander and the Zurich branded businesses.

In North America a mix shift to sales of higher margin products resulted in the new business value increasing 30% for the region despite a slight decrease in sales.

Analyzed by pillar and in local currency, Corporate Life and Pensions new business value was up 46% compared to the prior year, while Bank Distribution values increased 13% year on year and Retail new business value increased 8%.

New business value is calculated using swap rates at the end of the immediately preceding quarter. Looking forward, the lower rates experienced the end of Q2 will have a negative impact to reported Q3 new business value.

Net inflows were positive for the quarter, reflecting sales of profitable individual savings business in Italy and Spain.

**Slide 18: Global Life – BOP by region**

Global Life BOP increased 4% in local currency, but decreased 1% compared to the prior year quarter in US dollars, to USD 349m.

In EMEA, local currency BOP earnings increased by 7%, growing 5% in USD, where a strong result in Italy and one-off gains in the UK outpaced a positive prior year quarter one-off in Germany.

In Latin America Zurich Santander earnings increased by 24% in local currency, while the Zurich branded business benefitted from some FX gains following the devaluation of the Argentine Peso.

Asia Pacific profits reduced by 50% in local currency or 51% in US dollars, where current quarter one-off costs and a prior year quarter favorable reserve true up in Japan drove the difference.

And in North America earnings were down 25% compared to the prior year quarter, mainly due to reserve assumptions updates in the Farmers New World Life business.
Slide 19: Global Life – Source of earnings

Adjusting for various one-off factors, and as explained in the half-year 2016 Sources of Earnings briefing document, overall revenues were flat in local currency in the first half of 2016.

While all regions except EMEA saw increases in loadings, a decline in fund-based fees offset this growth to leave overall loadings and fees flat in local currency compared to the first half of the prior year. The decrease in EMEA is largely driven by market movements’ impact to fund-based fees, and lower loadings due to a mix shift to lower margin Corporate business as the Retail book runs off.

Adjusting for one-off factors and in local currency, the investment margin increased by 41% due to higher yields in Latin America, some re-risking in Switzerland and lower policyholder crediting rates. The technical margin when adjusted for one-off items decreased by 15% in local currency, mainly as a result of adverse claims experience in North America.

Overall, expense items decreased by 2% in local currency on an adjusted basis. Within this, operating costs decreased by 3%, driven by expense savings programs in EMEA and reduced central costs, while acquisition costs, excluding the impact of deferrals, decreased by 3% as commissions related to higher sales in Japan and LatAm were offset by mix-related reductions in EMEA.

Taken together, and adjusting for various one-offs factors, BOP increased by 7% on a local currency basis.

Overall this is a good result for the Global Life business, where strong underlying growth continues to be achieved despite continued pressures exerted by the macro environment.

Slide 20: Farmers Exchanges – KPIs

At the Farmers Exchanges, which are owned by their policyholders, the second quarter followed the same path as the first quarter, with good premium growth driven by rate increases but weak underwriting results as a result of high catastrophe losses concentrated in Texas and continued poor performance of the Auto businesses given unfavorable industry claims trends.

Continuing operations saw growth of 5.5% in the second quarter, in-line with the first quarter and driven by higher average premiums in Auto and Home combined with stable retention.

Further rate actions are planned, however, given the competitive nature of many product lines, it remains to be seen whether these will continue to feed directly into premium growth as in the first half of the year.
The performance of Farmers Auto businesses remains challenged as reflected in a further increase of the combined ratio excluding catastrophes. This has been driven by continuing elevated frequency and an increase in auto physical damage severity in line with broader industry trends.

Restoring the profitability of the Auto line is expected to take time as rate and underwriting actions earn through the book.

Continued growth in premiums together with the negative impact of catastrophe losses and weak results in auto have resulted in the surplus ratio moving back into the near term target range of 33-36%. The Farmers Exchanges aggregate catastrophe reinsurance cover would be expected to have a dampening impact on catastrophe losses over the second half of the year.

**Slide 21: Farmers – KPIs**

Farmers Management Services BOP increased by 7% in the second quarter as management fees continued to grow in line with earned premiums. There were some one-off elements in management expenses and other income which largely offset each other.

Farmers Re BOP is sensitive to catastrophe losses and thus the second quarter performance has been weak over past years given the prevailing seasonal weather patterns. While catastrophe losses were more severe than in the prior year quarter there also was deterioration in the combined ratio excluding catastrophes, mainly driven by the deterioration in the underlying results in the Farmers Exchanges’ auto book. While catastrophe losses reached USD 79m in first half, they are capped at USD 100m for the year.

**Slide 22: Group Investments – Investment income yield**

Annualized new money yields for debt securities were around 2.0% for General Insurance and around 1.7% for Life. Compared to Q1-16 the gap to the annualized accounting yield has widened slightly reflecting strong bond markets.

Higher dividend income combined with continued investments in less liquid assets have supported investment income in 2016.

**Slide 23: Group – Balance sheet and capital**

Shareholders’ equity increased by USD 0.8 billion to USD 31.6 billion in the quarter. Falling yields drove unrealized capital gains of USD 0.9 billion but also an increase in defined benefit pension liabilities. The weakness of the British pound and the euro against the US dollar in the wake of the UK referendum on Europe was the main driver of movement in the cumulative foreign currency translation adjustment.
Z-ECM is estimated to be at 107% end of June. The slight decrease since end of March mainly is due to a reduction in Available Financial Resources caused by a further decline in yields and partly offset by the issuance of dated subordinated debt in May. Unlike Solvency II the Z-ECM does not benefit from the use of an ultimate forward rate (UFR) or other adjustments to the yield curve such as the volatility balancer that can have a dampening impact on falls in yield. This further demonstrates the resilience of the Group’s capital position.

An update on 2015 Free Capital Generation is included in the Appendix, while management continues to expect cash remittances to exceed USD 10bn for the 2014-2016 period.

**Slide 24: Key messages**

In summary, this result continues to build on the good start to the year and the improvement in underlying results.

GI’s underlying combined ratio is improving in-line with expectations, while prior year development is in line with our expectations of 1-2pts. Actions taken to improve GI operating performance are expected to further enhance the performance as the year progresses.

Global Life delivered continued underlying improvement, in part masked by US dollar strengthening, while the Farmers Exchanges were able to grow further in their continuing operations, which is reflected in the fee income of Farmers.

The Group has made progress on simplifying the Group structure, while improving its focus through a number of disposals aimed at simplifying the footprint, coupled with targeted acquisitions to strengthen positions in key markets.

The Group’s capital position remains resilient, with the Z-ECM ratio comfortably within the target range at the end of the second quarter.
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