

# Zurich to acquire Rural Community Insurance Services (RCIS)

December 18, 2015



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# Compelling strategic and financial rationale



<b>Enhances US footprint</b>	Transaction is in-line with strategy to prioritize investments in distinctive positions within US Commercial Middle Market
<b>Builds on Zurich's expertise</b>	Long-term quota share arrangement with RCIS has provided a deep understanding of Crop Insurance and the RCIS business; Zurich Predictive Analytics offers scope for future enhancement
<b>Capital efficient</b>	Capital efficient business with added diversification benefits to the General Insurance book
<b>Financially attractive</b>	Expected to exceed Zurich's 10% return on investment hurdle rate in 2017, with further upside in future years

# Transaction highlights

<b>Transaction</b>	<ul style="list-style-type: none"><li>• Cash purchase of 100% of RCIS from Wells Fargo</li></ul>
<b>Deal value</b>	<ul style="list-style-type: none"><li>• Transaction value of ~USD 675m, excluding RCIS capital in excess of expected regulatory minimum requirements of up to USD 375m</li><li>• Purchase price is for a targeted USD 250m statutory book value as of FY-15, and ~USD 425m of goodwill; implies a P/2017E of below 9x</li></ul>
<b>Consideration mix</b>	<ul style="list-style-type: none"><li>• 100% Cash</li></ul>
<b>Expected financing</b>	<ul style="list-style-type: none"><li>• Funded using internal resources</li><li>• Results in approximately 2ppt reduction in Z-ECM ratio</li></ul>
<b>Expected benefits and integration costs</b>	<ul style="list-style-type: none"><li>• Crop business largely uncorrelated with the wider P&amp;C market</li><li>• Zurich Predictive Analytics will be utilized to enhance future fund designation and profitability</li><li>• Initial integration and transaction costs in 2016 and 2017 expected to be approximately USD 35m</li></ul>
<b>Approvals / timeline</b>	<ul style="list-style-type: none"><li>• Closing expected to take place by Q1 2016, subject to regulatory approvals, with integration completed in 2017</li><li>• Some 3<sup>rd</sup> party quota share arrangements will remain into 2016</li></ul>

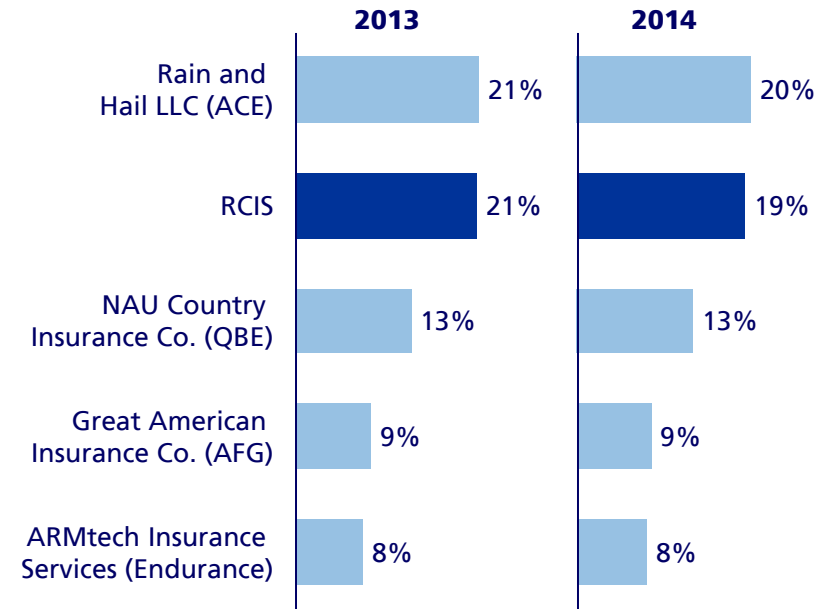
# Zurich to become a leading crop insurer



## STRATEGIC BENEFITS

- Unique opportunity to acquire the #2 Crop insurance platform with full capabilities and 19.1% market share
- Increases risk diversity through low correlation to the rest of our General Insurance book
- Capital light business
- Strong national distribution footprint with highly tenured agents and outstanding service reputation
- Upside potential from Zurich Predictive Analytics not captured in ROI projections

## MARKET POSITIONS<sup>1</sup> (%)



<sup>1</sup> Source: National Crop Insurance Service (includes Gross Written Premium from business ceded to Federal Crop Insurance Corporation).

# Financially attractive for Zurich

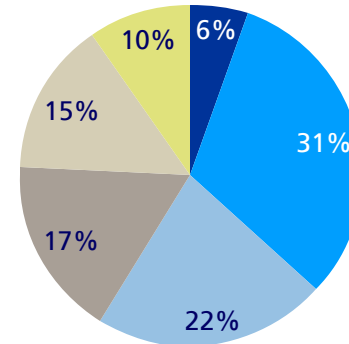
## KEY FINANCIALS

### 2017 Expected Impact<sup>1</sup>

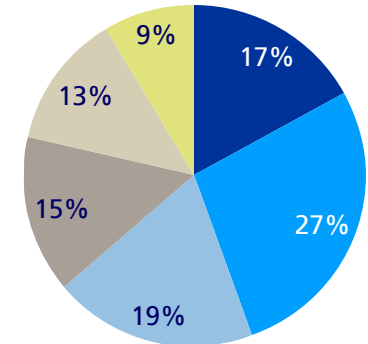
Gross Written Premiums	~USD 2.0bn
Net Earned Premiums <sup>2</sup>	~USD 1.6bn
Expected 2017 ROI <sup>3</sup>	>10%

## NAC PRO FORMA NEP BY LINE<sup>4</sup>

As-is



Including 100% RCIS



<sup>1</sup> Expected 2017 incremental impact vs current 25% quota share reinsurance of ~USD 1.7bn Gross Written Premiums and ~USD 1.3bn of Net Earned Premiums.

<sup>2</sup> Following cessions to the Federal Crop Insurance Corporation (FCIC) and other potential reinsurance arrangements.

<sup>3</sup> 'Return' is the expected after tax profits from the acquired business in 2017, before integration costs or amortization.

<sup>4</sup> Pro forma percentages based on expected 2015 Net Earned Premiums (NEP).

## COMPANY OVERVIEW

RCIS, founded in 1982 and headquartered in Anoka, Minnesota, is a leading provider of agricultural insurance in the U.S.; RCIS is owned by Wells Fargo & Company (“WFC”)

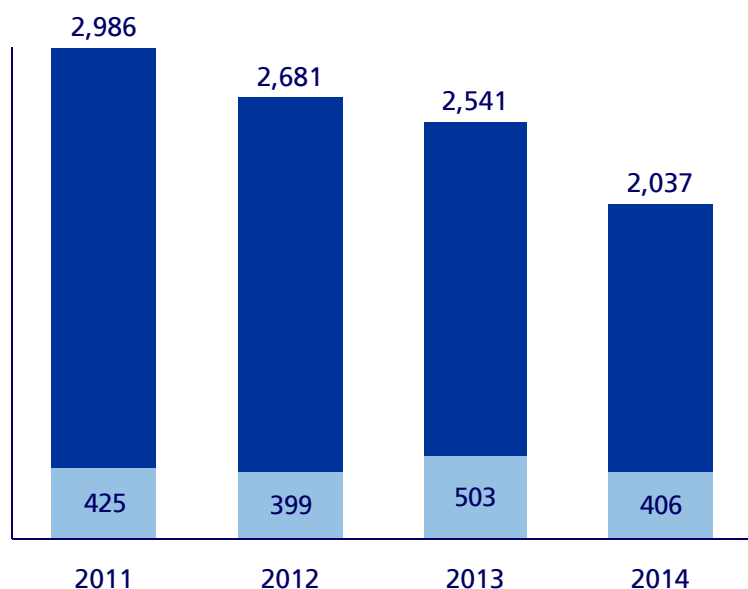
- Offers federal crop insurance programs including Multi-Peril Crop Insurance (“MPCI”) and other private crop insurance products
- Is a highly diversified Approved Insurance Provider (AIP) by crop mix and geography
- Insures over 90 million acres and over 130 crops in all 50 states
- Distributes a comprehensive set of products and services through a network of ~4,000 independent agents, serviced by ~1,600 RCIS employees

### **RCIS has scale with a meaningful market share**

- 2<sup>nd</sup> in market share at 19.1% at year end 2014
- Maintained a leading position through building strong agency relationships and retaining tenured adjusters
- Scale provides flexibility in terms of fund designation and diversification by region and crop type

# Substantial opportunity for Zurich to capture profitable ceded business

## RCIS TOPLINE (USDm)<sup>1</sup>



■ Gross Written Premium  
■ Net Earned Premium<sup>2</sup>

## COMMENTARY

- RCIS has historically ceded ~75% of its business to other carriers<sup>1</sup>
  - Zurich is one of five companies that currently participate in a quota share (QS) agreement with RCIS, currently 25%
  - Zurich's QS arrangement has been in place with RCIS since 2000
- Purchase of RCIS will result in Zurich retaining close to 100% of the direct business in 2017
- 2016 transition year will result in Zurich retaining ~55% of gross earned premiums (after FCIC cessions) due to run-off of existing QS contracts which normally renew mid-year
- Recent decreases in Gross Written Premiums largely driven by lower crop commodity prices

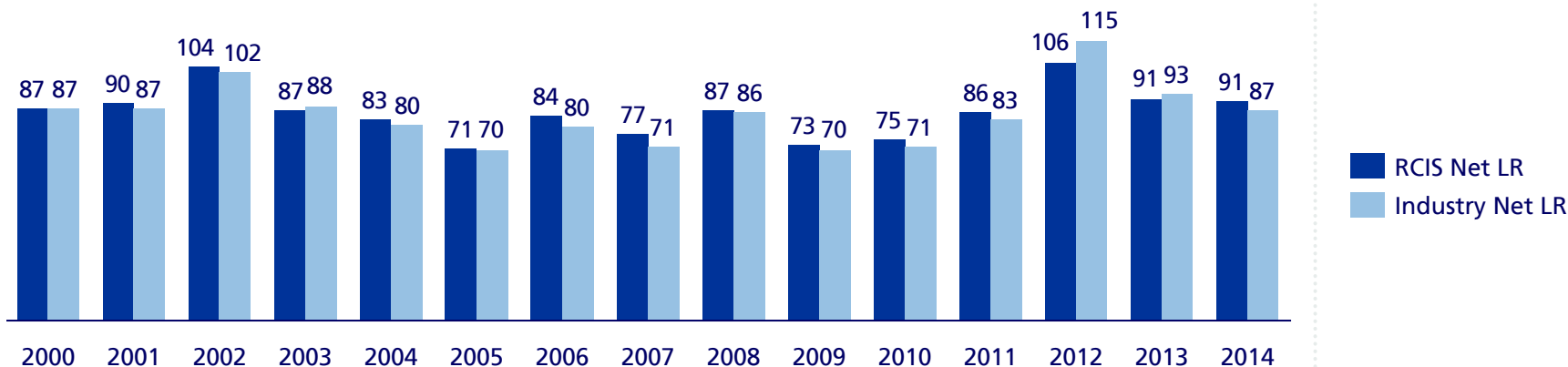
<sup>1</sup> Source: S&P SNL; Calendar Year view.

<sup>2</sup> Following FCIC cessions, quota share arrangements and other reinsurance.



# Long term industry average MPCIR LR of ~85%<sup>1</sup> with very low expense ratios

## RCIS AND INDUSTRY NET (AFTER FCIC CESSIONS) MPCIR LOSS RATIOS<sup>1,2</sup>



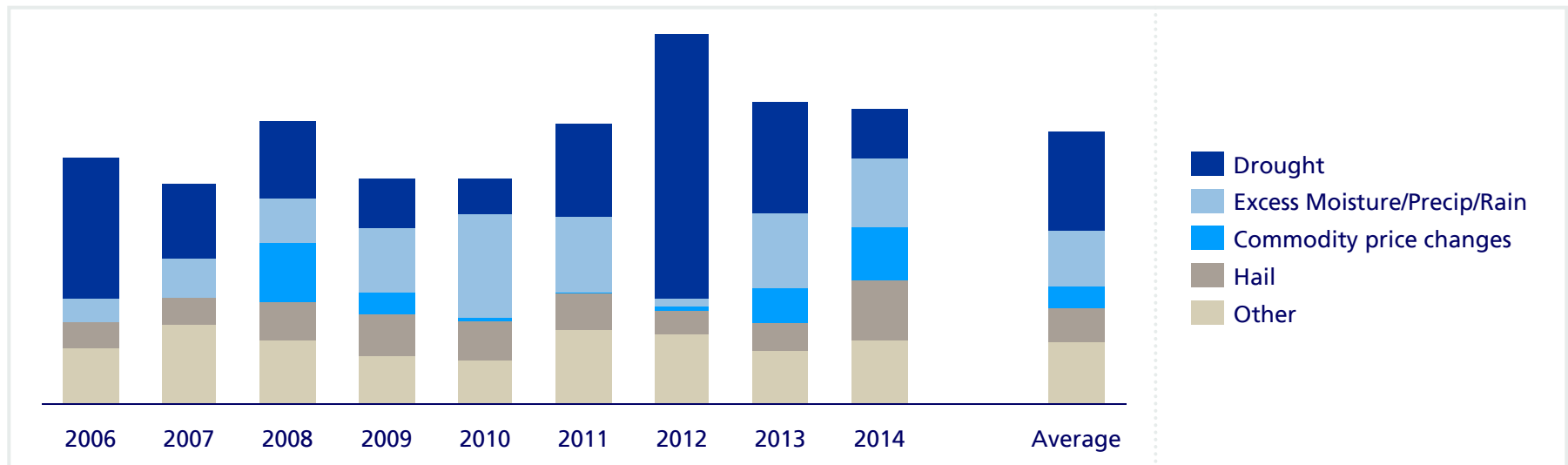
- RCIS Long term MPCIR loss ratio averages around 1ppt higher than industry<sup>1</sup>
- Historically RCIS retained more Commercial Risk Fund premiums, which resulted in MPCIR LRs slightly higher than industry in most years
- We see this as further potential for improvement as we will focus on capital efficiency
- Further, loss ratio improvements can be expected through leveraging Zurich's Predictive Analytics to assist in the fund designation process; back testing has shown the potential for enhancements in the 2009-2014 period
- Expense ratios benefit from the administrative and operating expenses (A&O) subsidy, provided by the Federal Government to largely offset commission expenses

<sup>1</sup> Source: Risk Management Agency (RMA) and RCIS internal data. Pre-2011 LRs adj. for 2011 Standard Reinsurance Agreement (SRA) terms.

<sup>2</sup> Reinsurance Year (RY) view; 2014 RY represents policies that were written from July 1, 2013 through June 30, 2014.

# Recent losses driven by record drought and declines in commodity prices

## CROP CAUSE OF LOSS 2006-2014 LRs (%)<sup>1,2</sup>



- Losses in the previous three years have exceeded long-term average experience
- Very high drought losses in 2012, driving industry LR of 115% (after FCIC cessions)
- 2013 also saw higher than average levels of drought, combined with a decline in commodity prices
- 2014 suffered from a decline in commodity prices as well as some hail losses
- Zurich's initial 2015 loss ratio emerging in-line with or better than the long-term average
- Recent years are an important indicator for policy makers to maintain current subsidy levels to the sector

<sup>1</sup> Source: RMA Reinsurance Reports and industry data collected by Guy Carpenter, Conning and the Insurance Information Institute.

<sup>2</sup> Cause of Loss represents industry cause of loss data applied to industry total loss ratios by Reinsurance Year.

# Recent years impacted by worse than average experience; 2015 expected to be in-line or better



USDm	RCIS Consolidated US GAAP				Adjustments <sup>1</sup>				Stand alone 100% view			
	2011	2012	2013	2014	2011	2012	2013	2014	2011	2012	2013	2014
	Actual	Actual	Actual	Actual					Adjusted	Adjusted	Adjusted	Adjusted
Gross Written Premium	2,986	2,681	2,541	2,037	-	-	-	-	2,986	2,681	2,541	2,037
Net Earned Premium	425	399	503	406	1,747	1,608	1,533	1,309	2,172	2,007	2,036	1,714
Net losses	(381)	(402)	(467)	(368)	(1,542)	(1,623)	(1,409)	(1,255)	(1,923)	(2,025)	(1,876)	(1,623)
Underwriting (loss)/gain	44	(1)	37	38	205	(16)	122	53	249	(18)	159	91
Net investment income	5	3	3	5	-	-	-	-	5	3	3	5
Net commissions	173	193	164	132	(164)	(167)	(164)	(142)	9	26	(1)	(10)
Operating expenses	(176)	(177)	(162)	(197)	6	13	20	30	(171)	(164)	(142)	(167)
Net income	25	6	19	(22)	30	(111)	(14)	(38)	55	(105)	5	(60)
<b>KPI</b>												
Loss ratio	89.8%	100.3%	92.6%	90.6%					88.5%	100.9%	92.2%	94.7%
Expense ratio	0.9%	-3.0%	0.8%	17.3%					7.5%	7.1%	7.3%	10.6%
Combined ratio	90.6%	97.3%	93.5%	107.9%					96.0%	108.0%	99.4%	105.3%

- Operating expenses have been stable over time, although some volatility seen in the A&O subsidy mechanism, where agent commission expenses are largely subsidized by the Federal Government
  - Expectation of a ~10% expense ratio going forward
- Short-tailed reserves and low capital requirements lead to moderate levels of investment income
- Using long-term industry average LRs and expected expenses would result in a ~95% combined ratio
  - Zurich's initial 2015 loss experience is developing in-line with or better than industry long-term average

<sup>1</sup> Adjustments are to provide a 100% stand alone view, i.e. the RCIS business without any external QS arrangements, and include reversal of QS premium and loss cessions and related ceding commissions, removal of RCIS fees paid to Wells Fargo for shared services and other items, and the addition of expected stand alone expenses.

# Compelling strategic and financial rationale



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# Crop Insurance overview



## PRODUCT OVERVIEW

Crop insurance helps to protect farmers from natural perils and creates a safety net for the agriculture industry. Two types of products exist:

- Multi Peril Crop Insurance (“MPCI”), which is a US federal government program administered by the U.S. Department of Agriculture (“USDA”).
- Private Products offer additional insurance protection, but not as part of the federal program; the largest product type is hail coverage.

	<b>Multi Peril Crop Insurance (“MPCI”)</b>	<b>Private Products</b>
<b>Coverage</b>	<ul style="list-style-type: none"> <li>• Standardized rates, terms and product types</li> <li>• Can only be issued by AIPs</li> <li>• Products include:                             <ul style="list-style-type: none"> <li>– Revenue protection against yield or price changes</li> <li>– Yield protection against production loss</li> <li>– CAT coverage – pays 50% of the average yield and 55% of the projected price</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Protects against specific perils, e.g. Crop-Hail</li> <li>• Often purchased in areas where hail is a frequent event</li> <li>• Usually in addition to MPCI</li> <li>• Pricing and underwriting decision fully at the discretion of AIPs</li> </ul>
<b>Subsidies</b>	<ul style="list-style-type: none"> <li>• Subsidized by the Federal Government</li> <li>• Federal regulator sets premiums, reinsures insurance losses, subsidizes premiums and AIP’s A&amp;O costs</li> </ul>	<ul style="list-style-type: none"> <li>• Not part of the Federal program and thus not subsidized</li> </ul>

## OVERVIEW OF FEDERAL SUBSIDIES

Through the 1994 Federal Crop Insurance Act and the 2000 Agriculture Risk Protection Act, the USDA is authorized to offer Multi-Peril Crop Insurance (MPCI) coverage to farmers who grow insurable crops. The Federal Crop Insurance Corporation (FCIC) is the USDA's subsidized multi-peril insurance program, which the USDA administers via the Risk Management Agency (RMA). In 2014, the Government paid premiums were USD 6.2 billion vs. farmer paid premiums of USD 3.8 billion.

Federal crop insurance is sold and serviced through private insurance companies, the Approved Insurance Providers, or AIPs. Today, there are 17 AIPs accredited with the FCIC, incl. RCIS.

The Federal government requires each AIP to underwrite all eligible farmers/crops, across all counties in the states in which they operate. Thus, the higher risk counties and states are in fact subsidized by those with lower risk. In return, the Federal government provides:

- Subsidies on administrative and operating expenses ("A&O subsidies"), capped to an overall amount of industry A&O reimbursement. Individual payments to AIPs are determined by market share. This cap grows at a fixed inflation adjustment factor, but does not reflect annual crop pricing; and
- XOL reinsurance to all AIPs through the FCIC. The extent of the reinsurance protection is chosen by the AIPs at the beginning of each crop cycle via the fund designation process.

Private Products are not part of the FCIC and are therefore not subsidized.

## FUND DESIGNATION

- Fund designation is the AIP's election of the risk-sharing arrangement with the FCIC, based on the rules and parameters spelled out in the Standard Reinsurance Agreement ("SRA"). Fund designation is the most important risk management tool for AIPs and is available on a by county or by field level.
- AIPs place their policies into one of two funds with the FCIC: the Assigned Risk Fund and the Commercial Fund.

### Assigned Risk Fund

- Higher risk policies – most of the risk is transferred to Federal government
- Greater risk protection to AIP
- Limitations:
  - AIP must retain 20% of risk
  - Capped at 75% of policies written per state
- FCIC retains additional 6.5% quota share on 20% of pool

### Commercial Fund

- Lower risk policies
- Greater risk retention (RCIS typically retains 100%, before private quota share reinsurance)
- FCIC retains 6.5% quota share on 100% of pool



## FEDERAL SUBSIDIES – RECENT PROPOSALS

- In an effort to reduce Federal crop insurance subsidies the Bipartisan Budget Act of 2015, signed into law by the President on November 2, 2015, amended the Federal Crop Insurance Act and in particular the Standard Reinsurance Agreement (“SRA”). The primary changes were as follows:
  - Mandated renegotiation of the SRA not later than December 31, 2016
  - Established that the new SRA would have a target rate of return for the crop insurance industry of 8.9% of retained premium for the 2017-2026 reinsurance years (vs. 14.5% as per the 2011 SRA)
- Following strong opposition from agriculture and financial services interests the US Congress and the President recently enacted the Highway Trust Fund Conference Report Bill, which included corrective provisions removing the 8.9% rate of return cap on AIPs.
- We believe that political risk surrounding crop insurance is manageable given the removal of the rate of return cap and subsidy reduction. This also confirms the following mitigants to future proposed reductions in federal subsidies for crop insurance:
  - Strong political interest groups (the “Farm Lobby”) support the agriculture industry in the U.S.
  - Insured risks exist in all 50 states and therefore changes which may be proposed from time to time garner significant scrutiny and resistance from the bipartisan majority of the United States Congress

# For further information

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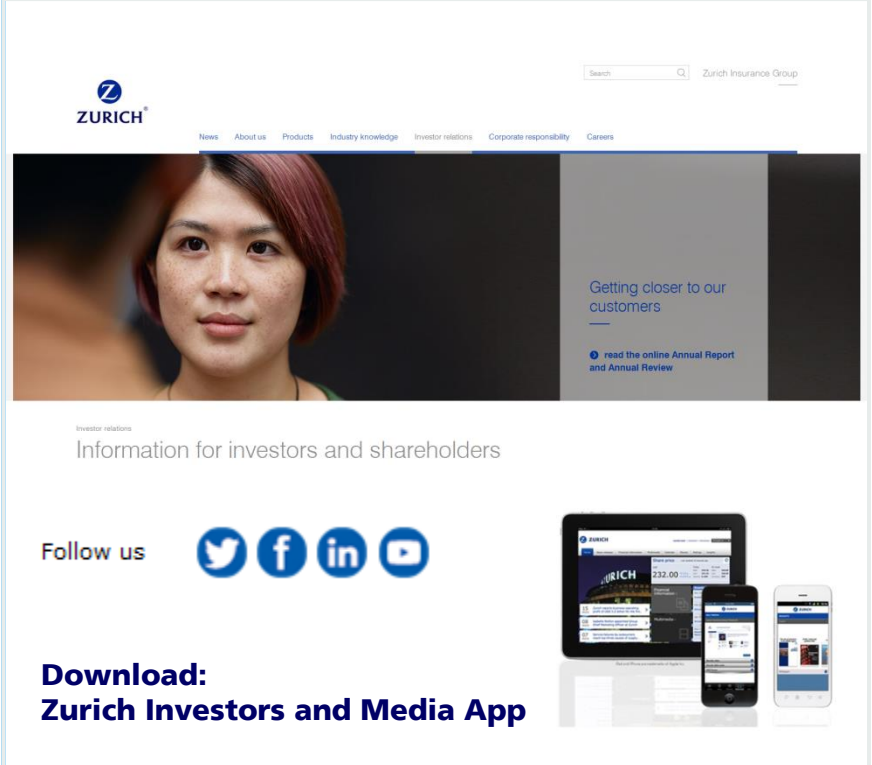
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**Calendar:**

- February 11, 2016, Annual Results 2015
- March 30, 2016, Annual General Meeting 2016
- May 12, 2016, Results for the three months to March 31, 2016
- August 11, 2016, Half year results 2016
- November 10, 2016, Results for the nine months to September 30, 2016
- December 1, 2016, Investor Day

