

2005



ZURICH

Financial Report

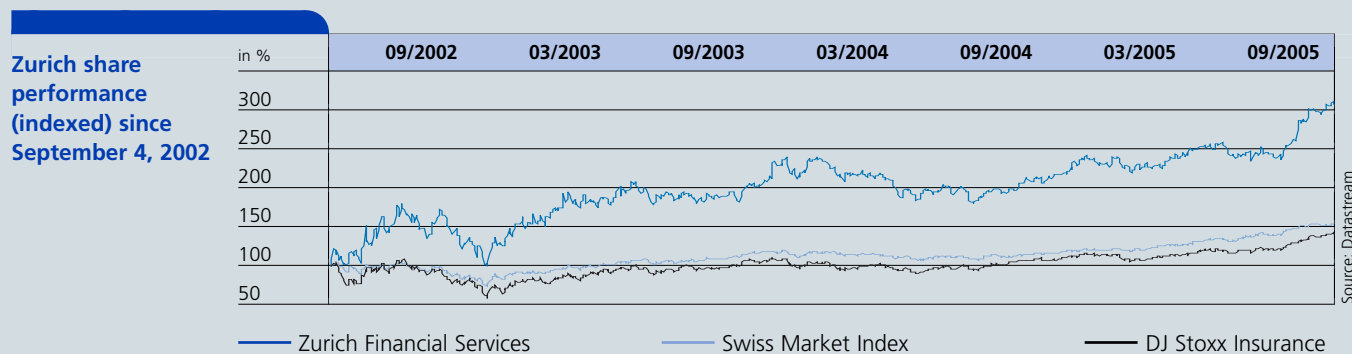
We aspire to become the leading global insurance group in our chosen general and life insurance markets, consistently delivering top-tier results for our shareholders. By so doing, we will create strong relationships with customers, agents and brokers and rewarding opportunities for employees.

Financial Highlights

The following table presents the summarized consolidated results of the Group for the years ended December 31, 2005 and 2004 and the financial positions as of December 31, 2005 and 2004. The 2004 amounts have been restated for the implementation of new and revised accounting standards. Certain prior year amounts have also been reclassified to conform to the 2005 presentation.

Consolidated results of the Group	2005	2004	Change
Consolidated operating statements			
<small>in USD millions, for the years ended December 31</small>			
Gross written premiums and policy fees	46,797	49,236	(5%)
Net investment result	23,147	15,595	48%
<i>of which: Net investment income on Group investments</i>	7,782	7,460	4%
Business operating profit	3,947	2,988	32%
Net income attributable to shareholders	3,214	2,466	30%
Consolidated balance sheets			
<small>in USD millions, as of December 31</small>			
Total investments	277,293	282,155	(2%)
Reserves for insurance contracts	219,924	228,029	(4%)
Liabilities for investment contracts	40,999	39,260	4%
Senior and subordinated debt	7,540	5,871	28%
Shareholders' equity	22,426	20,515	9%
General Insurance key performance indicators			
<small>for the years ended December 31</small>			
Business operating profit (in USD millions)	1,914	1,241	54%
Combined ratio	100.8%	102.0%	1.2 pts
Life Insurance key performance indicators			
<small>for the years ended December 31</small>			
Business operating profit (in USD millions)	1,079	934	16%
New business profit margin (as % of APE)	14.5%	11.4%	3.1 pts
Return on common shareholders' equity (ROE)¹			
<small>Returns for the years ended December 31</small>			
Return on common shareholders' equity (ROE)	15.5%	13.6%	1.9 pts
Business operating profit (after tax) return on common shareholders' equity	13.6%	12.6%	1.0 pts
Per share data			
<small>for the years ended December 31</small>			
Diluted earnings per share (in CHF)	27.11	20.83	30%

¹ ROE is based on net income attributable to common shareholders.



In September 2002, Zurich announced a comprehensive action plan to improve the Group's profitability and strengthen its balance sheet. The figure depicts Zurich's share price development since the launch of the program.

Key Performance Indicators

Business operating profit

in USD millions, for the years ended December 31

	Total		General Insurance		Life Insurance		Farmers Mgmt Services		Other Businesses		Corporate Functions	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	3,947	2,988	1,914	1,241	1,079	934	1,221	1,109	441	229	(708)	(525)

General Insurance – combined ratio

in %, for the years ended December 31

	Total		Global Corporate		North America Commercial		Europe General Insurance		International Businesses		Centrally Managed Businesses	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	100.8%	102.0%	107.4%	93.9%	106.3%	121.9%	93.8%	92.5%	94.0%	93.0%	482.2%	156.8%

Life Insurance – ¹ new business profit margin, after tax (in % of APE)

	Total		United States		United Kingdom		Germany		Switzerland		Rest of Europe		International Businesses	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	14.5%	11.4%	42.0%	61.0%	8.9%	5.4%	16.6%	12.0%	15.7%	10.0%	17.1%	13.9%	17.0%	3.1%

¹ In %, for the years ended December 31.

Life Insurance – ¹ embedded value operating return, after tax

	Total		United States		United Kingdom		Germany		Switzerland		Rest of Europe		International Businesses	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	10.9%	10.8%	14.1%	15.0%	6.2%	4.4%	10.9%	33.8%	21.9%	9.2%	17.1%	16.2%	15.8%	13.7%

¹ In %, for the years ended December 31, not adjusted for foreign currency translation effects.

Content

The Annual Report 2005 of Zurich Financial Services Group consists of two publications: the Corporate Review and the Financial Report.

The Corporate Review contains a detailed description of the Group's performance and way forward, risk management report, corporate governance and remuneration reports, the financial review, which provides an overview of the Group's business in 2005, and some Group financial information (balance sheets, operating statements, cash flow statements and shareholders' equity statements). The Corporate Review is published in English, German and French.

The Financial Report consists of the audited consolidated financial statements, including the notes, as well as the audited financial statements of the Zurich Financial Services holding company. The Financial Report is published in English and German.

Both reports are available on our Web site and can be downloaded at www.zurich.com.

Alternatively, printed copies can be ordered in writing, including language version preference, from Zurich Financial Services, Logistik-Hotline, Postfach 8002 Zurich, Switzerland (for shareholders, except in the UK) and from Lloyds TSB Registrars, The Causeway, Goring by Sea, Worthing, West Sussex BN996DA United Kingdom (for CDI-holders and shareholders in the UK) or on our Web site under Investor Relations.

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Consolidated Financial Statements

Consolidated operating statements

in USD millions, for the years ended December 31	Notes	2005	2004
Revenues			
Gross written premiums and policy fees	30	46,797	49,236
Less premiums ceded to reinsurers	30	(6,377)	(7,570)
Net written premiums and policy fees	30	40,420	41,666
Net change in reserves for unearned premiums	30	37	124
Net earned premiums and policy fees	30	40,457	41,790
Farmers management fees	14	2,058	1,985
Net investment income	7	9,765	9,053
Net capital gains on investments and impairments	7	13,382	6,542
Net gain/(loss) on divestments of businesses	4	(2)	88
Other income		1,526	1,756
Total revenues		67,186	61,214
Benefits, losses and expenses			
Insurance benefits and losses, gross of reinsurance	10	38,261	39,677
Less ceded insurance benefits and losses	10	(5,842)	(5,565)
Insurance benefits and losses, net of reinsurance	10	32,419	34,112
Policyholder dividends and participation in profits, net of reinsurance	10	14,432	8,752
Underwriting and policy acquisition costs, net of reinsurance	10	7,253	7,390
Administrative and other operating expense		5,860	5,494
Amortization and impairments of intangible assets	20	254	430
Interest expense on debt	22	446	362
Interest credited to policyholders and other interest		1,056	1,006
Total benefits, losses and expenses		61,720	57,546
Net income before income taxes		5,466	3,668
Income tax expense	18	(2,136)	(1,096)
Net income after taxes		3,330	2,572
Net income attributable to minority interests		(116)	(106)
Net income attributable to shareholders		3,214	2,466
in USD			
Basic earnings per share	23	22.04	16.92
Diluted earnings per share	23	21.80	16.79
in CHF			
Basic earnings per share	23	27.41	20.98
Diluted earnings per share	23	27.11	20.83

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

Consolidated balance sheets

Assets	in USD millions, as of December 31	Notes	2005	2004
Investments				
Cash and cash equivalents			23,482	22,457
Equity securities			90,314	86,088
Debt securities			125,297	131,370
Real estate held for investment			12,702	12,541
Mortgage loans			9,307	10,251
Policyholders' collateral and other loans			11,987	14,905
Investments in associates			580	645
Other investments			3,624	3,898
Total investments		7	277,293	282,155
Reinsurers' share of reserves for insurance contracts			20,494	21,168
Deposits made under assumed reinsurance contracts			2,450	3,282
Deferred policy acquisition costs		15	11,179	11,281
Deferred origination costs		15	690	736
Accrued investment income			2,390	2,614
Receivables		16	11,283	12,873
Derivative assets and other assets			1,787	3,095
Mortgage loans given as collateral		17	3,064	4,135
Deferred tax assets		18	4,393	4,211
Fixed assets		19	1,729	2,116
Goodwill		20	605	744
Other intangible assets		20	2,255	2,477
Total assets			339,612	350,887

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

**Liabilities
and equity**

in USD millions, as of December 31	Notes	2005	2004
Liabilities			
Reserve for premium refunds		753	820
Liabilities for investment contracts	12	40,999	39,260
Deferred profit on inception of reinsurance contracts		39	130
Deposits received under ceded reinsurance contracts		2,500	4,276
Deferred front-end fees		4,659	4,912
Reserves for insurance contracts	11	219,924	228,029
Obligation to repurchase securities		5,295	5,009
Accrued liabilities		2,150	2,605
Derivative liabilities and other liabilities	21	21,001	24,887
Collateralized loans	17	3,056	4,135
Deferred tax liabilities	18	6,317	5,718
Debt related to capital markets and banking activities	22	2,139	3,880
Senior and subordinated debt	22	7,540	5,871
Total liabilities		316,372	329,532
Equity			
Share capital		186	635
Treasury shares		–	(1)
Additional paid-in capital		10,315	10,288
Net unrealized gains on investments	7	1,139	1,144
Cumulative translation adjustment		(111)	743
Retained earnings		9,801	6,610
Common shareholders' equity		21,330	19,419
Preferred securities		1,096	1,096
Shareholders' equity		22,426	20,515
Minority interests	24	814	840
Total equity		23,240	21,355
Total liabilities and equity		339,612	350,887

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

Consolidated statements of cash flows

in USD millions, for the years ended December 31	2005	2004
Cash flows from operating activities		
Net income attributable to shareholders	3,214	2,466
Adjustments for:		
<i>Net capital gains on investments and impairments</i>	(13,382)	(6,542)
<i>Net loss/(gain) on divestments of businesses</i>	2	(88)
<i>Equity in income of investments in associates</i>	(105)	(86)
<i>Depreciation, amortization and impairments of fixed and intangible assets</i>	447	677
<i>Other non-cash items</i>	(5)	21
Changes in operational assets and liabilities:		
<i>Deferred policy acquisition costs</i>	(1,085)	(755)
<i>Deferred origination costs</i>	(31)	(40)
<i>Reinsurers' share of reserves for insurance contracts</i>	43	(148)
<i>Deposits made under assumed reinsurance contracts</i>	820	312
<i>Deposits received under ceded reinsurance contracts</i>	(1,580)	(619)
<i>Receivables and payables</i>	779	164
<i>Net change in trading securities</i>	383	1,586
<i>Reserves for insurance contracts, gross</i>	10,629	10,722
<i>Liabilities for investment contracts</i>	6,163	2,758
<i>Deferred income tax, net</i>	867	(143)
<i>Net changes in other operational assets and liabilities</i>	(1,104)	655
Net cash provided by operating activities	6,055	10,940
Cash flows from investing activities		
Sales and maturities:		
<i>Debt securities</i>	72,771	69,823
<i>Equity securities</i>	41,585	34,069
<i>Other (primarily other investments and fixed assets)</i>	12,626	7,992
Purchases:		
<i>Debt securities</i>	(75,364)	(78,395)
<i>Equity securities</i>	(41,417)	(32,771)
<i>Other (primarily other investments and fixed assets)</i>	(13,911)	(12,707)
Investments in associates, net	75	106
Acquisitions of companies, net of cash acquired	(1)	–
Divestments of companies, net of cash balances	40	2,053
Dividends from associates	–	19
Net cash used in investing activities	(3,596)	(9,811)

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

	2005	2004
Cash flows from financing activities		
Proceeds from sale and repurchase agreements	836	954
Dividends on preferred securities and minorities	(64)	(42)
Nominal value reduction of share capital	(449)	(288)
Issuance/(redemption) of preferred securities by subsidiaries	12	(12)
Issuance of debt	2,386	1,745
Payments on debt outstanding	(1,868)	(2,759)
Net cash provided by/(used in) financing activities	853	(402)
Foreign currency translation effects on cash and cash equivalents	(1,661)	683
Change in cash and cash equivalents excluding change in cash received as collateral for securities lending	1,651	1,410
Change in cash received as collateral for securities lending	(626)	5,158
Cash and cash equivalents as of January 1, including cash received as collateral for securities lending	22,457	15,889
Cash and cash equivalents as of December 31, including cash received as collateral for securities lending	23,482	22,457
Other supplementary cash flow disclosures		
Other interest income received	7,605	7,081
Dividend income received	1,833	1,547
Other interest expense paid	(1,502)	(1,341)
Income tax paid	(1,234)	(891)

As of December 31, 2005 and 2004, cash and cash equivalents restricted as to use were USD 331 million and USD 908 million, respectively. Cash and cash equivalents held for the benefit of policyholders in connection with unit-linked products amounted to USD 4,758 million and USD 3,507 million as of December 31, 2005 and 2004, respectively. Cash received as collateral for securities lending was USD 4,571 million and USD 5,197 million as of December 31, 2005 and 2004, respectively.

	2005	2004
Cash and cash equivalents		
in USD millions, as of		
Cash and cash equivalents comprise the following:		
Cash at bank and in hand	5,075	8,728
Cash equivalents	13,836	8,532
Cash held as collateral for securities lending	4,571	5,197
Balance as of December 31	23,482	22,457

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

Consolidated statements of equity

in USD millions

	Share capital	Treasury shares	Additional paid-in capital	
Balance as of December 31, 2003, as previously reported	923	(6)	10,208	
Total adjustment due to implementation of new and revised IFRS accounting standards ¹	–	–	–	
Balance as of December 31, 2003, restated	923	(6)	10,208	
Change in net unrealized gains/losses on investments (excluding currency translation adjustments)	–	–	–	
Transfer arising from initial application of “legal quote” legislation in Switzerland	–	–	–	
Currency translation adjustments	–	–	–	
Change in net unrealized gains/losses on investments not recognized in the operating statement	–	–	–	
Nominal value reduction of share capital	(288)	–	–	
Share-based payment transactions	–	–	19	
Treasury share transactions	–	5	61	
Net income after taxes	–	–	–	
Dividends	–	–	–	
Net changes in capitalization and minority interests	–	–	–	
Balance as of December 31, 2004, restated	635	(1)	10,288	
Balance as of December 31, 2004, as previously reported	635	(1)	10,288	
Total adjustment due to implementation of new and revised IFRS accounting standards ¹	–	–	–	
Balance as of December 31, 2004, restated	635	(1)	10,288	
Write-off of negative goodwill (IFRS 3)	–	–	–	
Change in net unrealized gains/losses on investments (excluding currency translation adjustments)	–	–	–	
Currency translation adjustments	–	–	–	
Change in net unrealized gains/losses on investments not recognized in the operating statement	–	–	–	
Nominal value reduction of share capital ²	(449)	–	–	
Share-based payment transactions	–	–	16	
Treasury share transactions	–	1	11	
Net income after taxes	–	–	–	
Dividends	–	–	–	
Net changes in capitalization and minority interests	–	–	–	
Balance as of December 31, 2005	186	–	10,315	

¹ Implementation of new and revised accounting standards as discussed in note 3.

² As approved by the Annual General Meeting on April 19, 2005, the share capital was reduced by a nominal value reduction of CHF 4.00 from CHF 6.50 to CHF 2.50 in respect of each registered share. The payment to shareholders was made on July 4, 2005.

The number of common shares issued was 144,006,955 as of December 31, 2005, 2004 and 2003.

The notes to the consolidated financial statements are an integral part of these consolidated financial statements.

	Net unrealized gains/losses on investments	Cumulative translation adjustment	Retained earnings	Common shareholders' equity	Preferred securities	Total shareholders' equity	Minority interests	Total equity
	862	152	5,699	17,838	1,096	18,934	969	19,903
	69	–	(1,517)	(1,448)	–	(1,448)	–	(1,448)
	931	152	4,182	16,390	1,096	17,486	969	18,455
	386	–	–	386	–	386	19	405
	(226)	–	–	(226)	–	(226)	–	(226)
	53	591	–	644	–	644	36	680
	213	591	–	804	–	804	55	859
	–	–	–	(288)	–	(288)	–	(288)
	–	–	–	19	–	19	–	19
	–	–	–	66	–	66	–	66
	–	–	2,428	2,428	38	2,466	106	2,572
	–	–	–	–	(38)	(38)	(4)	(42)
	–	–	–	–	–	–	(286)	(286)
	1,144	743	6,610	19,419	1,096	20,515	840	21,355
	1,075	840	8,248	21,085	1,096	22,181	846	23,027
	69	(97)	(1,638)	(1,666)	–	(1,666)	(6)	(1,672)
	1,144	743	6,610	19,419	1,096	20,515	840	21,355
	–	–	23	23	–	23	–	23
	81	–	–	81	–	81	7	88
	(86)	(854)	–	(940)	–	(940)	(125)	(1,065)
	(5)	(854)	–	(859)	–	(859)	(118)	(977)
	–	–	–	(449)	–	(449)	–	(449)
	–	–	–	16	–	16	–	16
	–	–	–	12	–	12	–	12
	–	–	3,168	3,168	46	3,214	116	3,330
	–	–	–	–	(46)	(46)	(18)	(64)
	–	–	–	–	–	–	(6)	(6)
	1,139	(111)	9,801	21,330	1,096	22,426	814	23,240

The Board of Directors of Zurich Financial Services has authorized on February 15, 2006 these consolidated financial statements for issue. These financial statements will be submitted for approval to the Annual General Meeting of Shareholders to be held on April 20, 2006.

1. Basis of presentation

Zurich Financial Services and its subsidiaries (collectively the "Group") are an insurance-based financial services provider with a global network. The Group also distributes non-insurance products, such as mutual funds, mortgages and other financial services products, from selected third-party providers.

The holding company, Zurich Financial Services, is incorporated in Zurich, Switzerland. The Group operates through subsidiaries and branch offices. The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law. IFRS does not contain guidelines governing the accounting treatment of certain transactions including those that are specific to insurance products. When a specific topic is not addressed by the standards, the IFRS Framework permits reference to another comprehensive body of accounting principles. In these cases, the Group typically refers to accounting principles generally accepted in the United States (US GAAP) for guidance.

Certain amounts recorded in the consolidated financial statements reflect estimates and assumptions made by management about insurance liability reserves, investment valuations, interest rates and other factors. Significant estimates are discussed in note 5. Actual results may differ from the estimates made.

The new and revised accounting standards, discussed in note 3, resulted in the restatement of 2004 consolidated financial statements. In addition, certain reclassifications have been made to prior year amounts and segment disclosures to conform to the current year presentation. These reclassifications have no effect on the previously reported net income.

The Group's balance sheet is not presented using a current/non-current classification. However, the following balances would generally be classified as current: cash and cash equivalents, short-term investments, deferred policy acquisition costs on general insurance contracts, accrued investment income, receivables, reserve for premium refunds, deferred profit on inception of reinsurance contracts, and accrued liabilities.

The following balances will generally be classified as non-current: equity securities, investments in associates, investments held by investment companies, real estate held for investment, deferred policy acquisition costs on life insurance contracts, deferred tax assets, goodwill, other intangible assets, reserves for unit-linked products, liabilities for investment contracts and deferred tax liabilities.

The following balances are of a mixed nature (including both current and non-current portions): debt securities, mortgage loans, policyholders' collateral and other loans, other investments - other, reinsurers' share of reserves for insurance contracts, deposits made under assumed reinsurance contracts, deferred front-end fees, deferred origination costs, derivative trading assets and other assets, mortgage loans given as collateral, fixed assets, liabilities for investment contracts, deposits received under ceded reinsurance contracts, reserves for losses and loss adjustment expenses, reserves for unearned premiums, future life policyholders' benefits, policyholders' contract deposits and other funds, obligation to repurchase securities, derivative liabilities and other liabilities, collateralized loans, debt related to capital markets and banking activities, and senior and subordinated debt.

Maturity tables have been provided for the following balances: debt securities (table 7.3), derivative assets and derivative liabilities (tables 9.1 and 9.2), reserves for losses and loss adjustment expenses (table 11.9), future life policyholders' benefits (table 11.9) and outstanding debt (table 22.3).

All amounts in the notes are shown in USD millions, rounded to the nearest million unless otherwise stated.

Segment information

The Group is managed on a matrix basis, reflecting both line of business and geography. Accordingly, segment information is presented in two formats. The primary format is based on the operating businesses of the Group and how they are strategically managed to offer different products and services to specific customer groups. The Group's primary segments are defined as follows:

- General Insurance
- Life Insurance
- Farmers Management Services
- Other Businesses
- Corporate Functions

In 2004, the Group's primary reporting segments were defined as General Insurance, Life Insurance, Farmers Management Services, Other Businesses and Corporate Center. The only change to these primary segments in 2005 was to rename Corporate Center to Corporate Functions. However, to be consistent with the Group's management structure, the following transfers between primary segments have been made for 2005 financial reporting:

- Farmers Re business from General Insurance to Other Businesses
- Group Reinsurance business relating to certain European run-off operations from Corporate Functions to Other Businesses
- Certain investments of Farmers New World Life from Life Insurance to Farmers Management Services
- The reinsurance business of various Group entities from Corporate Functions to Other Businesses or General Insurance

The Group's secondary format for segment information is geographic:

- North America
- Europe
- International Businesses, and
- Centrally Managed Businesses

In 2004, these secondary segments were North America Corporate, North America Consumer, Continental Europe, UKISA, Rest of the World and Centrally Managed Businesses. For 2005 financial reporting, these regions have been aligned to better reflect management responsibility. The 2004 results have been restated to reflect these changes.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Group accounts for inter-segment revenues and transfers as if the transactions were with third parties at current market prices, with the exception of realized capital gains, which are eliminated.

2. Summary of significant accounting policies

The principal accounting policies applied in the presentation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented unless otherwise stated.

a) Consolidation principles

The Group's consolidated financial statements include the assets, liabilities, equity, revenues, expenses and cash flows of Zurich Financial Services and its subsidiaries. A subsidiary is an entity in which Zurich Financial Services owns, directly or indirectly, more than 50% of the outstanding voting rights, or which it otherwise has the power to control. The results of subsidiaries acquired are included in the consolidated financial statements from the date of acquisition. The results of subsidiaries that have been sold during the year are included up to the date control ceased. All significant intercompany balances, profits and transactions are eliminated.

Associates and partnerships where the Group has the ability to exercise significant influence, as well as joint ventures where there is joint control, are accounted for using the equity method. Significant influence is presumed to exist when the Group owns, directly or indirectly, between 20% and 50% of the outstanding voting rights.

b) Insurance contracts and investment contracts with discretionary participating features (DPF)

Classification

Insurance contracts are those contracts that transfer significant insurance risk. These contracts may also contain financial risk. Significant insurance risk is defined as the possibility of paying significantly more in a scenario where the insured event occurs than in a scenario where the insured event does not occur. Scenarios considered include those which are deemed to be possible.

A number of insurance and investment contracts contain discretionary participation features (DPF) which entitle the contract holder to receive, as a supplement to guaranteed benefits, additional benefits:

- whose amount or timing is contractually at the discretion of the Group; and
- that are contractually based on:
 - the performance of a specified pool of contracts or a specified type of contract;
 - realized and/or unrealized investment returns on a specified pool of assets held by the issuer; or
 - the profit or loss of the company, fund or other entity that issues the contract.

The Group applies the same accounting policies for the recognition and measurement of obligations arising from insurance contracts and from investment contracts with DPF. These recognition and measurement criteria apply to obligations arising from the contract, deferred acquisition costs and other related intangible assets. The Group developed its accounting policies for insurance contracts before the adoption of IFRS 4 and in the absence of a specific standard for insurance contracts. Management used their judgment in developing a set of accounting policies for the recognition and measurement of rights and obligations arising from insurance contracts issued and reinsurance contracts held that provide the most useful information to users of the Group's financial statements. In making this judgment, Management primarily considered the pronouncements of the Financial Accounting Standards Board (US GAAP) on insurance and reinsurance contracts.

The Group also issues products containing an embedded option to the policyholder to switch all or part of the current and future invested funds into another product issued by the Group, usually from a unit-linked product into a unitized with-profits contract or similar. Certain of these products allow the policyholder to switch back to the previous product at his convenience. Where this results in a change to a product whose classification as insurance or investment is different to that currently, this is then reflected in the accounts according to the nature of the product which is purchased and the amounts so transferred.

Premiums

Premiums from the sale of general insurance products are recorded when written and are accreted to earnings on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are recognized over the period of risk in proportion to the amount of insurance protection provided. The unearned premium reserve represents the portion of the premiums written relating to the unexpired terms of coverage.

Premiums from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognized as revenue when due from the policyholder. Benefits and expenses are provided against such revenue to recognize profits over the estimated life of the policies. Moreover, for single premium and limited pay contracts, premiums are recorded as income when due with any excess profit deferred and recognized in income in a constant relationship to the insurance in-force or, for annuities, the amount of expected benefit payments.

Amounts collected as premiums from investment type contracts such as universal life, unit-linked and unitized with-profits contracts, are reported as deposits. Revenue from these contracts consists of policy fees for the cost of insurance, administration and surrenders during the period. Front-end fees are recognized over the estimated life of the contracts. Policy benefits and claims that are charged to expenses include benefit claims incurred in the period in excess of related policyholder contract deposits and interest credited to policyholder deposits.

Deferred policy acquisition costs

The costs of acquiring new business, including commissions, underwriting and policy issue expenses, which vary with and are directly related to the production of new business, are deferred. Future investment income is taken into account in assessing recoverability.

Deferred policy acquisition costs for participating traditional life insurance contracts are amortized over the expected life of the contracts as a constant percentage of estimated gross margins. Estimated gross margins include anticipated premiums and investment results less benefits and administration expenses, changes in the net level premium reserve and expected policyholder dividends, as appropriate. Estimated gross margins are re-estimated regularly with the impact of deviations of actual result from estimated experience on the amortization of deferred acquisition costs reflected in earnings.

Deferred policy acquisition costs for other traditional life insurance and annuity policies are amortized over the expected life of the contracts as a constant percentage of expected premiums. Expected premiums are estimated at the date of policy issue and are consistently applied throughout the life of the contract unless premium deficiency occurs.

Deferred policy acquisition costs for investment type contracts such as universal life, unit-linked and unitized with-profits contracts are amortized over the expected life of the contracts based on a constant percentage of the present value of estimated gross profits expected to be realized over the life of the contract. Estimated gross profits include expected amounts to be assessed for mortality, administration, investment and surrender, less benefit claims in excess of policyholder balances, administrative expenses and interest credited. Estimated gross profits are revised regularly and the interest rate used to compute the present value of revised estimates of expected gross profits is the latest revised rate applied to the remaining benefit period. Deviations of actual results from estimated experience are reflected in earnings.

The impact on the deferred policy acquisition cost asset of the change in unrealized gains or losses on investments is recognized through an offset to unrealized gains or losses at the balance sheet date.

Unamortized deferred policy acquisition costs associated with internally replaced contracts that are, in substance, contract modifications, continue to be deferred and amortized. Costs associated with internally replaced contracts that are, in substance, new contracts, are written off.

Liability adequacy testing is performed by portfolio of contracts, in accordance with the Group's manner of acquiring, servicing and measuring the profitability of its insurance contracts. Net unearned premiums are tested to determine whether they are sufficient to cover related expected claims, loss adjustment expenses, policyholder dividends, commission, amortization and maintenance expenses. If there is a premium deficiency, the deferred policy acquisition cost asset is written down by the amount of the deficiency. If, after writing down the deferred policy acquisition cost asset to nil (for the portfolio of contracts), a premium deficiency still exists, then a premium deficiency reserve is recorded to provide for the deficiency in excess of the deferred policy acquisition cost asset written down.

Losses and loss adjustment expenses

Losses and loss adjustment expenses are charged to income as incurred. Reserves for losses and loss adjustment expenses represent the accumulation of estimates for ultimate losses and include provisions for losses incurred but not yet reported (IBNR). The reserves represent estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. Reserving is a complex process dealing with uncertainty, requiring the use of informed estimates and judgments. The Group does not discount its loss reserves, other than for settled claims with fixed payment terms. Any changes in estimates are reflected in results of operations in the period in which estimates are changed.

Future life policyholders' benefits and policyholders' contract deposits

These represent the estimated future policyholder benefit liability for traditional life insurance policies and for certain unit-linked contracts, respectively.

Future life policyholders' benefits for participating traditional life insurance policies are calculated using a net level premium method based on actuarial assumptions equal to guaranteed mortality and interest rates.

Future life policyholders' benefits for other traditional life insurance policies are calculated using a net level premium valuation method based on actuarial assumptions as to mortality, persistency, expenses and investment return including a margin for adverse deviation.

Future life policyholders' benefits include the value of accumulated declared bonuses or dividends that have been vested to policyholders.

Policyholders' contract deposits represent the accumulation of premium received less charges plus declared dividends.

The policyholders' share of unrealized gains or losses, which may be paid in the future in respect of assets, is included in future life policyholders' benefits.

For products containing discretionary participation features the amount of the discretionary participation feature is deemed to be the investment return on all related assets where the apportionment between the shareholder and the contract holder has not yet been determined. This includes certain elements of unrealized gains and portions of retained earnings.

The minimum mandated amounts, which are to be paid to policyholders plus any declared additional benefits, are recorded in liabilities. Undeclared discretionary balances are recorded in shareholders' equity until such time as the allocation is determined and a bonus is declared.

Reserves for unit-linked products are recorded as equal to the consideration received plus accumulated investment yield less any fees charged or dividends paid to the policyholder.

For products containing guarantees in respect of minimum death benefits ("GMDB"), retirement income benefits ("GRIB") and annuitization options ("GAO"), additional liabilities are recorded in proportion with the receipt of the contracted revenues.

Reinsurance

The Group's insurance subsidiaries cede risk in the normal course of business in order to limit the potential for losses arising from certain exposures. Reinsurance does not relieve the originating insurer of its liability. Certain Group insurance companies assume reinsurance business incidental to their normal business, as well as from the Farmers Exchanges. Reinsurance assets include balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses, ceded unearned premiums and ceded future life policy benefits. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded gross in the consolidated balance sheet unless a legal right of offset exists.

Reinsurance contracts are assessed to ensure that underwriting risk, defined as the reasonable possibility of significant loss, and timing risk, defined as the reasonable possibility of a significant variation in the timing of cash flows, are transferred by the ceding company to the reinsurer. Those contracts that do not transfer both risks, referred to in total as insurance risk, are accounted for using the deposit method. A deposit asset or liability is recognized based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the ceding company. Deposits for contracts that transfer only significant underwriting risk are subsequently measured based on the unexpired portion of coverage until a loss is incurred, after which the present value of expected future cash flows under the contract is added to the remaining unexpired portion of coverage. Changes in the deposit amount are recorded in the consolidated operating statements as an incurred loss. Interest on deposits that transfer only timing risk, or no risk at all, are accounted for using the effective interest rate method. Future cash flows are estimated to calculate the effective yield, and revenue and expense are recorded as interest income or expense.

c) Investment contracts (without discretionary participating features)

The Group issues investment contracts without fixed terms (unit-linked) and investment contracts with fixed and guaranteed terms (fixed interest rate).

Investment contracts without fixed terms are financial liabilities where the fair value of the contract is determined with reference to the fair value of the underlying financial assets, derivatives and/or investment property (unit-linked) and are recorded at inception at their fair value.

Liabilities for investment contracts (unit linked)

These represent portfolios maintained to meet specific investment objectives of policyholders who bear the investment risk. The assets are classified as fair value through the profit and loss. The liabilities are carried at fair value. The costs of policy administration, investment management, surrender charges and certain policyholder taxes assessed against the policyholders' account balances are included in policy fee revenue.

The liability held for unit-linked products with capital units is measured at the funded value of those units. At issue, the difference between the funded and unfunded value of units is treated as deferred revenue.

Liabilities for investment contracts (amortized cost)

These represent contracts which are not unit-linked. Liabilities are measured at amortized cost, using the effective interest rate method. Transaction costs are deducted from the initial amount and form part of the effective yield. Future assumptions, except for the effective interest rate, are reviewed each reporting period. Changes in the liability due to changes in future assumptions are reflected in the income statement.

Valuation techniques are used to establish the fair value at inception and each reporting date.

The Group's main valuation techniques incorporate all factors that market participants would consider and are based on observable market data. The fair value of a unit-linked financial liability is determined using the current unit values that reflect the fair values of the financial assets contained within the Group's unitized investment funds linked to the financial liability, multiplied by the number of units attributed to the contract holder at the balance sheet date.

If the investment contract is subject to a put or surrender option, the fair value of the financial liability is never less than the amount payable on surrender, discounted for the required notice period, where applicable.

For investment contracts with fixed and guaranteed terms, the amortized cost basis is used. In this case, the liability is initially measured at its fair value minus transaction costs that are incremental and directly attributable to the acquisition or issue of the contract.

Subsequent measurement of investment contracts at amortized cost uses the effective interest method. This method requires the determination of an interest rate (the effective interest rate) that exactly discounts to the net carrying amount of the financial liability the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period if the holder has the option to redeem the instrument before maturity.

The Group re-estimates at each reporting date the expected future cash flows and recalculates the carrying amount of the financial liability by computing the present value of estimated future cash flows using the financial liability's original effective interest rate. Any adjustment is immediately recognized as income or expense in the income statement.

Deferred origination costs

The costs of acquiring new investment contracts with investment management services, including commissions and other incremental expenses directly related to the issuance of each new contract are amortized in line with revenue generated by the investment management service. The deferred origination costs (DOC) are tested for recoverability at each reporting date.

The costs of acquiring new investment contracts without investment management services are included as part of the effective interest rate used to calculate the amortized-cost measure of the related liabilities.

d) Other revenue recognition

Fee revenue for the provision of non-claims related management services to the Farmers Exchanges is calculated primarily as a percentage of gross premiums earned by the Farmers Exchanges. Farmers Group, Inc. and its subsidiaries ("FGI") provides the following non-claims related management services to the Farmers Exchanges: risk selection, preparation and mailing of policy forms and invoices, premium collection, management of the investment portfolios and certain other administrative and managerial functions. The Farmers Exchanges are responsible for their own claims functions, including the settlement and payment of claims and claims adjustment expenses. They are also responsible for the payment of agent commissions and bonuses and the payment of premium and income taxes.

Revenues from investment management and distribution fees are based on contractual fee arrangements applied to assets under management and recognized as earned when the service has been provided. For practical purposes, the Group recognizes these fees on a straight-line basis over the estimated life of the contract.

Certain upfront payments received for asset management services ("front-end fees") are deferred and amortized in proportion to the stage of completion of the service for which they were paid.

The Group charges its customers for asset management and other related services using the following different approaches:

- Front-end fees are charged to the client at inception. This approach is used particularly for single premium contracts. The consideration received is deferred as a liability and recognized over the life of the contract on a straight-line basis.
- Regular fees charged to the customer periodically (monthly, quarterly or annually) either directly or by making a deduction from invested funds. Regular charges billed in advance are recognized on a straight-line basis over the billing period; fees charged at the end of the period are accrued as a receivable that is offset against the financial liability when charged to the customer.

Interest income on financial assets that are not classified as fair value through profit or loss is recognized using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument and continues unwinding the discount as interest income.

Dividend income is recognized when the right to receive payment is established; usually this is the ex-dividend date.

e) Investments

Classification

Financial assets are classified either as "held-to-maturity", "fair value through profit or loss", "available-for-sale", or "loans originated by the Group". The classification depends on the purpose for which the investments were acquired.

Held-to-maturity financial assets are debt securities which the Group has the ability and positive intent to hold to maturity. Fair value through profit or loss has two sub-categories: financial assets held for trading and those designated at fair value through profit and loss at inception. Derivatives are also classified as held for trading unless they are designated as hedges. Trading financial assets are debt and equity securities which the Group buys with the principal intention to resell in the near term. The remaining debt and equity securities are classified as available-for-sale.

Loans originated by the Group, such as mortgage loans, policyholders' collateral and other loans, include loans where money is provided directly to the borrower, other than those that are originated with the intent to be sold in the short term, which are recorded in the trading category.

Measurement

Financial assets are initially recorded at cost, net of transaction costs directly attributable to the acquisition. Held-to-maturity financial assets are subsequently carried at amortized cost using the effective interest rate method. Fair value through profit or loss financial assets are subsequently carried at fair value, with changes in fair value recognized in the current period income. Available-for-sale financial assets are subsequently carried at fair value, with unrealized changes in fair value recorded in shareholders' equity. The cumulative unrealized gains or losses recorded in shareholders' equity are net of cumulative deferred income taxes, certain life policyholder liabilities, certain life deferred acquisition costs and minority interests. The realized gain or loss on divestment is based on the difference between the proceeds received and the carrying value of the investment plus any unrealized gains or losses on the investment recorded in shareholders' equity using the specific identification method. When available-for-sale financial assets are sold, impaired or otherwise disposed of, the cumulative gains and losses previously recognized in shareholders' equity are included in the current period income. The amortization of premium and accretion of discount on available-for-sale and held-to-maturity investments in debt securities is computed using the effective interest method and is recognized in current period income.

Investments backing certain life insurance policies with participation features are held as fair value through profit or loss. Movements in the carrying value of these assets are recognized in current period income to match the offsetting amounts attributable to policyholders.

Loans originated by the Group are initially recorded at cost and are subsequently measured at amortized cost using the effective interest rate method, less allowances for doubtful accounts.

Real estate held for investment purposes is initially recorded at cost (including transaction costs) and is subsequently measured at fair value with changes in fair value recognized in current period income. No depreciation is recorded for real estate held for investment. The gain or loss on disposal of real estate held for investment is based on the difference between the proceeds received and the carrying value of the investment.

Investments held by investment companies are carried at fair value.

The carrying values of short-term investments approximate fair values.

Impairments

Financial assets are assessed for impairment on a regular basis. A financial asset is impaired if its carrying value exceeds the estimated recoverable amount and there is objective evidence of impairment to the financial asset.

The Group considers an available for sale equity for impairment when the fair value of the security has been not insignificantly below the weighted-average cost for more than 12 months. Additionally, the Group considers an available for sale equity for impairment when the fair value has been below the weighted-average cost by more than 50% for any period of time.

The fair value of available for sale debt securities may fall temporarily below their carrying value, but, provided there is no risk resulting from changes in financial standing, an impairment is not recorded for such securities.

When a decline in the fair value of an available-for-sale asset has been recognized directly in shareholders' equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized directly in shareholders' equity is removed from equity and recognized in current period income. The amount of the cumulative loss that is removed from shareholders' equity and recognized in current period income is the difference between acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that asset instrument previously recognized in income.

For held-to-maturity financial assets and loans originated by the Group the impairment is considered to have taken place if it is probable that the Group will not be able to collect principal and interest due according to the contractual terms of the instrument. When impairment is determined to have occurred, the carrying amount of the held-to-maturity financial assets is decreased through a charge to current period income. The amount of the impairment loss is the difference between the asset's carrying value and the present value of expected future cash flows discounted at the security's original effective interest rate.

f) Derivative financial instruments

Derivative financial instruments are carried at fair value on the balance sheet as assets or liabilities. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Inputs used in pricing models are generally market observable or can be derived from market observable data. Derivative financial instruments with positive fair values are recorded as derivative trading assets and those with negative fair values are recorded as derivative trading liabilities. Apart from derivative financial instruments designated as qualifying cash flow hedging instruments (see below), changes in fair value are recognized in current period income.

Derivative financial instruments include interest rate, currency and total return swaps, futures, forwards and option contracts, all of which derive their value mainly from underlying interest rates, foreign exchange rates, commodity values or equity instruments. A derivative contract may be traded on an exchange or over-the-counter ("OTC"). Exchange-traded derivatives are standardized and include futures and certain option contracts. OTC derivative contracts are individually negotiated between contracting parties and include forwards, caps, floors and swaps. Derivative financial instruments are subject to various risks similar to those related to the underlying financial instruments, including market, credit and liquidity risk.

In addition to the derivative financial instruments described above, the Group enters into contracts that are not considered derivative financial instruments in their entirety but that include embedded derivative features. Such embedded derivatives are assessed at inception of the contract and, depending on their characteristics, are accounted for as separate derivative financial instruments pursuant to IAS 39.

Derivative financial instruments used for hedging

For the purpose of hedge accounting, hedging instruments are classified as either fair value hedges where they hedge the exposure to changes in the fair value of a recognized asset or liability, or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecast transaction.

To qualify for hedge accounting, the relationship of the hedging instrument to the underlying transaction must meet several strict conditions on documentation, probability of occurrence, hedge effectiveness and reliability of measurement. If these conditions are not met, then the relationship does not qualify for hedge accounting, in which case the hedging instrument and the hedged item are reported independently as if there was no hedging relationship.

Gains or losses from re-measuring hedging instruments are recognized immediately in the operating statement. Offsetting gains or losses on the fair value hedged item attributable to the hedged risk are adjusted against the carrying amount of the hedged item and recognized in the operating statement. Where the adjustment is to the carrying amount of a hedged interest-bearing financial instrument carried at amortized cost, the adjustment is amortized to current period income such that it is fully amortized by maturity.

The portion of gain or loss on the cash flow hedging instrument is recognized directly in shareholders' equity. The ineffective portion is recognized in current period income. When the hedged firm commitment results in the recognition of an asset or a liability, then, at the time the asset or liability is recognized, the associated gains or losses that had previously been recognized in shareholders' equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For other cash flow hedges, the gains or losses that are recognized in shareholders' equity are transferred to the operating statement in the same period in which the item hedged affects the net profit and loss, for example, when the future sale actually occurs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, cumulative gains or losses on the hedging instrument recognized in shareholders' equity remain in shareholders' equity until the forecasted transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognized in shareholders' equity is transferred to current period income.

g) Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and offset by bank overdrafts. Cash and cash equivalents also includes cash received as collateral for securities lending. Cash and cash equivalents are stated at face value, with holdings of foreign notes and coins valued at year end closing prices.

h) Securities lending

Certain entities within the Group participate in securities lending arrangements whereby specific securities are loaned to other institutions, primarily banks and brokerage firms, for short periods of time. Under the terms of the securities lending agreements, the loaned securities remain under the Group's control and therefore are not derecognized from the Group's balance sheet.

i) Obligation to repurchase securities

Sales of securities under agreements to repurchase are accounted for as collateralized borrowing transactions and are recorded at their contracted repurchase amount plus accrued interest at the balance sheet date.

j) Debt issued

Debt issued by the Group is initially measured at cost, which is the fair value of the consideration received, net of transaction costs incurred. Subsequent measurement is at amortized cost, using the effective interest rate method to amortize cost at inception to the redemption value over the life of the debt.

k) Interest expense

Interest expense is recognized when incurred on an amortized cost basis.

l) Intangible assets

Goodwill

Acquisitions of subsidiaries and associates are accounted for under the purchase method, whereby the purchase price is allocated to the fair value of assets and liabilities acquired at the date of acquisition with any residual amount allocated to goodwill. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Goodwill is allocated to cash generating units for the purpose of impairment testing. The Group's cash generating units, at which impairment losses are assessed, are the reporting units. If impairment indications exist, the recoverable amount of the cash generating unit will be determined. An impairment loss will be recorded if the recoverable amount is less than the carrying amount of the cash generating unit, including goodwill.

The recoverable amount for a cash generating unit is determined using net selling price, if available, or value in use, whichever is higher. Net selling price for a cash generating unit is determined based on various factors, including quoted market prices, current share values in the market place for similar publicly traded entities, and recent sale transactions of similar entities or businesses in the market place. Value in use is determined using the present value of estimated future cash flows expected to be generated from or used by the cash generating unit. The estimated future cash flows are based on best estimate assumptions, such as revenue and expense projections, growth rate, interest rates and investment yields, and inflation rate.

Indications that goodwill related to a cash generating unit may be impaired include events or changes in circumstances that may have a significant negative impact on the operations of the cash generating unit, or material adverse changes in the assumptions used in determining its recoverable amount.

Present value of profits of acquired insurance contracts ("PVFP")

PVFP is amortized over the expected life of the policies acquired, based on a constant percentage of the present value of estimated gross profits (margins) expected to be realized, or over the premium recognition period, as appropriate.

Attorney-in-fact relationships ("AIF")

At the date of the acquisition of FGI in 1988, a portion of the purchase price was assigned to the attorney-in-fact relationships. The asset representing the attorney-in-fact relationships represents the ability of FGI to generate future revenues based on the Group's relationship with the Farmers Exchanges. In determining that these relationships have an indefinite useful life, the Group considered the organizational structure of inter-insurance exchanges, under which subscribers exchange contracts with each other and appoint an attorney-in-fact to provide certain management services. In addition, the Group considered the historical attorney-in-fact relationship between FGI and the Farmers Exchanges. To the extent that there is a change in these circumstances, the Group would reevaluate the value of this intangible asset.

Other intangibles

Other intangible assets are carried at cost less accumulated amortization and consist primarily of acquired brand names and software costs that meet the recognition criteria for capitalization. The costs of these assets are amortized using the straight-line method over the following estimated economic lives: brand names 20 years; software three to five years.

Impairments

Intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the excess of the asset's carrying value over its recoverable amount. The recoverable amount is the higher of an asset's fair value less selling costs and value in use.

m) Income taxes

The Group provides current tax expense according to the tax laws of each jurisdiction in which it operates. Income taxes are recognized using the asset and liability method. Deferred income taxes are recorded for temporary differences, which are based on the difference between financial statement carrying amounts and income tax bases of assets and liabilities using enacted income tax rates and laws. Losses for tax purposes are treated as deferred tax assets to the extent it is probable that the losses can offset future taxable income and is allowed by the applicable local tax laws and regulations.

Current and deferred tax assets and liabilities are offset when the income taxes are levied by the same taxation authority and when there is a legally enforceable right to offset them.

Taxes payable by either the holding company or its subsidiaries on distribution to the holding company of the undistributed profits of subsidiaries are recognized as deferred income taxes unless a distribution of those profits is not intended or would not give rise to a tax liability.

Taxes paid by certain of our life insurance businesses are based on investment income less allowable expenses. To the extent that these taxes exceed the amount that would have been payable in respect of the shareholders' share of taxable profits, it is normal practice for certain of our businesses to recover this tax from policyholders. While the relevant company has the contractual right to charge policyholders for the taxes attributable to their share of investment income less expenses, the obligation to pay the tax authority rests with the company and therefore, the full amount of tax including that charged to policyholders is accounted for as an income tax. Income tax expense therefore includes an element attributable to policyholders. In addition, deferred tax on unrealized gains on investment contracts with DPF related to certain unit-linked policies is included as income tax expense and an accrual for future policy fees to recover the tax charge is included in gross written premiums and policy fee revenue.

n) Employee benefits

Retirement benefits

The operating companies in the Group provide employee retirement benefits through both defined benefit plans providing specified benefits and defined contribution plans. The assets of these plans are generally held separately from the Group's general assets in trustee-administered funds. Defined benefit plan obligations and contributions are determined annually by qualified actuaries using the projected unit credit method. The Group's expense related to these plans is accrued over the employees' service periods based upon the actuarially determined cost for the period. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are then recognized over the expected average remaining working lives of the employees participating in the plans. Contributions to defined contribution pension plans are charged to the operating statement as they become due.

Other post-retirement benefits

Other defined post-employment benefits, such as medical care and life insurance, are also provided for certain employees and are primarily funded internally. The cost of such benefits is accrued over the service period of the employee based upon the actuarially determined cost for the period.

o) Share based compensation

Under the Group's equity-settled share-based compensation plan, the fair value of the employee services received in exchange for the grant of shares and/or options is recognized as an expense in the consolidated operating statement over the vesting period. A corresponding amount is recorded in additional paid-in capital.

The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares and/or options granted, excluding the impact of any non-market vesting conditions (for example, profitability and premium income growth targets). Non-market vesting conditions are included in assumptions about the number of shares and/or options that are expected to be issued or become exercisable. At each balance sheet date, the Group revises its estimates of the number of shares and/or options that are expected to be issued or become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the shares are delivered or options are exercised.

p) Fixed assets

Real estate (buildings) held for own use and other fixed assets are carried at cost less accumulated depreciation and any necessary write-downs due to impairment. The costs of these assets are depreciated principally on a straight-line basis over the following estimated useful economic lives: buildings 25 to 50 years; furniture and fixtures five to ten years; and computer equipment three to five years. Real estate (land) is carried at cost less any necessary write-downs. Maintenance and repair costs are charged to income as incurred. Costs of systems purchased from outside vendors and developed internally are deferred and amortized over expected useful lives up to five years. Gains and losses on the disposal of fixed assets and real estate held for own use are determined based on their respective carrying amounts and recorded in income.

q) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the operating statement on a straight-line basis over the lease term.

r) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

s) Treasury shares

Zurich Financial Services shares held by the Group are classified as treasury shares and are deducted from equity at its nominal value. The differences between the nominal value and the amount paid for acquiring, or received for disposing of treasury shares, are recorded as an adjustment to additional paid-in capital in shareholders' equity.

t) Foreign currency translation and transactions

Foreign currency translation

In view of the international nature of the Group there are many individual entities with different functional currencies. A functional currency is the currency of the primary economic environment in which the entity operates. Therefore, a common presentation currency is required. Due to the Group's economic exposure to the US dollar (USD), the presentation currency of the Group has been determined to be the US dollar. Assets and liabilities of Group companies with functional currencies other than US dollars are translated at end-of-period exchange rates, while operating statements are translated at average exchange rates for the period. The resulting translation differences are recorded directly in shareholders' equity as cumulative translation adjustments.

Foreign currency transactions

Foreign currency monetary items are translated at end-of-period exchange rates, non-monetary items which are carried at historical cost denominated in a foreign currency are translated at historical rates. Revenues and expenses are translated using the exchange rate at the date of the transaction or a weighted average rate. The resulting exchange differences are recorded in the consolidated operating statement.

The table below summarizes the principal exchange rates that have been used for translation purposes. Net gains and (losses) on foreign currency transactions included in the consolidated operating statements were USD (71) million and USD 124 million for the years ended December 31, 2005 and 2004, respectively. Foreign currency exchange forward and swap gains and (losses) included in the amounts above were USD (453) million and USD 477 million for the years ended December 31, 2005 and 2004, respectively.

Principal
exchange
rates

Table 2

USD per foreign currency unit

	Balance sheets as of		Operating statements and cash flows for the years ended	
	12/31/05	12/31/04	12/31/05	12/31/04
Euro	1.1849	1.3555	1.2447	1.2440
Swiss franc	0.7614	0.8769	0.8039	0.8063
British pound sterling	1.7228	1.9183	1.8200	1.8329

3. Implementation of new accounting standards and adjustments in 2005 (IFRS restatement)

The Group has implemented several new and revised accounting standards within the International Financial Reporting Standards (IFRS) framework (as listed in the table below), which became effective January 1, 2005. The main restatement adjustments for the Group result from the adoption of IFRS 4, which relates to the definition of an insurance contract. They primarily affect the accounting treatment of the Group's life business with impacts on both the Group's consolidated balance sheet and operating statement.

The International Accounting Standards Board (IASB) issued IFRS 4 "Insurance Contracts" on March 31, 2004. The standard applies to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRS standards. The most significant change as a result of the adoption of the standard is the reclassification of certain contracts as financial instruments and hence application of IAS 39 to these contracts. IFRS 4 does not provide comprehensive guidance on the accounting treatment for insurance contracts and as such the Group will continue to apply US GAAP in certain circumstances where IFRS is silent.

IAS 39 "Financial Instruments: Recognition and Measurement" was revised in December 2003 as part of the IASB's project to improve IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39. Further amendments were made in 2005 and 2004. These changes related to Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk. The major changes are as follows:

- The standard clarifies that the evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for all derecognition transactions.
- The standard permits an entity to designate certain financial assets or financial liabilities on initial recognition as one to be measured at fair value, with changes in fair value recognized in profit or loss. To impose discipline on this categorization, an entity is precluded from reclassifying financial instruments into or out of this category.
- The standard provides additional guidance about how to determine fair values using valuation techniques.
- The standard clarifies that an impairment loss is recognized only when it has been incurred. It also provides additional guidance on what events provide objective evidence of impairment for investments in equity instruments.
- Hedges of firm commitments are treated as fair value hedges rather than cash flow hedges. However, the standard clarifies that a hedge of the foreign currency risk of a firm commitment can be treated as either a cash flow hedge or a fair value hedge.

The IASB issued IFRS 3 "Business Combinations" on March 31, 2004. In accordance with the transitional provisions of the standard, the Group has applied this standard to business combinations for which the agreement date is on or after March 31, 2004. The remaining requirements of IFRS 3 were adopted as of January 1, 2005. The most significant changes required by this standard are:

- All business combinations within its scope are to be accounted for using the purchase method, previously IAS 22 permitted business combinations to be accounted for using the pooling of interests method in certain circumstances.
- The acquiree's identifiable assets, liabilities and contingent liabilities are to be recognized as part of allocating the cost of the combination to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree is stated at the minority's proportion of the net fair values of those items.
- Goodwill acquired in a business combination is to be measured after initial recognition at cost less any accumulated impairment losses. Therefore, the goodwill is not amortized and instead must be tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. Negative goodwill is recognized immediately in the operating statement.

Upon adoption of IFRS 3, the Group wrote back USD 23 million of negative goodwill.

IAS 36 "Impairment of Assets" and IAS 38 "Intangible Assets" were revised in March 2004 by the IASB as part of the Business Combinations project. Consistent with the group's adoption of IFRS 3, the revised standards were adopted as of January 1, 2005.

The IASB issued IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" on March 31, 2004. The standard adopts the classification "held for sale", introduces the concept of a disposal group, and specifies that assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell. It also replaces IAS 35 "Discontinuing Operations" regarding the accounting treatment for discontinued operations.

IAS 27 "Consolidated and Separate Financial Statements" was revised in March 2004. The adoption of the revised guidance with respect to the consolidation requirements of venture capital organizations, mutual funds and similar entities resulted in an equivalent gross up of the Group's assets and liabilities to reflect the liabilities to third parties and minority interests. Also, IAS 27 revised requires the disclosure of minority interests within equity separately from shareholders' equity.

The accounting policy for securities lending has been changed, primarily driven by the revised IFRS which led the Group to review its previous policy and make changes to the criteria for recognizing collateral received as part of securities lending arrangements. As a result of the Group having future economic benefits and retaining significant risk and rewards of the cash collateral received, the Group now recognizes both cash collateral and an equal and offsetting liability related to the cash collateral. No income effect resulted from the change in this policy.

All changes in accounting policies have been made in accordance with transitional provisions in the respective standards and the impact is summarized in the following tables.

Consolidated operating statement for the year ended December 31, 2004 IFRS restatement – reconciliation to previously reported financial information

Table 3.1

in USD millions for the year ended December 31, 2004

	As reported ¹	IFRS 4	Other IFRS	Restated
Revenues				
Gross written premiums and policy fees	49,304	(68)	–	49,236
Less premiums ceded to reinsurers	(7,625)	55	–	(7,570)
Net written premiums and policy fees	41,679	(13)	–	41,666
Net change in reserves for unearned premiums	125	(1)	–	124
Net earned premiums and policy fees	41,804	(14)	–	41,790
Farmers management fees	1,985	–	–	1,985
Net investment income	9,114	(61)	–	9,053
Net capital gains on investments and impairments	4,934	1,596	12	6,542
Net gain on divestments of businesses	88	–	–	88
Other income	1,753	3	–	1,756
Total revenues	59,678	1,524	12	61,214
Benefits, losses and expenses				
Insurance benefits and losses, gross	40,099	(422)	–	39,677
Less ceded insurance benefits and losses	(5,599)	34	–	(5,565)
Insurance benefits and losses, net of reinsurance	34,500	(388)	–	34,112
Policyholder dividends and participation in profits, net of reinsurance	7,014	1,726	12	8,752
Underwriting and policy acquisition costs, net of reinsurance	7,243	147	–	7,390
Administrative and other operating expenses	5,316	178	–	5,494
Amortization and impairments of intangible assets	448	(18)	–	430
Interest expense on debt	362	–	–	362
Interest credited to policyholders and other interest	1,009	(3)	–	1,006
Total benefits, losses and expenses	55,892	1,642	12	57,546
Net income before income taxes	3,786	(118)	–	3,668
Net income attributable to shareholders²	2,587	(121)	–	2,466

¹ As published in the Annual Report 2004.² Revised IAS 1 changed the description "Net income" to "Net income attributable to shareholders".

in USD, for the year ended December 31, 2004

	As reported ¹	IFRS 4	Dividends preferred securities	Restated
Basic earnings per share	18.01	(0.83)	(0.26)	16.92
Diluted earnings per share	17.88	(0.83)	(0.26)	16.79

Table 3.2 in USD millions, as of December 31, 2004		As reported ¹	IFRS 4	Other IFRS	Restated
Consolidated balance sheet as of December 31, 2004 IFRS restatement – reconciliation to previously reported financial information					
Assets					
Investments	251,159	24,373	6,623	282,155	
Investments held on account and at risk of life insurance policyholders	24,189	(24,189)	–	–	
Reinsurers' share of reserves for insurance contracts	21,046	122	–	21,168	
Deposits made under assumed reinsurance contracts	3,312	(30)	–	3,282	
Deferred policy acquisition costs	13,344	(2,063)	–	11,281	
Deferred origination costs	–	736	–	736	
Goodwill	744	–	–	744	
Other intangible assets	2,590	(113)	–	2,477	
Other assets	29,699	(462)	(193)	29,044	
Total assets	346,083	(1,626)	6,430	350,887	
Liabilities and equity					
Liabilities for investment contracts	–	39,260	–	39,260	
Reserves for insurance contracts for life insurance where the investment risk is carried by policyholders	24,261	(24,261)	–	–	
Reserves for insurance contracts, gross	246,162	(17,950)	(183)	228,029	
Debt related to capital markets and banking activities	3,880	–	–	3,880	
Senior and subordinated debt	5,871	–	–	5,871	
Other liabilities	42,882	3,008	6,602	52,492	
Total liabilities	323,056	57	6,419	329,532	
Equity					
Share capital	635	–	–	635	
Treasury shares	(1)	–	–	(1)	
Additional paid-in capital	10,288	–	–	10,288	
Net unrealized gains on investments	1,075	–	69	1,144	
Cumulative translation adjustment	840	(85)	(12)	743	
Retained earnings	8,248	(1,598)	(40)	6,610	
Common shareholders' equity	21,085	(1,683)	17	19,419	
Preferred securities	1,096	–	–	1,096	
Shareholders' equity	22,181	(1,683)	17	20,515	
Minority interests	846	–	(6)	840	
Total equity	23,027	(1,683)	11	21,355	
Total liabilities and equity	346,083	(1,626)	6,430	350,887	

¹ As published in the Annual Report 2004.

Forthcoming changes in accounting standards

In August 2005 the IASB released IFRS 7 "Financial Instruments: Disclosures". IFRS 7 is effective January 1, 2007, however earlier application is encouraged. IFRS 7 applies to all risks arising from all financial instruments, except those covered by another more specific standard such as interests in subsidiaries, associates and joint venture, post-employment benefits, share-based payment and insurance contracts. IFRS 7 requires disclosure of:

- a) the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in IAS 32.
- b) qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

In December 2004 the IASB released a revised version of IAS 19 "Employee Benefits". The amendment to IAS 19 introduces an additional option for actuarial gains and losses arising in post-employment defined benefit plans to be recognized outside profit or loss providing all of the actuarial gains and losses for all defined benefit plans are recognized in the period in which they occur.

The Group has not yet fully analyzed the impact of these changes on its financial position, results or disclosures.

4. Changes in the scope of consolidation

During the years ended December 31, 2005 and 2004, the Group completed divestments of several businesses and recognized post-completion adjustments on divestments made in the previous year.

Table 4.1			
in USD millions, for the years ended December 31		2005	2004
Net gain on divestments	Consideration received	129	2,488
	Less: net assets divested	(138)	(2,356)
	Other income/(costs) related to divestments	7	(44)
	Net (loss)/gain on divestments before tax	(2)	88
	Tax effect	(1)	(17)
	Net (loss)/gain on divestments after tax	(3)	71
	Net assets divested		
	Cash and cash equivalents	89	435
	Other assets	236	6,090
	Insurance liabilities	(54)	(4,014)
Other liabilities	(133)	(155)	
Net assets divested	138	2,356	

During 2005, the Group divested businesses in markets where it did not have a significant presence or which were no longer part of its business strategy. The Group's principal transactions affecting the scope of consolidation during the years ended December 31, 2005 and 2004 are described below.

Changes in 2005

The Group completed the following sales: 100% of the share capital of Claims Management Group Limited, the Group's equity stake in ZC Sterling Corporation, 10% of the total issued share capital of South African Eagle Insurance Company Limited (SA Eagle) and the Group's interest in Zurich National Life Assurance Company Limited in Thailand.

Additionally, the Group acquired the life business portfolio of ING Insurance Argentina.

In 2005, the companies and businesses divested did not contribute materially to the Group's net income attributable to shareholders.

On April 4, 2005, the Group announced the sale of Universal Underwriters Group (UUG) to an investor group led by Hellman and Friedman LLC. The assets and liabilities of UUG were classified as held for sale in accordance with IFRS 5. However, on January 16, 2006 the Group announced the mutual cessation of negotiations to complete the sale and its intention to integrate UUG into the North America Commercial business. As a result, the assets and liabilities of UUG are no longer classified as held for sale.

Changes in 2004

During 2004, the Group completed the following sales: Zurich Atrium B.V., Turegum Insurance Company, Thai Zurich Insurance Company, Zurich Insurance (Singapore) Pte.Ltd., Zürich Krankenversicherung AG (Deutschland), the Group's stake in Globale Krankenversicherungs-AG, the insurance portfolio of its subsidiary Zurich Life Philippines, Inc, McMillan Shakespeare Australia Pty Limited, and the general insurance (consumer and small commercial lines) and life insurance (consumer and commercial lines) operations in Belgium.

The Group also recognized several post-completion adjustments for divestments completed during or prior to 2004, realizing a net gain before tax of USD 95 million.

5. Critical accounting judgments and estimates

Critical accounting estimates are those which involve the most complex or subjective judgments or assessments, and relate to general insurance and life insurance reserves, the determination of fair value for financial assets and liabilities, impairment charges, deferred policy acquisition costs and deferred taxes. In each case, the determination of these items requires management to make complex judgments based on information and financial data that may change in future periods.

a) Reserves for losses and loss adjustment expenses

The Group is required by applicable insurance laws, regulations and IFRS to establish reserves for payment of losses and loss adjustment expenses that arise from the Group's general insurance products and the run-off of its former third party reinsurance operations. These reserves represent the expected ultimate cost to settle claims occurring prior to, but still outstanding as of, the balance sheet date. The Group establishes its reserves by product line, type and extent of coverage and year of occurrence. Loss reserves fall into two categories: reserves for reported losses and reserves for incurred but not reported (IBNR) losses. Additionally, reserves are held for loss adjustment expenses, which contain the estimated legal and other expenses expected to be incurred to finalize the settlement of the losses.

The Group's reserves for reported losses and loss adjustment expenses are based on estimates of future payments to settle reported general insurance claims and claims from the run-off of its former third party reinsurance operations. The Group bases such estimates on the facts available at the time the reserves are established. The Group generally establishes these reserves on an undiscounted basis to recognize the estimated costs of bringing pending claims to final settlement, taking into account inflation, as well as other factors that can influence the amount of reserves required, some of which are subjective and some of which are dependent on future events. In determining the level of reserves, the Group considers historical trends and patterns of loss payments, pending levels of unpaid claims and types of coverage. In addition, court decisions, economic conditions and public attitudes may affect the ultimate cost of settlement and, as a result, the Group's estimation of reserves. Between the reporting and final settlement of a claim circumstances may change, which would result in changes to established reserves. Items such as changes in law and interpretations of relevant case law, results of litigation, changes in medical costs, as well as costs of vehicle and home repair materials and labor rates can substantially impact ultimate settlement costs. Accordingly, the Group reviews and re-evaluates claims and reserves on a regular basis. Amounts ultimately paid for losses and loss adjustment expenses can vary significantly from the level of reserves originally set.

The Group establishes IBNR reserves, generally on an undiscounted basis, to recognize the estimated cost of losses for events which have already occurred but which have not yet been notified. These reserves are established to recognize the estimated costs required to bring claims for these not yet reported losses to final settlement. As these losses have not yet been reported, the Group relies upon historical information and statistical models, based on product line, type and extent of coverage, to estimate its IBNR liability. The Group also uses reported claim trends, claim severities, exposure growth, and other factors in estimating its IBNR reserves. The Group revises these reserves as additional information becomes available and as claims are actually reported.

The time required to learn of and settle claims is an important consideration in establishing the Group's reserves. Short-tail claims, such as for automobile and property damage, are normally reported soon after the incident and are generally settled within months following the reported incident. Long-tail claims, such as bodily injury, pollution, asbestos and product liability, can take years to develop and additional time to settle. For long-tail claims, information concerning the event, such as the required medical treatment for bodily injury claims and the measures and costs required to clean up pollution, may not be readily available. Accordingly, the reserving analysis of long-tail lines of business is generally more difficult and subject to greater uncertainties than for short-tail losses.

Since the Group does not establish reserves for catastrophes in advance of the occurrence of such events, these events may cause volatility in the levels of its incurred losses and reserves, subject to the effects of reinsurance recoveries.

The Group uses a number of accepted actuarial methods to estimate and evaluate the amount of reserves recorded. The nature of the claim being reserved for and the geographic location of the claim influence the techniques used by the Group's actuaries. Additionally, the Group's Corporate Center actuaries perform periodic reserve reviews of the Group's businesses throughout the world. Management considers the results of these reviews and adjusts its loss and loss adjustment expense reserves, where necessary.

Refer to notes 10 and 11 for further information on reserves for losses and loss adjustment expenses.

b) Future life policyholders' benefits and policyholders' contract deposits

The future life policyholders' benefits and policyholders' contract deposits liabilities contain a number of assumptions regarding mortality (or longevity), lapses, surrenders, expenses, and investment returns. These assumptions are determined with reference to past experience adjusted for new trends, current market conditions and future expectations. As such the liabilities for future life policyholders' benefits and policyholders' contract deposits may not represent the ultimate amounts paid out to policyholders. For example:

- The estimated number of deaths determines the value of the benefit payments. The main source of uncertainty arises because of the potential for pandemics and wide-ranging lifestyle changes, such as changes in eating, smoking and exercise habits, which could result in earlier deaths for age groups in which the Group has significant exposure to mortality risk.
- For contracts that insure the risk of longevity, such as annuity contracts, an appropriate allowance is made for people living longer. Continuing improvements in medical care and social conditions could result in further improvements in longevity in excess of those allowed for in the estimates used to determine the liability for contracts where the Group is exposed to longevity risk.
- Under certain contracts, the Group has offered product guarantees (or options to take up product guarantees), including fixed minimum interest rate or mortality rate returns. In determining the value of these options and/or benefits, estimates have been made as to the percentage of contract holders that will exercise them. Changes in investment conditions could result in significantly more contract holders exercising their options and/or benefits than has been assumed.
- Estimates are also made as to future investment income arising from the assets backing long-term insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments.
- Assumptions are determined with reference to current and historical client data, as well as industry data. Interest rate assumptions reflect expected earnings on the assets supporting the future policyholder benefits. The information used by the Group's qualified actuaries in setting such assumptions includes, but is not limited to, pricing assumptions, available experience studies and profitability analysis.

Refer to notes 10 and 11 for further information on future life policyholders' benefits and policyholders' contract deposits.

c) Fair value of financial assets and liabilities

Certain of the Group's assets and liabilities are recorded at fair value on the balance sheet. Fair value determinations for financial assets and liabilities are based generally on listed market prices or broker or dealer price quotations. If prices are not readily determinable, fair value is based on either internal valuation models or management estimates of amounts that could be realized under current market conditions. Fair values of certain financial instruments, including over-the-counter ("OTC") derivative instruments, are determined using pricing models that consider, among other factors, contractual and market prices, correlations, yield curves, credit spreads volatility factors and/or prepayment rates of the underlying positions. The use of different pricing models and assumptions could lead to different estimates of fair value.

The Group issues a number of investment contracts that are recorded at fair value through profit or loss. These financial instruments are not quoted in active markets, and their fair values are determined by using valuation techniques. A variety of factors are considered in the Group's valuation techniques, including credit risk (both own and counterparty), embedded derivatives (such as unit-linking features), volatility factors (including contract holder behavior), servicing costs and surrenders of similar instruments.

Changes in assumptions for any of these factors could affect the reported fair value of these financial instruments. The extent that actual surrenders are different from the Group's estimates is the most critical factor in the fair valuation process. Increased surrender volumes may not be fully recognized in the valuation of investment contract liabilities owing to the requirement to maintain the fair value of financial liabilities above the amount payable on demand.

Refer to notes 7, 8, 9 and 21 for further information on the fair value of financial assets and liabilities.

d) Impairment of assets

Assets are subject to regular impairment reviews under the relevant IFRS standard. Impairments are measured as the difference between the cost (or amortized cost) of a particular asset and the current fair value or the recoverable amount.

For quoted available-for-sale financial assets the decision to make an impairment provision is based on a review of the issuer's current financial position and future prospects and an assessment of the probability that the current market price will recover to former levels within the foreseeable future. The recoverable amount is determined by reference to the market price. For non-quoted available-for-sale financial assets the Group takes into consideration the issuer's current financial position and future prospects in determining whether an impairment provision is required. The recoverable amount is determined by applying recognized valuation techniques.

Impairments are recorded in the current period operating statement when they occur.

Refer to notes 7, 16, 18, 19 and 20 for further information on impairments of assets.

e) Deferred policy acquisition costs

Deferred policy acquisition costs generally consist of commissions, underwriting expenses and policy issuance costs. The amount of acquisition costs to be deferred is dependant on management's judgment as to which issuance costs are directly related to and vary with the acquisition. Further, once the costs are deferred, the related asset is amortized over the estimated life of the contract.

Refer to note 15 for further information on deferred policy acquisition costs.

f) Deferred taxes

Deferred tax assets are recognized if sufficient future taxable income, including income from the reversal of existing taxable temporary differences and available tax planning strategies, are available for realization. The utilization of deferred tax assets arising from temporary differences depends on the generation of sufficient taxable profits in the period in which the underlying asset or liability is recovered or settled. As of each balance sheet date, management evaluates the recoverability of deferred tax assets and if it is considered more likely than not that all or a portion of the deferred tax asset will not be utilized, then a valuation allowance would be recognized.

Refer to note 18 for further information on deferred taxes.

g) Pension plans

The Group operates a number of defined benefit pension plans. In assessing the Group's liability for these plans, critical judgments include estimates of mortality rates, rates of employment turnover, disability, early retirement, discount rates, expected long-term rates of return on plan assets, future salary increases, future pension increases and increases in long-term healthcare costs. These assumptions may differ from actual results due to changing economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences may result in variability of pension income or expense recorded in future years.

Refer to note 25 for further information on defined benefit pension plans.

6. Analysis of risk

As a major, global insurance carrier, the Group helps customers around the world to manage a broad range of business and personal risks. In turn, the Group faces a number of risks. These risks include, but are not limited to:

- Insurance risk - risk transferred to us by customers through the underwriting process.

- Investment and credit risk – risk associated with the Group’s investment portfolio, reinsurance agreements and other counterparty credit risk.
- Financial risk – risk associated with currency fluctuations and management of the relative duration of assets and liabilities.

The Board of Directors establishes the Group’s corporate risk management framework. In turn, the Audit Committee of the Board assesses whether management is addressing risk and control issues in a timely and appropriate manner. The Audit Committee of the Board receives regular reports regarding the Group’s risk profile and mitigation actions.

The Group has additional audit or risk committees at all levels of the organization that regularly review risks. The Management Audit Committees established in 2004 and implemented in 2005 at a business division level is providing a particularly good forum for systematically reviewing risks in the Group’s various businesses and ensuring appropriate management attention.

The Chief Executive Officer, together with the Group Executive Committee, oversees the Group’s performance with regard to its risk management policies as well as the further development of these policies when required. The Chief Risk Officer reports to the Chief Executive Officer. The Group also benefits from the cooperation of its network of risk management and functional specialists within each business as well as at Corporate Center, where it has dedicated managers for various types of risk.

Group-wide risk management policies specify risk tolerance boundaries and authorities, reporting requirements, and procedures for referring risk issues to senior management. The Group regularly monitors its risks through analyses and reports, and through relevant risk modeling.

The Group systematically and regularly identifies a wide range of possible risk scenarios in the business units and the centralized Group functions. Through its Total Risk Profiling process, the Group assesses each risk scenario strategically for its probability of occurrence and for the severity of the consequences should it occur. The Group then develops, monitors and implements appropriate action plans.

Group Risk Management monitors the risk issues identified and reports regularly to senior management and the Group’s audit and risk committees.

In addition to risk-specific monitoring and modeling, the Group takes a holistic view with risk-based capital (RBC) modeling. This type of modeling measures the difference between what the Group expects in a normal business-operating environment and worst-case scenarios. The Group defines risk-based capital as the capital needed to protect the Group’s policyholders against the worst-case loss (which the Group defines as an event with a one-in-2000 probability of occurring in one year). The Group continues to embed RBC modeling into its organization and decision-making, such as allocating capital to lines of business.

a) Insurance risk

As an insurer, the Group assumes certain of its customers’ risks, and therefore must carefully manage that transfer of risk including the setting of limits on underwriting authority and requiring specific approvals for transactions involving new products or where established limits of size and complexity may be exceeded. The Group’s underwriting strategy reflects the variety of industries and geographic regions in which the Group operates.

The Group uses a variety of reserving and modeling methods to address the various insurance risks inherent in its general and life insurance business.

The Group has centralized the management of reinsurance and closely monitors emerging issues that may affect its overall risk exposures, such as new areas of liability. The Group models and estimates risk associated with natural catastrophes and monitors potential exposures to man-made catastrophes.

The Group focuses on a disciplined approach to underwriting and pricing. Further, because the Group manages a diversified portfolio across geographies, segments and lines of business, the effects of underwriting losses arising from specific events or adverse reserve developments may be moderated.

General insurance risk

General insurance risk includes the reasonable possibility of significant loss due to uncertainty of the frequency of insured events occurring and the uncertainty of the amount of the resulting claims.

The table below shows the Group's concentration of risk within the General Insurance segment by region based on direct written premiums. The Group's exposure to general insurance risks varies significantly by geographic region and may change over time.

Table 6.1						
in USD millions, for the year ended December 31, 2005		Motor	Property	Third Party Liability	Accident and Health	Other
General Insurance – Direct written premiums by line of business and by region	North America	1,912	2,322	5,242	391	4,296
	Europe	6,235	4,167	2,934	1,077	844
	International Businesses ¹	880	570	231	743	352
	Centrally Managed Businesses	–	–	–	–	(2)
	Total	9,027	7,059	8,407	2,211	5,490

¹ Including intercompany eliminations

Table 6.2						
in USD millions, for the year ended December 31, 2004		Motor	Property	Third Party Liability	Accident and Health	Other
General Insurance – Direct written premiums by line of business and by region	North America	1,987	2,672	5,443	327	4,397
	Europe	6,168	4,139	2,921	1,150	967
	International Businesses ¹	834	576	247	657	314
	Centrally Managed Businesses	–	–	–	–	(3)
	Total	8,989	7,387	8,611	2,134	5,675

¹ Including intercompany eliminations

The main risks in each line of business are as follows:

- Motor includes, but is not limited to, the auto physical damage and auto third-party liability risks.
- Property includes, but is not limited to, fire and flood risks.
- Third Party Liability includes, but is not limited to, the liability risks, such as workers injury, from the Group's customers, such as workers injury. Premiums underwritten in this line of business have included cover for risks such as asbestos and environmental risks. The reserves arising from these risks are shown in note 11. These exposures demonstrate how the frequency and severity of losses in certain lines of business can be difficult to predict. Further, the legal and tort environment, including the development of class actions, previously have had an impact on the frequency and severity of losses in the third party liability line of business.
- Accident and Health includes, but is not limited to, the accident and health insurance risks from the Group's Personal customer segment.
- Other includes, but is not limited to, other risks such as credit and surety, marine and aviation.

As well as the specific risks insured, all these lines expose the Group to natural and man-made catastrophes, such as terrorism.

The Group assesses natural catastrophe risk represented by Zurich property policies located in the most hazard prone areas. These assessments principally address the risk of tornadoes, hail, windstorms, earthquakes, and river floods. In recent years the Group has been particularly impacted by the exceptional claims arising from windstorms in North America.

Man-made catastrophes include such risks as train collisions, hotel fires and terrorism. Man-made catastrophe risks present challenges for the Group to assess due to the high degree of uncertainty about what events might actually occur. The Group monitors potential exposures by analyzing certain accumulations in some geographic areas, using a number of assumptions about the potential characteristics of the threat.

Life insurance risk

Life insurance risk includes the reasonable possibility of significant loss due to uncertainty of rates of deaths among policyholders, rates of disability among policyholders, investment returns, and surrenders or lapses.

The table below shows the Group's concentration of risk within the life insurance segment by region based on direct written premiums. The Group's exposure to life insurance risks varies significantly by geographic region and may change over time.

Table 6.3

Life Insurance: Direct written premiums by line of business and by region	in USD millions, for the year ended December 31, 2005					
	Individual Annuity	Individual Capital	Group	Accident and Health	Unit-Linked	
North America	319	9	–	11	256	
Europe	3,797	1,098	2,053	54	2,334	
International Businesses ¹	165	78	58	92	123	
Total	4,281	1,185	2,111	157	2,713	

¹ Including intercompany eliminations

Table 6.4

Life Insurance: Direct written premiums by line of business and by region	in USD millions, for the year ended December 31, 2004					
	Individual Annuity	Individual Capital	Group	Accident and Health	Unit-Linked	
North America	288	8	–	10	243	
Europe	4,030	1,209	2,539	76	1,763	
International Businesses ¹	285	73	82	94	145	
Total	4,603	1,290	2,621	180	2,151	

¹ Including intercompany eliminations

The main risks in each line of business are as follows:

- Individual annuity includes, but is not limited to, longevity and interest rate risks arising on personal annuity insurance contracts. Longevity risk is the risk that an annuitant may live longer than expected.
- Individual capital includes, but is not limited to, mortality, morbidity and interest rate risks arising on personal capital insurance contracts. Mortality risk is the risk that the policyholder dies sooner than expected. Morbidity risk is the risk that the policyholder suffers a total and permanent disability.
- Group includes, but is not limited to, mortality, morbidity, longevity and interest rate risks arising on commercial death, disability and annuity insurance contracts.
- Accident and Health includes, but is not limited to, mortality, morbidity and interest rate risks arising on accident and health insurance contracts.
- Unit-linked includes, but is not limited to, significant mortality risks. However on unit-linked products, the interest rate or equity market risk is largely passed on to the policyholder.

As well as the specific risks insured, all these lines expose the Group to lapse, surrender and expense risks.

Certain of the products above contain guarantees for which liabilities have been recorded for additional benefits and minimum guarantees, primarily in the subsidiary Kemper Investors Life Insurance Company which has written variable annuity contracts that provide annuitants with certain guarantees related to minimum death and income benefits. The determination of these liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates, annuitization elections and mortality experience. The assumptions used are consistent with those used in determining estimated gross profits for purposes of amortizing deferred policy acquisition costs.

Refer to note 11 for details of the carrying value of the liability relating to these products and its development.

b) Investment and credit risk

Investment risk

Debt securities represent 64.3% of the Group's investment portfolio (excluding unit-linked assets), and within these, the largest concentration is in government and supra-national securities at 44.3%.

Debt securities are primarily exposed to interest rate risk while equity securities are primarily exposed to equity market risk. Some of the following impacts have been estimated after taking into account changes that would be absorbed by policyholders.

Concentrations of investments are managed by issuer, industry, geography and credit rating.

Financial and insurance liabilities risk

The Group is exposed to interest rate risk on its reserves for insurance contracts, liabilities for investment contracts and floating rate borrowings.

General insurance reserves are not discounted other than for settled claims with fixed payment terms, therefore interest rate risks to the Group on these reserves are not significant.

Returns on unit-linked contracts, whether classified as insurance or investment contracts, are for the risk of the contract holder, therefore interest rate risks to the Group on these liabilities are not significant.

The table 6.5 below shows, both for the general insurance businesses and life insurance businesses, the estimated impacts on the total investments, reserves for insurance contracts and liabilities for investment contracts (including unit-linked contracts) and net assets of a one percentage point increase in yield curves and a 10% decline in all stock markets as of December 31, 2005. All amounts shown are before taxation effects, except for net assets of the life insurance business.

Table 6.5

in USD millions, as of December 31, 2005

Interest rate and equity market sensitivities for the Group's general insurance and life insurance businesses	General Insurance Business	Life Insurance Business
1% increase in the interest rate yield curves		
Total investments	(1,542)	(4,143)
Reserves for insurance contracts and liabilities for investment contracts	–	(3,156)
Net assets	(1,542)	(688)
10% decline in all stock markets		
Total investments	(349)	(7,271)
Reserves for insurance contracts and liabilities for investment contracts	–	(6,702)
Net assets	(349)	(215)

Most of the Group's debt is subject to fixed interest rates, which may be adjustable during the course of the term. No adjustments are made to the principal value of the debt for change in the yield curve. However, an increase in interest rates would result in an increase to the Group's interest expense on floating rate debt.

Credit risk

As part of its overall risk management strategy, the Group cedes insurance risk via proportional, non-proportional and specific risk reinsurance treaties. While these cessions mitigate insurance risk the recoverable from reinsurers exposes the Group to credit risk.

To manage this risk the Group has centralized the purchase of treaty reinsurance, and only conducts business with companies authorized by its Corporate Reinsurance Security Committee. The Group also limits its maximum credit exposure by reinsurance group.

In addition to reinsurers, another source of credit risk for the Group is third party brokers, agents and other intermediaries. The Group's credit risk exposures to third party brokers, agents and other intermediaries arise where those intermediaries collect premiums from customer to be paid to the Group or pay claims to customers on behalf of the Group. For details of the amount receivable from brokers, agents and other intermediaries refer to note 16.

The Group cedes new business to authorized reinsurers that are rated at least BBB. The premiums ceded shown in the table below that are below investment grade relate to former transactions, pools and captives, and to a lesser extent, broker business.

The reinsurance assets in the table below are shown net of collateral. The Group only accepts high quality collateral such as cash or letters of credit of banks rated A and above.

Table 6.6
in USD millions, for the year ended December 31, 2005

Reinsurance premiums ceded and assets by rating of reinsurer	Table 6.6	
	Amounts ceded	Reinsurance assets ¹
Rating		
AAA	159	659
AA	1,356	5,787
A	2,800	10,330
BBB	1,026	3,337
BB	60	92
B	40	392
Unrated	936	1,964
Total	6,377	22,561 ²

¹ Including receivables from reinsurers.

² Including collateral of USD 9,836 million.

The Group is also exposed to credit risk from third party companies where the Group holds debt and equity securities issued by those companies. The credit risk related to investment assets is monitored and assessed, and the Group limits maximum exposures.

Table 6.7
in USD millions, as of December 31, 2005

Debt securities by rating of investee	Table 6.7	
	Debt securities	
Rating		
AAA	74,577	
AA	18,773	
A	17,555	
BBB	6,483	
BB	272	
B	119	
Unrated	232	
Total	118,011 ¹	

¹ Excluding debt securities for unit-linked contracts.

In the case of derivatives, such as interest rate or currency swaps, forward contracts and purchased options, the replacement value of the outstanding derivatives represents a credit risk to the Group. The Group controls the credit risk of its outstanding positions with external counterparties through approval process embedded in derivative programs.

To limit credit risk, derivative financial instruments are typically executed with counterparties rated A- or better by an external rating agency. Wherever possible collateral is requested.

c) Financial risk

The Group is exposed to the risk that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts, as well as risk from currency and interest rate changes.

Asset and liability mismatch risk

In order to have adequate liquid assets available to fund liability cash flows when they come due, the Group manages its overall asset/liability matching exposure and oversees the activities of local asset/liability management committees. The Group monitors relative asset and liability durations at both a business and a Group level. This process enables the Group to manage its exposures to interest rates, equity market risks and other financial risks, in particular for insurance and investment contracts.

Currency risk

As an international group, the Group is exposed to various foreign currency risks. Most prominently, those risks can affect its liquidity, its reported profits and losses, its reported equity, its regulatory capital position and the economic value of its firm. The Group attempts to minimize its foreign currency risk by matching foreign currency positions on local balance sheets, and by managing the currency composition of its available capital. Because the Group holds a portfolio of risks from its businesses denominated in various currencies, the Group also holds its available capital in various currencies. The Group does not hedge emerging surpluses. The Group does not take speculative positions on foreign currency market movements. Foreign currency is a centrally managed risk type, with hedging coordinated at the Corporate Center.

The table below shows the Group's top three functional currencies, other than the US dollar, and the approximate effect on net assets and on shareholders' equity of an instantaneous adverse movement in currency exchange rates of 10%.

Table 6.8

Effect of a 10% adverse movement in the exchange rate on the net assets of the Group's top 3 functional currencies other than the US dollar

	Effect on net assets of a 10% movement	Effect on shareholders' equity of a 10% movement
Functional currency		
Euro	1.9%	1.6%
Swiss Francs	1.5%	1.5%
British Pounds	1.8%	1.8%

Net gains and losses on foreign currency transactions included in the consolidated operating statements for the years ended December 31, 2005 and 2004 are shown in note 2 t).

Derivative financial instruments

The Group uses derivative financial instruments to manage risks related to its capital, assets and liabilities and its commitments to third parties. The Group uses derivative financial instruments to mitigate the risks posed by changes in foreign currency rates and interest rates. The Group addresses the risks posed by derivatives through a stringent policy that requires approval of a derivative program before transactions are initiated, and by monitoring open positions. If the Group were required to settle outstanding derivative positions, the sum of gains and losses would not be material to the Group as of December 31, 2005.

Zurich Capital Markets ("ZCM") has portfolios of derivative products, including total return swaps, for the benefit of their customers and their investment books. ZCM's positions on derivative financial instruments are separately reported in note 9.

Effective interest rates

The table below shows the ranges for weighted average effective interest rates for selected balance sheet statement captions.

The ranges for the liabilities for investment contracts and future policyholder benefit reserves represent the weighted average of the minimum and maximum effective interest rate across the Group's life business.

Table 6.9

for the years ended December 31

Effective interest rates on selected assets and liabilities

	2005	2004
Debt securities	4.3%	4.3%
Liabilities for investment contracts	5.0% - 7.9%	2.6% - 7.9%
Future policyholders' benefits reserves	2.6% - 4.8%	2.7% - 4.8%
Debt related to capital markets and banking activities	3.8%	1.9%
Senior debt	4.0%	3.8%
Subordinated debt	5.8%	6.5%

7. Investments

A summary of net investment income and net capital gains and losses on investments and impairments is given below.

Investment result	Net investment income		Net capital gains/ (losses) on investments and impairments ¹		Investment result	
	2005	2004	2005	2004	2005	2004
Cash and cash equivalents	644	356	4	9	648	365
Equity securities	1,818	1,580	11,150	4,322	12,968	5,902
Debt securities	5,573	5,451	1,142	1,420	6,715	6,871
Real estate held for investment	809	840	645	471	1,454	1,311
Mortgage loans	480	536	23	138	503	674
Policyholders' collateral and other loans	629	539	82	50	711	589
Investments in associates	105	86	(1)	(36)	104	50
Other investments	339	374	337	168	676	542
Short-term investments	109	129	–	3	109	132
Investments held by investment companies	6	14	264	140	270	154
Other ²	224	231	73	25	297	256
Investment result, gross	10,397	9,762	13,382	6,542	23,779	16,304
Investment expenses ³	(632)	(709)	–	–	(632)	(709)
Investment result, net	9,765	9,053	13,382	6,542	23,147	15,595

¹ Impairments on total investments amounted to USD 64 million and USD 175 million for the years ended December 31, 2005 and 2004, respectively.

² Including net capital gains/(losses) on derivative financial instruments of USD 85 million and USD nil million for the years ended December 31, 2005 and 2004, respectively.

³ Including rental operating expenses for real estate held for investment of USD 146 million and USD 182 million for the years ended December 31, 2005 and 2004, respectively.

Details of the investment balances as of December 31, 2005 and 2004 are given in the following tables by measurement category.

Breakdown of total investments

Table 7.2
as of December 31

	Total investments			
	2005		2004	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	23,482	8.5%	22,457	8.0%
Equity securities (including trading equity portfolios in capital markets and banking activities):				
Fair value through profit or loss	78,692	28.4%	73,930	26.2%
<i>of which:</i>				
<i>Trading</i>	2,180	0.8%	2,843	1.0%
<i>Trading equity portfolios in capital markets and banking activities</i>	2,026	0.7%	2,773	1.0%
Available-for-sale	11,622	4.2%	12,158	4.3%
Total equity securities	90,314	32.6%	86,088	30.5%
Debt securities:				
Fair value through profit or loss	15,876	5.7%	17,641	6.3%
<i>of which:</i>				
<i>Trading</i>	663	0.2%	540	0.2%
Available-for-sale	104,144	37.6%	107,874	38.2%
Held-to-maturity	5,277	1.9%	5,855	2.1%
Total debt securities	125,297	45.2%	131,370	46.6%
Real estate held for investment	12,702	4.6%	12,541	4.4%
Mortgage loans	9,307	3.3%	10,251	3.6%
Policyholders' collateral and other loans	11,987	4.3%	14,905	5.3%
Investments in associates	580	0.2%	645	0.2%
Other investments:				
Short-term investments	1,600	0.6%	1,943	0.7%
Investments held by investment companies	1,928	0.7%	1,789	0.6%
Other	96	0.0%	166	0.1%
Total other investments	3,624	1.3%	3,898	1.4%
Total investments	277,293	100.0%	282,155	100.0%

As of December 31, 2005 and 2004 investments included USD 12,486 million and USD 15,687 million, respectively, of loaned securities. Cash and cash equivalents contained USD 4,571 million and USD 5,197 million of cash received as collateral for loaned securities as of December 31, 2005 and 2004, respectively. Non-cash collateral received for loaned securities was USD 8,262 million and USD 12,543 million as of December 31, 2005 and 2004, respectively.

As of December 31, 2005 and 2004, respectively, debt securities with a carrying value of USD 5,295 million and USD 5,009 million have been sold to financial institutions under short-term sale and repurchase agreements. These securities continue to be recognized as investments in the balance sheets and an obligation to repurchase them is included in liabilities in the balance sheets at that date.

Cash and investments with a carrying value of USD 4,786 million and USD 7,781 million were deposited with regulatory authorities as of December 31, 2005 and 2004, respectively.

Unrealized gains on available-for-sale instruments are included in shareholders' equity as disclosed further below.

Table 7.3

in USD millions, as of December 31

Debt securities maturity schedule

	Amortized cost Held-to-maturity		Estimated fair value Available-for-sale		Fair value through profit or loss	
	2005	2004	2005	2004	2005	2004
Less than one year	215	181	6,199	9,498	1,671	3,517
One year through five years	1,456	1,195	32,787	32,759	3,046	2,528
Six years through ten years	313	948	23,449	30,601	3,597	2,540
Over ten years	3,293	3,531	19,940	20,791	5,577	8,153
Subtotal	5,277	5,855	82,375	93,649	13,891	16,738
Mortgage and asset-backed securities	–	–	21,769	14,225	1,985	903
Total	5,277	5,855	104,144	107,874	15,876	17,641

The amortized cost and estimated fair values of debt securities held-to-maturity, available-for-sale and fair value through profit or loss are shown by contractual maturity. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or pre-pay certain obligations with or without call or pre-payment penalties.

Table 7.4

in USD millions,
as of December 31**Available-for-sale (a-f-s) securities**

	Cost or amortized cost		Gross unrealized gains		Gross unrealized losses		Estimated fair value	
	2005	2004	2005	2004	2005	2004	2005	2004
Equity securities, a-f-s								
Common stock	6,432	7,743	1,407	1,135	(300)	(705)	7,539	8,173
Unit trusts	3,710	3,868	214	116	(67)	(267)	3,857	3,717
Non-redeemable preferred stock	182	237	45	47	(1)	(16)	226	268
Total equity securities, a-f-s	10,324	11,848	1,666	1,298	(368)	(988)	11,622	12,158
Debt securities, a-f-s								
Swiss federal and can- tional governments	6,849	8,898	314	455	(3)	(12)	7,160	9,341
United Kingdom government	6,600	9,287	146	456	5	(29)	6,751	9,714
United States government	7,559	8,694	112	196	(114)	(189)	7,557	8,701
Other governments and supra-nationals	24,114	27,787	968	992	(56)	(55)	25,026	28,724
Corporate securities	34,666	35,608	1,537	1,621	(333)	(72)	35,870	37,157
Mortgage and asset-backed securities	21,872	13,954	139	333	(242)	(62)	21,769	14,225
Redeemable preferred stocks	10	11	1	1	–	–	11	12
Total debt securities, a-f-s	101,670	104,239	3,217	4,054	(743)	(419)	104,144	107,874

Fair value through profit or loss securities	Total investments			
	2005		2004	
	USD millions	% of total	USD millions	% of total
Common stock	58,640	62.0%	55,826	61.0%
Unit trusts	20,052	21.2%	18,104	19.8%
<i>thereof: Trading equity portfolios in capital markets and banking activities</i>	2,026	2.1%	2,773	3.0%
<i>thereof: Common stock portfolios backing participating with-profit policyholder contracts</i>	1,691	1.8%	2,049	2.2%
Debt securities	15,876	16.8%	17,641	19.2%
Total	94,568	100.0%	91,571	100.0%

Realized capital gains/(losses) and impairments on available-for-sale debt and equity securities	Equity securities		Debt securities		Total	
	2005	2004	2005	2004	2005	2004
	Gross realized capital gains	757	635	963	765	1,720
Gross realized capital losses	(286)	(753)	(205)	(173)	(491)	(926)
Impairments	(51)	(123)	(7)	(25)	(58)	(148)
Total	420	(241)	751	567	1,171	326

Net capital gains/(losses) on trading debt and equity securities	Equity securities		Debt securities		Total	
	2005	2004	2005	2004	2005	2004
	Total	77	(80)	(2)	19	75

Net capital gains/(losses) on fair value through profit or loss debt and equity securities	Equity securities		Debt securities		Total	
	2005	2004	2005	2004	2005	2004
	Total	10,653	4,643	393	834	11,046

Real estate held for investment	Table 7.9 in USD millions		Total investments	
			2005	2004
	Carrying value as of January 1 (opening balance)		12,541	11,101
Additions and capital improvements		1,537	1,115	
Disposals		(508)	(636)	
Market value revaluation		521	436	
Transfer from/(to) assets held for own use		3	(27)	
Foreign currency translation effects		(1,392)	552	
Carrying value as of December 31 (closing balance)		12,702	12,541	

Real estate held for investment consists of investments in commercial, residential and mixed-use properties primarily located in Switzerland, Germany and the United Kingdom.

Investments in associates	Table 7.10 in USD millions, for the years ended December 31					
	Carrying value		Share in profit/(loss)		Ownership interest	
	2005	2004	2005	2004	2005	2004
Capital Z Financial Services Fund II, United States	401	379	100	66	29.43%	29.43%
Other	179	266	5	20	nm	nm
Total	580	645	105	86	nm	nm

Unrealized gains/losses on investments included in shareholders' equity	Table 7.11 in USD millions, as of December 31		Total	
			2005	2004
	Equity securities: available-for-sale		1,298	310
Debt securities: available-for-sale		2,474	3,635	
Other		73	200	
Less amount of net unrealized (gains)/losses on investments attributable to:				
Life policyholder dividends and other policyholder liabilities		(2,131)	(2,261)	
Life deferred acquisition costs		(159)	(176)	
Deferred income taxes		(384)	(539)	
Minority interests		(32)	(25)	
Total		1,139	1,144	

8. Fair value of financial instruments and other investments

The methods and assumptions used by the Group in estimating fair value of the financial instruments and other investments are discussed below.

Cash and cash equivalents: carrying amounts approximate fair values.

Debt and equity securities: fair values are based on quoted market prices when available. If quoted market prices are not available, then fair values are estimated on the basis of pricing models, discounted cash flow or other recognized valuation techniques.

Real estate held for investment: fair value is determined on a regular basis with reference to current market conditions.

Policyholders' collateral and other loans: fair values are estimated on the basis of discounted cash flow, pricing models, or other recognized valuation techniques.

Mortgage loans: fair values of loans backed by real estate are estimated using discounted cash flow calculations based on the Group's current incremental lending rates for similar types of loans.

Investments in associates: these investments are accounted for using the equity method. Accordingly, these participations are effectively carried at the Group's proportional interest of shareholders' equity of the associate. The fair value of these entities, particularly for publicly traded entities, may differ from the carrying value.

Investments held by investment companies: estimated fair values are determined by the investment managers.

Short-term investments: carrying amounts approximate fair values.

Derivative trading assets and liabilities: fair values are based on quoted market prices, dealer price quotations, discounted cash flow models and option pricing models.

Debt: fair values are estimated using discounted cash flow calculations based upon the Group's current incremental borrowing rates for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

Obligations to repurchase securities: carrying amounts approximate fair value.

Table 8.1
in USD millions, as of December 31

**Fair value and
carrying value
of financial
instruments**

	Total fair value		Total carrying value	
	2005	2004	2005	2004
Cash and cash equivalents	23,482	22,457	23,482	22,457
Equity securities (including trading equity portfolios in capital markets and banking activities)	90,314	86,088	90,314	86,088
Debt securities	125,591	131,577	125,297	131,370
Real estate held for investment	12,702	12,541	12,702	12,541
Mortgage loans	9,314	10,179	9,307	10,251
Policyholders' collateral and other loans	13,011	15,444	11,987	14,905
Investments in associates	580	647	580	645
Other Investments, of which:	3,624	3,898	3,624	3,898
<i>Short-term investments</i>	1,600	1,943	1,600	1,943
<i>Investments held by investment companies</i>	1,928	1,789	1,928	1,789
<i>Other</i>	96	166	96	166
Derivative assets	523	1,426	523	1,426
Total of financial instruments (assets)	279,141	284,257	277,816	283,581
Liabilities for investment contracts	(41,001)	(39,238)	(40,999)	(39,260)
Obligation to repurchase securities	(5,295)	(5,009)	(5,295)	(5,009)
Derivative liabilities	(589)	(1,314)	(589)	(1,314)
Total debt	(9,945)	(10,103)	(9,679)	(9,751)
Total of financial instruments (liabilities)	(56,830)	(55,664)	(56,562)	(55,334)

9. Derivative financial instruments

The Group uses derivative financial instruments for economic hedging purposes. In limited circumstances these instruments may also meet the definition of an effective hedge for accounting purposes. Where this is the case, hedge accounting is applied. Derivatives that do not meet the definition of an effective hedge for accounting purposes are classified as derivative financial instruments held at fair value through profit or loss. For further details of the Group's derivative financial instruments refer to table 9.1 and 9.2.

a) Outstanding positions of the Group (excluding "ZCM")

Maturity profile of notional principal amounts and market values of derivative financial instruments (excluding ZCM)	Table 9.1		in USD millions, as of December 31		Notional principal amounts		Market values	
	Remaining life			2005	2004	2005	2004	
	Up to 1 year	1 to 5 years	over 5 years					
Swaps								
Interest rate swaps	184	225	459	868	293	20	(30)	
Currency swaps	–	350	1,258	1,608	3,683	92	306	
Total return equity swaps	–	1,039	118	1,157	5,188	19	(249)	
Other swaps	–	–	–	–	178	(35)	(1)	
Options								
Purchased call options	121	1,175	1,434	2,730	2,286	191	23	
Purchased put options	443	134	456	1,033	1,187	60	32	
Written call options	20	1,189	195	1,404	1,095	(308)	(184)	
Written put options	1	–	(12)	(11)	–	(11)	(4)	
Futures/forwards								
Purchased futures/forwards	7,088	–	–	7,088	6,375	(24)	94	
Written futures/forwards	3,053	–	–	3,053	43	(20)	(9)	
Total	10,910	4,112	3,908	18,930	20,328	(16)	(22)	
<i>of which:</i>								
<i>Derivative trading assets</i>						413	562	
<i>Derivative trading liabilities</i>						(429)	(584)	
Fair value hedge liabilities ¹						(15)	–	

¹ This hedging instrument mitigates the Group's foreign currency risk exposure to the 4.5% EUR 500 million bond under the EMTN programme. For further details refer to note 22.

b) Outstanding positions of Zurich Capital Markets ("ZCM")

Maturity profile of notional principal amounts and market values of derivative financial instruments (ZCM)	Table 9.2		in USD millions, as of December 31		Remaining life		Notional principal amounts		Market values	
	Up to 1 year	1 to 5 years	over 5 years	2005	2004	2005	2004			
Swaps										
Interest rate swaps	219	66	494	779	10,688	33	94			
Currency swaps	–	–	17	17	547	3	(6)			
Total return equity swaps	–	–	37	37	88	(13)	(26)			
Other swaps	–	–	–	–	–	–	–			
Options										
Purchased call options	–	–	–	–	272	–	272			
Purchased put options	201	152	570	923	1,441	16	(28)			
Written call options	–	210	–	210	259	(62)	(205)			
Written put options	297	152	1,756	2,205	2,222	(13)	21			
Futures/forwards										
Purchased futures/forwards	17	–	–	17	420	1	36			
Sold futures/forwards	26	–	–	26	443	–	(24)			
Total	760	580	2,874	4,214	16,380	(35)	134			
<i>of which:</i>										
<i>Derivative trading assets</i>						110	864			
<i>Derivative trading liabilities</i>						(145)	(730)			

10. Insurance benefits, losses and expenses

Insurance benefits, losses and expenses	Table 10.1		in USD millions, for the years ended December 31		Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004	2005	2004		
Losses and loss adjustment expenses	28,124	28,428	(5,518)	(4,935)	22,606	23,493				
Life insurance death and other benefits	10,811	13,139	(275)	(268)	10,536	12,871				
Decrease in future life policyholders' benefits	(674)	(1,890)	(49)	(362)	(723)	(2,252)				
Total insurance benefits and losses	38,261	39,677	(5,842)	(5,565)	32,419	34,112				

Policyholder dividends and participation in profits	Table 10.2		in USD millions, for the years ended December 31		Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004	2005	2004		
Total policyholder dividends and participation in profits	14,432	8,751	–	1	14,432	8,752				

Underwriting and policy acquisition costs

Table 10.3

in USD millions, for the years ended December 31

	Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004
Underwriting and policy acquisition costs	7,962	8,621	(709)	(1,231)	7,253	7,390

11. Reserves for insurance contracts

Reserves for insurance contracts

Table 11.1

in USD millions, as of December 31

	2005	2004
Gross		
Reserves for losses and loss adjustment expenses	60,425	57,765
Reserves for unearned premiums	13,531	14,231
Future life policyholders' benefits	71,292	81,350
Policyholders' contract deposits and other funds	18,985	22,763
Reserves for unit-linked contracts	55,691	51,920
Total reserves for insurance contracts, gross	219,924	228,029
Ceded		
Reserves for losses and loss adjustment expenses	(14,231)	(14,278)
Reserves for unearned premiums	(1,675)	(2,097)
Future life policyholders' benefits	(1,305)	(1,418)
Policyholders' contract deposits and other funds	(3,504)	(3,594)
Reserves for unit-linked contracts	-	-
Total ceded reserves for insurance contracts (reinsurers' share of reserves for insurance contracts, gross)	(20,715)	(21,387)
Net		
Reserves for losses and loss adjustment expenses	46,194	43,487
Reserves for unearned premiums	11,856	12,134
Future life policyholders' benefits	69,987	79,932
Policyholders' contract deposits and other funds	15,481	19,169
Reserves for unit-linked contracts	55,691	51,920
Total reserves for insurance contracts, net	199,209	206,642

Development of reserves for losses and loss adjustment expenses

Table 11.2

in USD millions

	Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004
As of January 1 (opening balance)	57,765	51,007	(14,278)	(14,036)	43,487	36,971
Losses and loss adjustment expenses incurred						
Current period	27,047	25,240	(4,582)	(3,711)	22,465	21,529
Prior years	1,077	3,188	(936)	(1,224)	141	1,964
Total	28,124	28,428	(5,518)	(4,935)	22,606	23,493
Losses and loss adjustment expenses paid						
Current period	(8,401)	(8,555)	665	968	(7,736)	(7,587)
Prior years	(13,979)	(13,461)	4,515	3,531	(9,464)	(9,930)
Total	(22,380)	(22,016)	5,180	4,499	(17,200)	(17,517)
Divestments of companies and businesses	(47)	(952)	10	209	(37)	(743)
Foreign currency translation effects	(3,037)	1,298	375	(15)	(2,662)	1,283
As of December 31 (closing balance)	60,425	57,765	(14,231)	(14,278)	46,194	43,487

The Group establishes loss reserves, which are estimates of future payments of reported and unreported claims for losses and related expenses, with respect to insured events that have occurred. Reserving is a complex process dealing with uncertainty, requiring the use of informed estimates and judgments. Any changes in estimates are reflected in the consolidated operating statement in the period in which estimates are changed.

Significant delays occur in the notification of claims and a substantial measure of experience and judgment is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty as of the balance sheet date. The reserves for losses and loss adjustment expenses are determined on the basis of information currently available; however, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent developments.

Deferred charges relating to retrospective reinsurance assumed totaled USD 129 million and USD 182 million as of December 31, 2005 and 2004, respectively, have been deducted from reserves for losses and loss adjustment expenses.

The table below presents changes in the historical general insurance reserves net of reinsurance, that the Group established in 2001 and subsequent years. The top line of the table shows the estimated reserves for unpaid losses and loss adjustment expenses as of each balance sheet date, which represents the estimated amount of future payments for losses occurring in that year and in prior years. The upper, or paid, portion of the table presents the cumulative amounts paid through each subsequent year in respect of the reserves established at each year end. The lower or reserve re-estimated, portion of the table shows the re-estimation of the initially recorded reserve as of each succeeding year end. Changes to estimates are made as more information becomes known about the actual losses for which the initial reserves were established. The cumulative deficiency is equal to the initial net reserves less the liability re-estimated as of December 31, 2005. Conditions and trends that have affected the development of our reserves for losses and loss adjustment expenses in the past may or may not necessarily occur in the future, and accordingly, conclusion about future results may not be derived from the information presented in the tables below.

The table below presents our consolidated loss and loss adjustment expense reserve development as of December 31 for the years indicated.

**Development of
insurance losses,
net**

Table 11.3

in USD millions, as of December 31

	2001	2002	2003	2004	2005
Gross reserves for losses and loss adjustment expenses	37,695	45,306	51,068	57,765	60,425
Reinsurance recoverable	(13,605)	(14,940)	(14,055)	(14,278)	(14,231)
Initial net reserves for losses and loss adjustment expenses	24,090	30,366	37,013	43,487	46,194
Cumulative paid as of:					
<i>One year later</i>	(7,976)	(8,923)	(9,930)	(9,464)	
<i>Two years later</i>	(12,855)	(14,471)	(15,550)		
<i>Three years later</i>	(16,698)	(18,001)			
<i>Four years later</i>	(19,255)				
Net reserves re-estimated as of:					
<i>One year later</i>	26,908	32,240	38,977	43,628	
<i>Two years later</i>	28,471	34,471	40,413		
<i>Three years later</i>	30,636	36,118			
<i>Four years later</i>	31,784				
Cumulative deficiency	(7,694)	(5,752)	(3,400)	(141)	
Cumulative deficiency as a percentage of initial net reserves	(31.9%)	(18.9%)	(9.2%)	(0.3%)	
Gross reserves re-estimated as of December 31, 2005	48,732	53,355	56,221	58,842	
Cumulative deficiency	(11,037)	(8,049)	(5,153)	(1,077)	
Cumulative deficiency as a percentage of initial gross reserves	(29.3%)	(17.8%)	(10.1%)	(1.9%)	

The cumulative deficiency of reserves shown in the table above reflects the progressive strengthening that the Group has made to its reserves as issues have been identified. This included reassessments of exposure to asbestos, the run off of operations at Centre and the refinement of the Group's reserving process commenced in 2004.

Reserves for losses and loss adjustment expenses for asbestos and environmental claims

Table 11.4

in USD millions

	2005		2004	
	Gross	Net	Gross	Net
Asbestos				
As of January 1 (opening balance)	2,964	2,524	2,930	2,420
Losses and loss adjustment expenses incurred	309	262	497	433
Losses and loss adjustment expenses paid	(144)	(86)	(136)	(125)
Divestments, commutations, settlements and other	–	–	(410)	(297)
Foreign currency translation effects	(172)	(171)	83	93
As of December 31 (closing balance)	2,957	2,529	2,964	2,524
Environmental				
As at January 1 (opening balance)	500	395	703	559
Losses and loss adjustment expenses incurred	6	8	(55)	(50)
Losses and loss adjustment expenses paid	(43)	(24)	(91)	(61)
Divestments, commutations, settlements and other	–	–	(52)	(50)
Foreign currency translation effects	(1)	(1)	(5)	(3)
As of December 31 (closing balance)	462	378	500	395

Management has considered environmental and latent injury claims and claims expenses in establishing the reserves for losses and loss adjustment expenses. The Group continues to be advised of claims asserting injuries from toxic waste, hazardous materials and other environmental pollutants and alleged damages to cover the clean-up costs of hazardous waste dump sites relating to policies written in prior years and indemnity claims asserting injuries from asbestos. Coverage and claim settlement issues, such as determination that coverage exists and the definition of an occurrence, may cause the actual loss development to exhibit more variation than in other lines of the Group's business. Such claims cannot be estimated with traditional reserving techniques and, accordingly, the uncertainty with respect to the ultimate cost of these types of claims has been greater than the uncertainty relating to standard lines of business.

The uncertainties arise out of changes or potential changes in various laws or the interpretation of laws. While the Group believes that it has made adequate provision for these claims, it is possible that future adverse development could have a material effect on the Group's results of operations, cash flows and financial position. The net reserve amounts related to the above claims were USD 2,907 million and USD 2,919 million as of December 31, 2005 and 2004, respectively.

Roll forward of future life policyholders' benefits

Table 11.5

in USD millions

	Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004
As of January 1 (opening balance)	81,350	78,232	(1,418)	(977)	79,932	77,255
Premiums and claims	(3,897)	(5,934)	(55)	(240)	(3,952)	(6,174)
Interest and bonuses credited to policyholders	2,758	3,319	(50)	(55)	2,708	3,264
Change in assumptions	466	564	119	(143)	585	421
Acquisitions/(divestments)	(166)	(1,394)	16	39	(150)	(1,355)
Increase/(decrease) charged to shareholders' equity	40	823	(10)	(7)	30	816
Foreign currency translation effects	(9,259)	5,740	93	(35)	(9,166)	5,705
As of December 31, 2005 (closing balance)	71,292	81,350	(1,305)	(1,418)	69,987	79,932

Table 11.6

in USD millions, as of December 31

Policyholders' contract deposits and other funds (gross of reinsurance)

	2005	2004
Annuities	1,997	1,949
Universal life and other investment contracts	10,628	11,420
Policyholder dividends	6,360	9,394
Total	18,985	22,763

Table 11.7

in USD millions

Roll forward of policyholders' contract deposits and other funds

	Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004
As of January 1 (opening balance)	22,763	20,625	(3,594)	(3,694)	19,169	16,931
Premiums and claims	(4,233)	(1,199)	224	249	(4,009)	(950)
Interest and bonuses credited to policyholders	1,353	2,086	(136)	(146)	1,217	1,940
Change in assumptions	(10)	69	6	–	(4)	69
Acquisitions/(divestments)	4	(376)	–	–	4	(376)
Increase/(decrease) charged to shareholders' equity	427	802	(5)	–	422	802
Foreign currency translation effects	(1,319)	756	1	(3)	(1,318)	753
As of December 31, 2005 (closing balance)	18,985	22,763	(3,504)	(3,594)	15,481	19,169

Table 11.8

in USD millions

Roll forward of reserves for unit-linked contracts

	Gross		Ceded		Net	
	2005	2004	2005	2004	2005	2004
As of January 1 (opening balance)	51,920	43,875	–	–	51,920	43,875
Premiums and claims	920	1,287	–	–	920	1,287
Interest and bonuses credited to policyholders	6,897	4,355	–	–	6,897	4,355
Acquisitions/(divestments)	43	(22)	–	–	43	(22)
Foreign currency translation effects	(4,089)	2,425	–	–	(4,089)	2,425
As of December 31, 2005 (closing balance)	55,691	51,920	–	–	55,691	51,920

Maturity schedule of reserves for insurance contracts

Table 11.9

in USD millions, as of December 31, 2005

		Reserves for losses and loss adjustment expenses, gross	Reserves for losses and loss adjustment expenses, ceded	Reserves for losses and loss adjustment expenses, net	Future life policyholders' benefits, gross	Future life policyholders' benefits, ceded	Future life policyholders' benefits, net
< 1	Year	18,161	(3,960)	14,201	5,846	(76)	5,770
1 to 5	Years	25,291	(5,958)	19,333	19,386	(150)	19,236
6 to 10	Years	8,715	(2,272)	6,443	14,200	(110)	14,090
11 to 20	Years	6,116	(1,522)	4,594	12,723	(128)	12,595
> 20	Years	2,142	(519)	1,623	19,137	(841)	18,296
Total		60,425	(14,231)	46,194	71,292	(1,305)	69,987

Long-duration contract liabilities included in future life policyholders' benefits result primarily from traditional participating and non-participating life insurance products. Short-duration contract liabilities are primarily accident and health insurance products. The liability for future life policyholder benefits has been established based upon the following:

- interest rates which vary by country, year of issuance and product;
- mortality rates based on published mortality tables adjusted for actual experience by geographic area and modified to allow for variations in policy form;
- surrender rates based upon actual experience by geographic area and modified to allow for variations in policy form.

The amount of policyholder dividends to be paid is determined annually by each Group life insurance company. Policyholder dividends include life policyholders' share of net income and unrealized appreciation of investments that are required to be allocated by the insurance contract or by local insurance regulations. Experience adjustments relating to future policyholders' benefits and policyholders' contract deposits vary according to the type of contract and the country. Investment, mortality and morbidity results may be passed through by experience credits or as an adjustment to the premium mechanism, subject to local regulatory provisions.

Future life policyholder benefits increased by USD 585 million after reinsurance (USD 421 million in 2004) due to the recognition of changes in assumptions. In particular, the 2005 net changes include the following significant movements:

- USD 177 million related to changes in interest rate assumptions;
- USD 205 million related to changes in morbidity assumptions, primarily related to termination rate experience on disability;
- USD 116 million related to a change in the United Kingdom pensions legislation regarding maximum limits, which has resulted in higher payouts and reserves for certain policyholders.

As of January 1, 2006, the policyholder's participation for the individual life business in Switzerland becomes subject to regulatory guidelines whereby the statutory policyholders' dividend fund has to be distributed to the policyholders at least in an amount of 20% of the account balance on the statutory accounts.

Guarantees arising from minimum death benefits ("GMDB"), retirement income benefits ("GRIB") and annuitization options ("GAO")

The Group sells products for which policyholders bear the full investment risk associated with the underlying invested funds selected by them. Certain of these products contain guarantees for which liabilities have been recorded for additional benefits and minimum guarantees, primarily in the subsidiary Kemper Investors Life Insurance Company which has written variable annuity contracts that provide annuitants with certain guarantees related to minimum death and income benefits. The determination of these liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates, annuitization elections and mortality experience. The assumptions used are consistent with those used in determining estimated gross profits for purposes of amortizing deferred policy acquisition costs.

Table 11.10		2005	2004
Information on guarantee liabilities arising from minimum death benefits ("GMDB"), retirement income benefits ("GRIB") as well as annuitization options ("GAO")	in USD millions (except average age)		
	Account balance for products with guarantee features as of December 31		
	Gross	4,165	4,074
	Ceded	(545)	(554)
	Net	3,620	3,520
	Amount at risk as of December 31		
	Gross	723	735
	Ceded	(280)	(284)
	Net	443	451
	Average attained age of policyholders (in years)	62	61

The Group's exposure after reinsurance recoveries under these policies at the balance sheet date as of December 31, 2005 would be USD 443 million (USD 451 million as of December 31, 2004). The Group believes that ultimately the realization of such liability is not likely.

12. Liabilities for investment contracts (with and without DPF)

Table 12.1		2005	2004
Liabilities related to investment contracts	in USD millions, as of December 31		
	Liabilities related to unit-linked investment contracts	34,871	32,245
	Liabilities related to investment contracts (amortized cost)	133	128
	Liabilities related to investment contracts with discretionary participation features	5,995	6,887
	Total	40,999	39,260

Unit-linked investment contracts issued by the Group are recorded at a value reflecting the returns of investment funds which include selected equities, debt securities and derivatives. Policyholders bear the full risk of the returns on these investments.

The fair value of financial liabilities at amortized cost is based on a discounted cash flow valuation technique and is shown in note 8. The discount rate is determined by current market assessment of the time value of money and risk specific to the liability.

The movements in the liabilities arising from investment contracts with DPF are summarized below:

Table 12.2		2005	2004
Roll forward of investment contract liabilities	in USD millions		
	As of January 1 (opening balance)	39,260	34,863
	Premiums and claims	(297)	(1,569)
	Interest and bonuses credited to policyholders	5,840	3,867
	Foreign currency translation effects	(3,804)	2,099
	As of December 31 (closing balance)	40,999	39,260

13. Equity component of discretionary participation features

Certain investment and insurance contracts sold by the Group contain benefit features for which the amount and timing of declaration and payment are at the discretion of the Group. The table below shows the change in the amount of undeclared funds surplus recorded in shareholders' equity after minimum mandated allocations to policyholder liabilities.

Table 13.1		2005	2004
Equity component of discretionary participation features (DPF)	in USD millions		
	As of January 1 (opening balance)	1,425	1,484
	Initial application of the "legal quote" in Switzerland as of June 30, 2004	–	(226)
	Change in net unrealized gains on investments	99	14
	Change in current year period profit	46	38
	Foreign currency translation effects	(171)	115
	As of December 31 (closing balance)	1,399	1,425

14. Farmers management fees

Table 14.1		2005	2004
Farmers management fees	in USD millions, for the years ended December 31		
	Farmers management fees and other related revenue	2,058	1,985

FGL is contractually permitted to receive a management fee of up to 20% (25% in the case of the Fire Insurance Exchange) of the gross premiums earned by the Farmers Exchanges, which the Group manages but does not own. In order to enable the Farmers Exchanges to maintain appropriate capital and surplus while offering competitive insurance rates, FGL has historically charged a lower management fee than the maximum allowed. The range of fees has varied by line of business over time and from year to year. During the past five years, aggregate management fees have averaged between 12% and 13% of gross premiums earned by the Farmers Exchanges. The gross earned premiums of the Farmers Exchanges were USD 14,380 million and USD 14,020 million for the years ended December 31, 2005 and 2004, respectively.

15. Deferred policy acquisition costs and origination costs

Deferred policy acquisition costs	Table 15.1		Life Insurance		Other segments ¹		Total	
	in USD millions							
	General Insurance		Life Insurance		Other segments ¹		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
As of January 1 (opening balance)	2,143	1,916	8,932	7,858	206	303	11,281	10,077
Acquisition costs deferred and transfers ²	2,357	2,132	1,249	1,481	12	80	3,618	3,693
Amortization ³	(1,696)	(1,978)	(878)	(884)	(121)	(177)	(2,695)	(3,039)
Divestments	(22)	(14)	(12)	(73)	–	(1)	(34)	(88)
Foreign currency translation effects	(141)	87	(850)	550	–	1	(991)	638
As of December 31 (closing balance)	2,641	2,143	8,441	8,932	97	206	11,179	11,281

¹ Net of eliminations of intersegment transactions.

² Change in accounting classification increased the acquisition costs deferred by USD 450 million as of December 31, 2005, and amortization by USD 194 million for the year ended December 31, 2005.

³ Amortization recorded directly to common shareholders' equity for Life Insurance was USD 29 million and USD 105 million for the years ended December 31, 2005 and 2004, respectively.

Deferred origination costs	Table 15.2		Total ¹	
	in USD millions		2005	2004
As of January 1 (opening balance)			736	646
Origination costs deferred			121	57
Amortization			(92)	(13)
Foreign currency translation effects			(75)	46
As of December 31 (closing balance)			690	736

¹ Deferred origination costs are fully attributable to the Life Insurance segment.

16. Receivables

Receivables	Table 16		2005	2004
	in USD millions, as of December 31			
Receivables from policyholders			2,591	3,021
Receivables from insurance companies, agents, brokers and intermediaries			4,936	5,173
Other receivables			2,405	3,245
Receivables arising from ceded reinsurance			1,846	1,864
Allowance for uncollectible amounts			(495)	(430)
Total			11,283	12,873

Receivables are generally settled within one year.

17. Mortgage loans given as collateral and collateralized loans

As part of the Deutscher Herold transaction in the year 2002, the Group acquired various mortgage loans. Deutscher Herold had previously sold these loans to credit institutions while retaining the related credit and interest risk. Therefore the loans have not been derecognized from the balance sheet and the transaction is reflected as a collateralized borrowing. Accordingly, the loans are recorded as "Mortgage loans given as collateral" and the liability to credit institutions as "Collateralized loans".

18. Income taxes

Table 18.1		2005	2004
Income tax expense – current/deferred split	in USD millions, for the years ended December 31		
	Current	1,324	1,219
	Deferred	812	(123)
	Total income tax expense	2,136	1,096

Table 18.2		2005	2004
Income tax expense – policyholders/ shareholders split	in USD millions, for the years ended December 31		
	Total income tax expense attributable to policyholders	772	318
	Total income tax expense attributable to shareholders	1,364	778
	Total income tax expense	2,136	1,096

The Group is required to record taxes on policyholder earnings for life insurance policyholders in certain jurisdictions. Accordingly, the income tax expense or benefit attributable to these life insurance policyholder earnings is included in income tax expense. In certain jurisdictions an accrual for future policy fees that will cover the tax charge is included in gross written premiums and policy fees revenue.

Table 18.3		Rate	2005	Rate	2004
Expected and actual income tax expense	in USD millions, for the years ended December 31				
	Net income before income taxes		5,466		3,668
	Less: income tax expense attributable to policyholders		(772)		(318)
	Net income before income taxes attributable to shareholders		4,694		3,350
	Expected income tax expense attributable to shareholders	32.3%	1,514	30.1%	1,008
	Increase/(reduction) in taxes resulting from:				
	<i>Lower taxed income</i>		(419)		(392)
	<i>Non-deductible expenses</i>		115		129
	<i>Effect of tax losses</i>		215		45
	<i>Prior year adjustments and other</i>		(61)		(12)
	Actual income tax expense attributable to shareholders	29.1%	1,364	23.2%	778
	Plus income tax expense attributable to policyholders		772		318
	Actual income tax expense		2,136		1,096

The preceding table illustrates the factors that cause the actual income tax expense to differ from the expected amount computed by applying the weighted average statutory income tax rate.

The expected weighted average statutory income tax rate for the Group is 32.3% and 30.1% for the years ended December 31, 2005 and 2004, respectively. These rates were derived by obtaining a weighted average of the applicable statutory income tax rate in relation to the net income before income tax attributable to shareholders generated in the taxable territories in which the Group operates.

Table 18.4		2005	2004
in USD millions, as of December 31			
Deferred income taxes	Deferred tax assets		
	Reserves for losses and loss adjustment expenses	840	632
	Reserves for unearned premiums	464	374
	Accruals not currently deductible	153	176
	Unrealized losses on investments	104	9
	Depreciable and amortizable assets	171	174
	Deferred front-end-fees	720	490
	Reserves for life policy benefits	254	208
	Loss carryforwards	1,360	1,647
	Other	950	991
	Deferred tax assets, gross	5,016	4,701
	Valuation allowance on deferred tax assets	(623)	(490)
	Deferred tax assets, net of valuation allowance	4,393	4,211
	Deferred tax liabilities		
	Reserves for losses and loss adjustment expenses	(623)	(716)
	Deferred policy acquisition costs	(2,169)	(2,352)
	Unrealized gains on investments	(488)	(548)
	Depreciable and amortizable assets	(1,563)	(1,251)
	Reserves for life policy benefits	(695)	(678)
	Other	(779)	(173)
	Deferred tax liabilities	(6,317)	(5,718)
	Net deferred tax liabilities	(1,924)	(1,507)

The 2005 and 2004 numbers are shown before the netting of timing differences that reverse in the same period of USD 1,993 million and USD 1,765 million, respectively.

The current income tax payable (net of income tax receivable) was USD 982 million and USD 971 million as of December 31, 2005 and 2004, respectively.

Deferred tax charge included in shareholders' equity amounted to USD 384 million and USD 539 million for the years ended December 31, 2005 and 2004, respectively.

As of December 31, 2005 and 2004, respectively, the Group had income tax loss carryforwards of USD 5,258 million and USD 4,835 million available (subject to various statutory restrictions) for use against future taxable income. However, deferred tax assets for loss carryforwards of USD 3,150 million and USD 3,300 million were recognized as of December 31, 2005 and December 31, 2004, respectively. The difference represents unrecognized income tax loss carryforwards. The majority of the income tax loss carryforwards expire in a period between five and fifteen years.

The Group's deferred tax assets and liabilities are recorded in the tax paying entities throughout the world, which may include several legal entities within each tax jurisdiction. Legal entities are grouped into a single taxpayer only when permitted by local legislation and when deemed appropriate.

The recoverability of the deferred tax asset for each taxpayer is based on its ability to utilize the deferred tax asset over a reasonable period of time. This analysis considers the projected taxable income to be generated by the taxpayer, as well as the ability to offset deferred tax assets with deferred tax liabilities.

As of December 31, 2005 and 2004, the following taxpayer groups carry a net deferred tax asset position on their balance sheets.

Table 18.5
in USD millions, as of December 31

Deferred tax assets by taxpayer group

	Deferred tax assets		Deferred tax assets, net of valuation allowance and other tax liabilities	
	2005	2004	2005	2004
Taxpayer groups				
Zurich Holding Company of America taxpayer group	1,381	1,441	1,252	1,250
Centre group of companies	557	552	122	138
Zurich Capital Markets companies	214	226	–	–
UK General Insurance companies	99	123	91	116
Other	88	105	81	94

The Zurich Holding Company of America taxpayer group of companies (excluding Farmers Group, Inc., Centre and Zurich Capital Markets Inc.) has reported tax losses in the past few years due to a number of catastrophes, as well as prior year development, creating a net operating loss carryforward of approximately USD 2,310 million, which is utilizable over a 15 year period. Management is undertaking a number of actions to efficiently utilize the net operating loss carryforwards. Based on the current taxable income projections for the North America taxpayer group of companies, management believes that the carrying values of the deferred tax assets as of December 31, 2005 are recoverable.

19. Fixed assets

Table 19.1

in USD millions

Fixed assets

	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other fixed assets	Total
Gross carrying value as of January 1, 2005 (opening balance)	457	1,688	478	747	644	4,014
Less: accumulated amortization/impairments	–	(583)	(362)	(618)	(335)	(1,898)
Net carrying value as of January 1, 2005 (opening balance)	457	1,105	116	129	309	2,116
Additions, capital improvements and transfers	37	82	10	124	74	327
Disposals and transfers	(89)	(152)	(10)	(12)	(51)	(314)
Depreciation	–	(45)	(15)	(62)	(71)	(193)
Foreign currency translation effects	(50)	(122)	(7)	(9)	(19)	(207)
Net carrying value as of December 31, 2005 (closing balance)	355	868	94	170	242	1,729
Plus: accumulated amortization/impairments	–	473	284	514	268	1,539
Gross carrying value as of December 31, 2005 (closing balance)	355	1,341	378	684	510	3,268

Table 19.2

in USD millions

Fixed assets

	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other fixed assets	Total
Gross carrying value as of January 1, 2004 (opening balance)	487	1,820	558	865	638	4,368
Less: accumulated amortization/impairments	–	(648)	(375)	(704)	(335)	(2,062)
Net carrying value as of January 1, 2004 (opening balance)	487	1,172	183	161	303	2,306
Additions, capital improvements and transfers	14	12	7	105	101	239
Disposals and transfers	(76)	(101)	(38)	(63)	(38)	(316)
Depreciation	–	(54)	(44)	(82)	(67)	(247)
Foreign currency translation effects	32	76	8	8	10	134
Net carrying value as of December 31, 2004 (closing balance)	457	1,105	116	129	309	2,116
Plus: accumulated amortization/impairments	–	583	362	618	335	1,898
Gross carrying value as of December 31, 2004 (closing balance)	457	1,688	478	747	644	4,014

The fire insurance value of the Group's own-use real estate, investment real estate and other fixed assets totaled USD 8,252 million and USD 10,160 million as of December 31, 2005 and 2004, respectively.

20. Goodwill and other intangible assets

Table 20.1
in USD millions

Intangible assets

	Goodwill	
	2005	2004
Gross carrying value as of January 1 (opening balance)	744	1,285
Less: accumulated amortization/impairments	–	(506)
Net carrying value as of January 1 (opening balance)	744	779
Additions and transfers	19	47
Divestments and transfers	(76)	(31)
Amortization	–	(92)
Impairments	–	–
Foreign currency translation effects	(82)	41
Net carrying value as of December 31 (closing balance)	605	744
Plus: accumulated amortization/impairments	–	598
Gross carrying value as of December 31 (closing balance)	605	1,342

¹ This intangible asset relates to insurance contracts only.

² Other intangibles include internally generated capitalised software development costs and other costs.

Goodwill is allocated to the Group's cash-generating units (CGUs) identified according to its business and geographical segment. The table below shows goodwill and other intangible assets by business segment.

Table 20.2
in USD millions, as of December 31

Intangible assets by segments

	Goodwill	
	2005	2004
General Insurance	152	164
Life Insurance	448	514
Farmers Management Services	–	–
Other Businesses	–	60
Corporate Functions	5	6
Net carrying value as of December 31	605	744

	Present value of profits of acquired insurance contracts ¹		Other intangible assets ²		Attorney-in-fact relationships		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
	2,307	2,275	1,790	1,675	1,024	1,709	5,865	6,944
	(1,447)	(1,376)	(1,197)	(973)	–	(642)	(2,644)	(3,497)
	860	899	593	702	1,024	1,067	3,221	3,447
	8	–	151	135	–	–	178	182
	–	–	(18)	(22)	–	–	(94)	(53)
	(48)	(71)	(206)	(224)	–	(43)	(254)	(430)
	–	–	–	–	–	–	–	–
	(80)	32	(29)	2	–	–	(191)	75
	740	860	491	593	1,024	1,024	2,860	3,221
	1,377	1,447	1,279	1,197	–	685	2,656	3,927
	2,117	2,307	1,770	1,790	1,024	1,709	5,516	7,148

	Present value of profits of acquired insurance contracts		Other intangible assets		Attorney-in-fact relationships		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
	–	–	243	285	–	–	395	449
	740	860	115	140	–	–	1,303	1,514
	–	–	113	148	1,024	1,024	1,137	1,172
	–	–	2	7	–	–	2	67
	–	–	18	13	–	–	23	19
	740	860	491	593	1,024	1,024	2,860	3,221

When testing for impairment, the recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using estimated growth rates. The growth rate does not exceed the long-term average past growth rate for the insurance business in which the CGU operates and discount rates range between 6.0% and 10.4%.

21. Derivative liabilities and other liabilities

Table 21			
in USD millions, as of December 31		2005	2004
Derivative liabilities and other liabilities	Amounts due to reinsurers, agents and other insurance companies	2,942	3,238
	Amounts due to life policyholders	547	701
	Other liabilities	8,320	8,011
	Liabilities for cash collateral received for securities lending	4,714	5,197
	Tax payables	1,184	1,833
	Derivative liabilities	589	1,314
	Deferred income and other liabilities	1,591	1,746
	Provision for defined post employment benefits	1,114	2,847
	Total	21,001	24,887

Refer to note 9 for details on derivative financial instruments. Refer to note 25 for further details of the provision for defined post employment benefits.

22. Debt

Table 22.1

in USD millions, as of December 31

Debt

		2005	2004
a) Debt related to capital markets and banking activities			
Zurich Capital Markets	Notes and loans payable, due in the following year	653	1,973
	Notes and loans payable, due 2007 - 2015	543	582
	Notes and loans payable, due after 2015	–	150
Zurich Financial Services			
EUB Holdings Limited	Notes and loans payable, due in the following year	779	919
	Notes and loans payable, due 2007 - 2015	96	144
	Notes and loans payable, due after 2015	3	–
Centre Solutions (Bermuda) Ltd.	Various debt instruments	65	112
Debt related to capital markets and banking activities		2,139	3,880
b) Senior debt			
Zurich Finance (USA), Inc.	2.75% CHF bond, due July 2006	381	438
	3.5% CHF bond, due July 2008	228	263
	4.5% EUR bond, due September 2014	1,173	1,342
Kemper Corporation	Various debt instruments, due in 2009	26	27
Zurich Insurance Company	3.875% CHF bond, due July 2011	763	880
	Various borrowings and notes	48	99
Other	Various short- and medium-term debt instruments	314	306
Senior debt		2,933	3,355
c) Subordinated debt			
Zurich Capital Trust I	8.376% USD Capital Securities, due June 2037 ¹	1,000	1,000
Zurich Finance (UK) p.l.c	6.625% GBP bond, undated notes	762	848
Zurich Finance (USA), Inc.	5.75% EUR bond, due October 2023	583	668
	4.5% EUR bond, due June 2025	586	–
ZFS Finance (USA) Trust I	6.15% USD ECAPS, due December 2065	592	–
ZFS Finance (USA) Trust II	6.45% USD ECAPS, due December 2065	689	–
ZFS Finance (USA) Trust III	Floating Rate USD ECAPS, due December 2065	395	–
Subordinated debt		4,607	2,516
Total senior and subordinated debt		7,540	5,871
Total debt		9,679	9,751

¹ Net of unamortized transaction costs: USD 990 million.

a) Debt related to capital markets and banking activities

During the year, a restructuring was effected to combine the Zurich Bank and Dunbar Bank into a single banking unit under Zurich Financial Services EUB Holdings Limited. To aid comparison, the 2004 figures presented for ZCM exclude debt related to Zurich Bank, which was transferred to the new banking unit. Similarly, Dunbar Bank's 2004 debt is included under the new banking unit.

ZCM's debt reduced by USD 1,509 million to USD 1,196 million as of December 31, 2005 from USD 2,705 million as of December 31, 2004. The reduction resulted from the redemption of capital in Zurich Bank of USD 400 million, a reduction in liquidity levels of USD 191 million, with the remainder of the reduction attributable to the ongoing wind-down of ZCM's business.

Debt relating to the new banking unit amounted to USD 878 million as of December 31, 2005, compared to USD 1,063 million as of December, 2004.

b) Senior debt

The Group's Euro Medium Term Note Programme (EMTN Programme), which allows for the potential issuance of senior and subordinated notes, was increased on March 10, 2005 from a maximum of USD 4 billion to a maximum of USD 6 billion. Issuing entities under the EMTN Programme include Zurich Finance (USA), Inc. and Zurich Finance (UK) p.l.c.

c) Subordinated debt

On June 15, 2005, Zurich Finance (USA), Inc. issued under the EMTN Programme a 4.5% EUR 500 million bond, guaranteed by Zurich Insurance Company on a subordinated basis, due 2025 and callable beginning in 2015. The proceeds were swapped into 6-month floating rate US dollars until the call date under fair-value hedge accounting treatment. The bond pays a fixed-rate coupon of 4.5% until June 15, 2015, and a variable rate of 3-month Euribor plus a spread of 2.2% thereafter.

On December 9, 2005 ZFS Finance (USA) Trust I and ZFS Finance (USA) Trust II respectively issued 6.15% USD 600 million of Series I and 6.45% USD 700 million of Series II Fixed / Adjustable Rate Enhanced Capital Advantaged Preferred Securities (ECAPS), and on December 22, 2005 ZFS Finance (USA) Trust III issued USD 400 million of Series III Floating Rate ECAPS. These trust preferred securities were sold to a number of qualified institutional buyers and qualified purchasers under the exemption of rule 144A of the United States Securities Act (1933). Each Trust benefits from a subordinated support agreement of Zurich Financial Services and Zurich Group Holding. Distributions are payable quarterly or semiannually in arrears but may at any time be deferred at the Group's option. Distributions will be mandatory deferred if the Group fails to meet certain financial tests. If distributions are not paid in full after a certain period of time and during any mandatory deferral period, the Group must use commercially reasonable efforts to issue and/or sell share capital to fund accumulated and unpaid distributions. The Group has the option to call the securities after five or ten years from the issuance depending on the series. Each of the three Trusts will dissolve no later than December 15, 2065.

Distributions to holders of ECAPS are based on the following:

Table 22.2

Series I	6.15% payable semiannually until December 15, 2010 and then reset quarterly to the Adjustable Rate* plus 1.75%
Series II	6.45% payable semiannually until June 15, 2016 and then reset quarterly to the Adjustable Rate* plus 2.00%
Series III	3-month LIBOR plus 1.15% reset quarterly until December 15, 2010 and then 3-month LIBOR plus 2.15%

* Adjustable Rate is equal to the greatest of (i) the 3-month LIBOR rate; (ii) the 10-year Treasury CMT (Constant Maturity Treasury) Rate; and (iii) the 30-year Treasury CMT Rate, subject to a maximum under (ii) and (iii) of 13.25% Series I and 13% for Series II.

Table 22.3		2005
Maturity schedule of outstanding debt	in USD millions, as of	
	2006	1,883
	2007	681
	2008	265
	2009	89
	2010	21
	after 2010	6,740
	Total	9,679

Table 22.4			
Interest expense on debt	in USD millions, for the years ended December 31	2005	2004
	Debt related to capital markets and banking activities	106	94
	Senior debt	142	109
	Subordinated debt	198	159
	Total	446	362

Credit facilities

The Group has access to a syndicated revolving credit facility of USD 3 billion which was put in place in April 2004. This credit facility consists of two equal tranches maturing in 2007 and 2009. Zurich Group Holding, together with Zurich Insurance Company and Farmers Group, Inc. are guarantors of the facility and can draw up to USD 1.25 billion, USD 1.5 billion and USD 250 million, respectively. No borrowings were outstanding under this facility as of December 31, 2005.

Dunbar Bank has access to various committed credit facilities totaling GBP 465 million. GBP 10 million of borrowings were outstanding under these facilities as of December 31, 2005.

23. Share capital

Table 23.1			
Share capital and treasury shares	number of shares, as of December 31	2005	2004
	Authorized, contingent and issued share capital, CHF 2.50 and CHF 6.50 par value, respectively	156,988,783	156,988,783
	Issued share capital, CHF 2.50 and CHF 6.50 par value, respectively	144,006,955	144,006,955
	Treasury shares	192,423	298,113

Table 23.2			
Preferred securities	in USD millions, as of December 31	2005	2004
	Preferred securities, USD 1,000 par value	1,125	1,125

a) Issued share capital

As of December 31, 2005 and 2004, Zurich Financial Services had 144,006,955 issued and fully paid registered shares of CHF 2.50 par value and CHF 6.50 par value, respectively.

At the Annual General Meeting on April 19, 2005, shareholders approved a share capital reduction in the form of a nominal value reduction of each registered share from CHF 6.50 to CHF 2.50. As a result of this reduction, the share capital was reduced by CHF 576,027,820 from CHF 936,045,207.50 to a new total of CHF 360,017,387.50. In the previous year, shareholders approved, at the Annual General Meeting on April 16, 2004, a share capital reduction in the form of a nominal value reduction of each registered share from CHF 9 to CHF 6.50. As a result of that reduction, the share capital was reduced by CHF 360,017,387.50 from CHF 1,296,062,595 to CHF 936,045,207.50.

b) Authorized share capital

Until June 1, 2007, the Board of Zurich Financial Services is authorized to increase the share capital by an amount not exceeding CHF 15,000,000 by issuing up to 6,000,000 fully paid registered shares with a nominal value of CHF 2.50 each. An increase in partial amounts is permitted. The Board determines the date of issue of such new shares, the issue price, type of payment, conditions for exercising pre-emptive rights, and the beginning of the dividend entitlement. The Board may issue such new shares by means of a firm underwriting by a banking institution or syndicate with subsequent offer of those shares to the current shareholders. The Board may allow the expiry of pre-emptive rights which have not been exercised, or it may place these rights as well as shares, the pre-emptive rights of which have not been exercised, at market conditions.

The Board is further authorized to restrict or withdraw the pre-emptive rights of shareholders and to allocate them to third-parties if the shares are to be used for the take-over of an enterprise, or parts of an enterprise or of participations or if issuing shares for the financing including re-financing of such transactions; or for the purpose of expanding the scope of shareholders in connection with the quotation of shares on foreign stock exchanges.

c) Contingent share capital

Capital market instruments and option rights to shareholders

The share capital of Zurich Financial Services may be increased by an amount not exceeding CHF 13,704,570 by the issuance of up to 5,481,828 fully paid registered shares with a nominal value of CHF 2.50 each (1) through the exercise of conversion and/or option rights which are granted in connection with the issuance of bonds or similar debt instruments by Zurich Financial Services or one of its Group companies in national or international capital markets; and/or (2) by the exercise of option rights which are granted to the shareholders. When issuing bonds or similar debt instruments connected with conversion and/or option rights, the pre-emptive rights of the shareholders will be excluded. The current owners of conversion and/or option rights shall be entitled to subscribe for the new shares. The conversion and/or option conditions are to be determined by the Board.

The Board of Directors is authorized, when issuing bonds or similar debt instruments connected with conversion and/or option rights, to restrict or withdraw the right of shareholders for advance subscription in cases where such bonds are issued for the financing or re-financing of a takeover of an enterprise, of parts of an enterprise, or of participations. If the right for advance subscription is withdrawn by the Board, the convertible bond or warrant issues are to be offered at market conditions (including standard dilution protection provisions in accordance with market practice) and the new shares are issued at then current convertible bond or warrant issue conditions. The conversion rights may be exercisable during a maximum of 10 years and option rights for a maximum of seven years from the time of the respective issue. The conversion or option price or its calculation methodology shall be determined in accordance with market conditions, whereby for shares of Zurich Financial Services the quoted share price is to be used as a basis.

Employee participation:

The share capital may be increased by an amount not exceeding CHF 3,750,000 by issuing up to 1,500,000 fully paid registered shares with a nominal value of CHF 2.50 each to employees of Zurich Financial Services and Group companies. The pre-emptive rights of the shareholders, as well as the right for advance subscription, are excluded. The issuance of shares or respective option rights to employees shall be subject to one or more regulations to be issued by the Board of Directors and shall take into account performance, functions, levels of responsibility and criteria of profitability. Shares or option rights may be issued to the employees at a price lower than that quoted on the stock exchange.

d) Preferred securities

In February 2001, the Group placed six series of Trust Capital Securities (Zurich RegCaPS) for the total amount of USD 1,125 million (USD 1,096 million net of issuance costs) with a limited number of qualified institutional and corporate US investors. The securities, which were issued under Rule 144A in the United States, are perpetual, non-cumulative and have a par value of USD 1,000 each. They have no voting rights, except for certain specified circumstances and are linked to Farmers Group, Inc. Class C shares. The Group has the option to call the securities after five, seven or ten years, depending on the series. Two series have a fixed rate coupon (6.01% and 6.58%) and four have a floating rate coupon (between Libor +46 bps and +71 bps). These coupon rates step up after the first call dates.

e) Additional paid in capital

This reserve is not ordinarily available for distribution.

f) Dividend restrictions and capital and solvency requirements

Zurich Financial Services is not subject to legal restrictions on the amount of dividends it may pay to its shareholders other than under the Swiss Code of Obligations. The Swiss Code of Obligations provides that dividends may only be paid out of freely distributable reserves or retained earnings and that 5% of annual retained earnings must be allocated to the general legal reserve until such reserve in the aggregate has reached 20% of the paid-in share capital. As of December 31, 2005, the amount of the general legal reserve exceeded 20% of the paid-in share capital of Zurich Financial Services. Similarly, the company laws of many countries in which Zurich Financial Services' subsidiaries operate may restrict the amount of dividends payable by such subsidiaries to their parent companies.

Other than by operation of the restrictions mentioned above, the ability of Zurich Financial Services' subsidiaries to pay dividends may be restricted or, while dividend payments per se may be legally permitted, may be indirectly influenced by minimum capital and solvency requirements imposed by insurance, bank and other regulators in the countries in which the subsidiaries operate as well as by other limitations existing in certain of these countries such as foreign exchange control restrictions.

In the United States, restrictions on payment of dividends may be imposed by the insurance laws or regulations of an insurer's state of domicile. For general insurance subsidiaries, dividends are generally limited over a twelve month period to 10% of the previous year's policyholders' surplus or previous year's net income. For life, accident and health insurance subsidiaries, dividends are generally limited over a twelve month period to 10% of the previous year's policyholders' surplus or the previous year's net gain from operations. Dividends paid in excess of statutory limitations require prior approval from the Insurance Commissioner of the insurer's state of domicile.

Insurance enterprises in European Union member countries are required to maintain minimum solvency margins. The required minimum solvency margin for general insurers is the greater of 16% of premiums written for the year or 23% of a three-year average of claims, subject to the first tranche (EUR 50 million) of premiums being at 18% and the first tranche (EUR 35 million) of claims at 26%. Life insurance companies are required to maintain a minimum solvency margin of generally 4% of insurance reserves (up to 1% of "insurance reserves for life insurance where the investment risk is carried by policyholders") plus 0.3% of the amount at risk under insurance policies. The same minimum capital requirements are applicable for insurance enterprises operating in Switzerland. In addition, in certain European countries further requirements may apply.

Several regulatory changes came into force in Switzerland on January 1, 2006. Amongst others the capital requirements were changed to include risk based target capital for insurance companies and insurance groups (Swiss Solvency Test). Risk-bearing and target capital have to be determined building on a risk based capital model by 2008 for groups, conglomerates, reinsurers and small companies. However, large legal entities must carry out the calculations starting already in 2006 as part of a compulsory field test. Within this time the companies may develop their own risk based capital model to be approved by the Federal Office of Private Insurance (FOPI) if they do not opt for the standard model. Groups, conglomerates and reinsurers will have to use company specific internal models. The same applies for companies for which the standard model is not applicable. Zurich will adopt and extend the existing internal risk-based capital model for the Group and Zurich Insurance Company in close consultation with the FOPI to make it compliant with new regulatory requirements which are expected to be further detailed by FOPI.

The new target capital must be built up until beginning of 2011.

Meanwhile Zurich Financial Services continues to be subject to certain solvency requirements based on a Decree on the Consolidated Supervision of the Group issued by FOPI on April 23, 2001. It is expected that this decree will be replaced by a new decree to be issued by FOPI in the first half of 2006.

As of December 31, 2005, the subsidiaries were substantially in compliance with applicable regulatory capital adequacy requirements.

g) Earnings per share

Table 23.3

Earnings per share	Net income attributable to common shareholders (in USD millions)	Number of shares	Per share (USD)	Per share (CHF) ¹
2005				
Basic earnings per share	3,168	143,758,294	22.04	27.41
Effect of potentially dilutive shares related to share-based compensation plans	–	1,597,527	(0.24)	(0.30)
Diluted earnings per share	3,168	145,355,821	21.80	27.11
2004				
Basic earnings per share	2,428	143,577,437	16.92	20.98
Effect of potentially dilutive shares related to share-based compensation plans	–	1,067,047	(0.13)	(0.15)
Diluted earnings per share	2,428	144,644,484	16.79	20.83

¹ The translation from USD into CHF has been done for information purposes only at the Group's average exchange rates for the years ended December 31, 2005 and 2004, respectively.

Basic earnings per share is computed by dividing net income attributable to shareholders by the weighted average number of shares outstanding for the period, excluding the weighted average number of shares held as treasury shares and preferred securities.

Diluted earnings per share reflects the effect of potentially dilutive shares.

24. Preferred securities and minority interests

Table 24.1

Preferred securities and minority interests	in USD millions, as of December 31	
	2005	2004
Preferred securities	355	407
Minority interests	459	433
Total	814	840

Minority interests include third-party equity interests, preferred securities and similar instruments issued by consolidated subsidiaries of the Group in connection with the provision of structured financial solutions to its customers.

In December 1999, Zurich Financial Services (Jersey) Limited, a subsidiary of Zurich Group Holding (formerly Zurich Financial Services), issued 12,000,000 perpetual non-voting, non-cumulative Series A Preference Shares on the Euromarket with a par value of EUR 25 (EUR 300,000,000). The securities benefit from a subordinated support agreement from Zurich Group Holding and carry a fixed coupon of 7.125%, payable quarterly. The securities are, subject to certain conditions, redeemable at the option of the issuer in whole, but not in part, from time to time on or after five years from the issue date. Proceeds from the issue were used to refinance existing intercompany debt and for general corporate purposes. With this issue, the Group was able to reinforce its capital base while raising equity-like but non-dilutive long-term funds.

25. Employee benefits

The Group had 52,010 and 53,246 employees (full time equivalents) as of December 31, 2005 and 2004, respectively. Personnel and other related costs incurred for the year ended December 31, 2005 and 2004 were USD 4,884 million and USD 4,462 million, respectively. This includes wages and salaries of USD 3,903 million and USD 3,759 million, respectively.

The Group operates a number of active retirement benefit arrangements for pensions. The majority of employees belong to defined benefit plans. Other employees participate in defined contribution plans, which provide benefits equal to amounts contributed by both the employer and the employee plus investment returns.

The Group also operates post-employment plans, mainly in the United States, which provide employees with certain defined post-employment benefits other than pensions.

The status of the defined benefit plans and other defined post-employment benefits is given below.

a) Defined benefit plans

Defined benefit pension plans

Employees of the Group's operating companies are covered under various pension plans. Certain companies run defined benefit plans, some of which provide benefits related to final pensionable earnings and others provide cash balance plans, where the participants receive the benefit of annual contributions made by both employer and employee and a credit for the investment return achieved on the assets. Eligibility for participation in the various plans is either based on completion of a specified period of continuous service or from the date of commencement of employment. Benefits are generally based on each employee's years of credited service and average compensation in the years preceding retirement. Annual funding requirements are determined based on actuarial cost methods.

Most of the Group's defined benefit plans are funded through contributions by the Group to trusts or foundations independent of the Group's finances. In these cases, the annual funding requirements are determined in accordance with local funding and actuarial cost methods. Where plans are not specifically funded, for example, as is usual in the case of pension plans in Germany, a liability for the accrued pension obligations is recognized in the Group's balance sheet.

Other defined post-employment benefits

Certain of the Group's operating companies provide a post-employment benefit program for medical care and life insurance. Eligibility in the various plans is generally based on completion of a specified period of eligible service and reaching a specified age. The programs pay a stated percentage of medical expenses reduced by deductibles and other coverage. The cost of post-employment benefits is accrued during the employees' service period. The method of accounting and the frequency of valuations are similar to those for defined benefit pension plans.

Table 25.1
as of December 31

Weighted average assumptions used

	Defined benefit pension plans		Other defined post-employment benefits	
	2005	2004	2005	2004
Discount rate	4.8%	5.1%	5.7%	5.7%
Expected long-term rate of return on assets	5.9%	6.1%	5.0%	5.0%
Future salary increases	3.6%	3.8%	4.0%	3.7%
Future pension increases	2.3%	2.3%	–	–
Increase in long-term health cost	–	–	9.0%	9.5%

Table 25.2

in USD millions, as of December 31

Status of funded defined benefit plans

	Defined benefit pension plans		Other defined post-employment benefits	
	2005	2004	2005	2004
Present value of obligations	(10,612)	(10,640)	(87)	(104)
Fair value of plan assets	8,597	6,586	13	17
Funded status	(2,015)	(4,054)	(74)	(87)
Unrecognized net actuarial losses/(gains)	1,892	2,272	(12)	20
Unrecognized prior service cost	2	–	–	–
Liability	(121)	(1,782)	(86)	(67)

The funded status shows the deficit of the balance of pension plan assets at fair values less the pension liability based on the present value of obligation. Pensions, however, are long-term by nature. Short-term variations between long-term actuarial assumptions and actual experience may be positive or negative, resulting in actuarial gains or losses. Such actuarial gains or losses are not recognized under IAS 19 as it is expected that such actuarial gains and losses will equalize over time. Only unrecognized actuarial gains or losses exceeding certain “corridors” as defined in IAS 19 are amortized through the operating statement (see table 25.4 below, “Net actuarial losses recognized in year”).

The funded status of the Group’s funded defined benefit plans moved to a deficit of USD 2,015 million as of December 31, 2005 from a deficit of USD 4,054 million as of December 31, 2004. The assets held by the pension plans for the Group’s employees in Switzerland did not qualify as plan assets under IFRS 4. Therefore the funded status as of December 31, 2004 was restated to reflect the adoption of IFRS 4. The result was an increase to the deficit of USD 1,865 million. However, as per December 31, 2005 the funded status recovered due to a cash payment made to the plan during 2005.

On June 16, 2005, the Boards of Trustees of the pension plans for the Group’s employees based in Switzerland adopted new pension plan arrangements that reflect the changed economic and demographic environment. The principal changes to the pension plans, which became effective January 1, 2006, were the conversion from a defined benefit to a defined contribution system and the separation of the pension plan as an autonomous foundation. Employees transferred to the new arrangements, and future benefits at normal retirement for current active participants are targeted to be similar to those under the former arrangements. However, following a transition period of three years, the current additional benefits that are provided on early retirement will gradually be phased out over a nine-year period. The calculation of the reduced long-term obligation under IAS 19 resulted in a one-time non-cash gain of USD 103 million.

Table 25.3

in USD millions, as of December 31

Status of unfunded defined benefit plans

	Defined benefit pension plans		Other defined post-employment benefits	
	2005	2004	2005	2004
Present value of obligations	(886)	(894)	(206)	(224)
Unrecognized net actuarial losses	126	55	59	66
Unrecognized prior service cost	–	–	–	(1)
Liability	(760)	(839)	(147)	(159)

The summary of the amounts recognized in the consolidated operating statements is given below.

Table 25.4
in USD millions, for the years ended December 31

Components of net pension expenses

	Defined benefit pension plans		Other defined post-employment benefits	
	2005	2004	2005	2004
Current service cost	(337)	(351)	(7)	(8)
Interest cost	(527)	(520)	(14)	(17)
Expected return on plan assets	409	402	1	1
Net actuarial losses recognized in year	(162)	(106)	(1)	(5)
Past service cost	(67)	(11)	–	–
Gains on curtailment or settlement	94	15	17	–
Net pension expense	(590)	(571)	(4)	(29)

The actual returns on defined benefit pension plan assets for the years ended December 31, 2005 and 2004 were USD 1,026 million and USD 611 million, respectively. The actual returns on other defined post-employment plan assets were USD 1 million and USD nil million for the years ended December 31, 2005 and 2004, respectively.

The summary of the balance sheet movements in relation to defined benefit plans and other defined post-employment benefits is given below.

Table 25.5
in USD millions

Summary of balance sheet movements

	Defined benefit pension plans		Other defined post-employment benefits	
	2005	2004	2005	2004
Liability as of January 1 (opening balance)	(2,621)	(2,345)	(226)	(197)
Current year expense	(590)	(571)	(4)	(29)
Contributions paid	1,979	303	10	6
Divestments	–	24	–	–
Foreign currency translation effects	351	(32)	(13)	(6)
Liability in the consolidated balance sheets as of December 31 (closing balance)	(881)	(2,621)	(233)	(226)

b) Defined contribution pension plans

Certain of the Group's operating companies sponsor defined contribution plans. Eligibility for participation in such plans is either based on completion of a specified period of continuous service or date of commencement of employment. The plans provide for voluntary contributions by employees and contributions by the employer which typically range from 3% to 15% of annual salaries, depending on the employees' years of service. The Group's contributions under these plans amounted to USD 11 million and USD 13 million in 2005 and 2004, respectively.

26. Share based compensation and cash incentive plans

The Group has adopted various share-based compensation and cash incentive plans to attract, retain and motivate executives and employees. The plans are designed to reward employees for their contribution to the performance of the Group and to encourage employee share ownership. Share-based compensation plans include plans under which shares and options to purchase shares, based on the performance of the businesses, are awarded. Share-based plans are based on the provision of Zurich Financial Services shares.

a) Cash incentive plans

Various businesses throughout the Group operate short-term incentive programs for executives, management and, in some cases, for employees of that business unit. Awards are made in cash, based on the accomplishment of both organizational and individual performance objectives. The expenses recognized for these cash incentive plans amounted to USD 296 million and USD 242 million for the years ended December 31, 2005 and 2004, respectively.

b) Share based compensation plans for employees

The Group encourages employees to own shares of Zurich Financial Services and has set up a framework based on the implementation of either share options and/or performance share programs. Actual plans are tailored to meet local market requirements.

Table 26.1

Expenses recognized in the operating statements	in USD millions, for the years ended December 31	
	2005	2004
Total option-based expenses	21	23
Total share-based expenses	55	45
Total expenses	76	68

The explanations below give a more detailed overview of the plans of the Group.

Share option plans for United Kingdom employees

UK Sharesave Plan

The plan is open to employees in the United Kingdom. Participants enter into a savings contract with a bank for the accumulation of contributions of between GBP 5 and GBP 250 per month for a period of three or five years. An interest bonus is credited at the end of the savings period. Participants are granted options to acquire Zurich Financial Services shares at a pre-determined price, which is not less than 80% of the market price prior to grant. Options under the plan can normally be exercised for a period of six months after the end of the savings period. Early exercise, limited to the value of shares that can be acquired with accrued savings, is permitted in certain circumstances. There were a total of 864 and 2,409 participants in this plan as of December 31, 2005 and 2004, respectively. There have been no new grants under this plan since 2002.

Employee share plans

Share Incentive Plan for employees in the UK

The Group established an Inland Revenue approved Share Incentive Plan and launched the partnership shares element of this plan in 2003. This plan enables participating employees to make monthly purchases of Zurich Financial Services shares at the prevailing market price out of their gross earnings. There were 422 and 500 participants in the partnership element of the plan as of December 31, 2005 and 2004 respectively. The Group also operates the profit-sharing element of the Share Incentive Plan (reward shares) which were launched in 2004 with annual share allocations being made in May each year subject to business performance. The awards are based on the performance of the participating employee's business unit for the year, subject to a maximum award of 5% of participant's base salary (before any flexible benefit adjustments) or GBP 3,000. The total number of participating employees in the reward share element of the plans as of December 31, 2005 and 2004 was 6,680 and 6,149, respectively.

Share Incentive Plans for employees in Switzerland

In 2005, the Employee Incentive Plan introduced for employees in Switzerland continued to operate. Employees under this plan have the option to acquire sales-restricted shares at a 30% discount to the market value, with the maximum value of the discount being CHF 1,500. During 2005, 6,002 employees participated in the Employee Incentive Plan compared with 6,115 in 2004. For the year ended December 31, 2005, 1,870 employees received shares under the 2004 employee performance share plan. For the year ended December 31, 2004, 4,613 employees received shares under the 2003 employee performance share plan.

c) Share based compensation plans for executives

The Group operates long-term incentive plans for selected executives. These plans comprise the allocation of a target number of share options grants and/or share grants with the vesting of these option/share grants being subject to the achievement of specific financial performance goals. The Group can also make Restricted Share grants to selected employees, which provide share awards if the individual remains employed with the Group on selected dates in the future.

Senior Executive long-term incentive plans

Each year, Senior Executives are granted performance options and performance shares, which vest on an annual basis over the subsequent three year period. The actual level of vesting, which can be between 0% and 150% of the original number of options and/or shares granted, depends on the performance of the Group during the previous calendar year. The current performance metrics are the Group's return on equity (ROE) and position of the Group's total shareholder return against an international peer group of insurance companies. One-half of the shares that actually vest are sales-restricted for a further period of three years. The options have a seven year term from the date of grant. Grants under the plan are made annually on April 3. The actual number of performance options and performance shares granted is determined such that the economic value is a defined percentage of annual salary in the year of allocation. During 2005 and 2004, a total of 185 and 186 participants were granted shares and options under this plan.

Executive long-term performance share plans

Each year, selected executives are granted performance shares which vest over a period of three years, either on an annual basis or at the end of the three year period. Specific performance parameters are established for each of the Business Divisions and include, for example, return on equity or business operating profit objectives. The actual number of performance shares granted at the beginning of the performance period is determined such that the economic value is a defined percentage of the annual salary in the year of allocation. Actual awards under these plans are made fully in shares of Zurich Financial Services, of which 50% are sales-restricted for a further period of three years. There were a total of 787 and 535 participants in this plan as of December 31, 2005 and 2004, respectively.

d) Further information on share and option plans

Table 26.2
for the years ended December 31

Movements in options granted under the various equity participation plans

	Number of shares under option		Weighted average exercise price (in CHF)	
	2005	2004	2005	2004
Outstanding as of January 1	1,875,016	1,795,120	297	340
Options granted	705,882	477,022	164	202
Options forfeited	(125,480)	(260,671)	313	397
Options exercised	(161,575)	(24,692)	106	121
Expired during period	(186,497)	(111,763)	561	405
Outstanding as of December 31	2,107,346	1,875,016	210	297
Exercisable as of December 31	1,023,419	693,892	210	407

Certain plan participants elected in 2002 to take their option award in the form of Share Appreciation Rights. Included in the number of shares under option in the table above are 70,902 and 77,234 shares as of December 31, 2005 and 2004, respectively, which will be settled through cash payments rather than through delivery of shares.

The average share price for Zurich Financial Services shares in 2005 and 2004 was CHF 221.19 and CHF 188.76, respectively.

Range of exercise prices of options outstanding as of December 31, 2005	Weighted average contractual life in years	Weighted average remaining expected life in years
100-400	7.1	5.3
401-700	7.0	2.0
701-1000	7.0	0.1

Options and shares granted during the period	Number		Weighted average fair value at grant date (in CHF)	
	2005	2004	2005	2004
Shares granted during the period	811,350	384,420	206	213
Options granted during the period ¹	705,882	477,022	44	67

¹ Number of options granted is shown as the number of shares under option granted during the period.

The shares and options granted during the period are the target allocations made under the performance option and performance share plans together with any restricted share awards granted during the year. Whether these grants become vested or not will depend on whether the performance achievements are met. The expense is adjusted for actual grants made.

The fair value of options granted are estimated using the Black-Scholes option pricing model, with the following assumptions.

Black-Scholes assumptions for fair value of options	2005	2004
Share price, in CHF ¹	206	213
Exercise price, in CHF	206	213
Implied volatility	23.15%	31.75%
Risk-free interest rate	2.22%	2.47%
Expected dividend rate	2.00%	1.50%
Contracted option life	7 years	7 years

¹ Share price as at date of granting, April 4, 2005 and April 2, 2004, respectively.

The risk-free interest rate was determined by using the seven year CHF swap rate applicable in 2005 and 2004. The fair value of any other share options granted during the year has been determined using the same methodology.

27. Related party transactions

In the normal course of business, the Group enters into various transactions with related companies, including various reinsurance and cost-sharing arrangements. These transactions are not considered material to the Group, either individually or in aggregate. Parties are considered to be related if one party has the ability to control or exercise significant influence over the other party in making financial or operational decisions. The table below sets forth related party transactions reflected in the consolidated operating statement and consolidated balance sheet.

Related party transactions included in the consolidated financial statements

Table 27.1

in USD millions

	2005	2004
Consolidated operating statements for the years ended December 31		
Net earned premiums and policy fees	13	7
Net investment income	147	105
Other income/(expense)	(4)	(9)
Losses and loss adjustment expenses	(6)	(11)
Consolidated balance sheets as of December 31		
Policyholders' collateral and other loans	21	23
Reinsurers' share of reserves for insurance contracts	3	1
Other receivables	8	2
Reserves for losses and loss adjustment expenses	(7)	(4)
Accrued liabilities	(11)	–

The table below summarizes related transactions with key personnel reflected in the consolidated financial statements. Key personnel includes directors of Zurich Financial Services, directors of Zurich Insurance Company and members of the Group Executive Committee.

Related party transactions – key personnel

Table 27.2

in USD millions, for the years ended December 31

	2005	2004
Compensation of key personnel of the Group		
Compensation, fees and current benefits	25	26
Post-employment benefits	4	4
Termination benefits	–	5
Share based compensation	9	8
Total compensation paid to key personnel	38	43

Outstanding loans and guarantees granted to members of the Group Executive Committee amounted to USD 4 and USD 3 million for the years ended December 31, 2005 and 2004, respectively. No outstanding loans or guarantees were granted to directors of Zurich Financial Services and Zurich Insurance Company for either of the years ended December 31, 2005 or 2004. The term "directors" and "members of the Group Executive Committee" in this context includes the individual as well as members of their respective households. Remuneration paid to the members of the Board of Directors of Zurich Financial Services and Zurich Insurance Company in 2005 and 2004 was USD 2.8 million and USD 2.7 million, respectively.

28. Farmers Exchanges

FGI provides certain non-claims related management services to the Farmers Exchanges. In addition, the Group has the following relationships with the Farmers Exchanges.

a) Certificates of contribution and surplus notes of the Farmers Exchanges

As of December 31, 2005 and 2004, FGI and other Group companies held the following surplus note and certificates of contribution issued by the Farmers Exchanges. Originally these were purchased by FGI in order to supplement the policyholders' surplus of the Farmers Exchanges.

Surplus Notes

Table 28.1

in USD millions, as of December 31

	2005	2004
6.15% surplus note, due December 2013	88	88
6.15% certificates of contribution, due December 2013	524	524
6.15% certificates of contribution, due August 2014	296	296
6.00% certificates of contribution, due September 2006	107	107
Various other certificates of contribution	23	23
Total	1,038	1,038

Conditions governing payment of interest and repayment of principal are outlined in the certificates of contribution and the surplus note. Generally, repayment of principal may be made only when the issuer has an appropriate amount of surplus, and then only after approval is granted by the issuer's governing Board and the appropriate state insurance regulatory department in the United States. In addition, payment of interest may generally be made only when the issuer has an appropriate amount of surplus and then only after approval is granted by the appropriate state insurance regulatory department in the United States.

b) Quota share reinsurance treaties with the Farmers Exchanges

The Farmers Exchanges cede risk through quota share reinsurance treaties to Farmers Reinsurance Company ("Farmers Re"), a wholly owned subsidiary of FGI, and Zurich Insurance Company ("ZIC").

Effective January 1, 2004, Farmers Re assumes annually USD 200 million and ZIC assumes USD 800 million of gross written premiums under an Auto Physical Damage ("APD") Quota Share reinsurance agreement with the Farmers Exchanges. In addition, Farmers Re and ZIC assume a quota share percentage of ultimate net losses sustained by the Farmers Exchanges in their APD lines of business. The agreement, which can be terminated after 30 days' notice by any of the parties, also provides for the Farmers Exchanges to receive a ceding commission of 18% of premiums, with additional experience commissions that depend on loss experience. This experience commission arrangement limits Farmers Re and ZIC's potential underwriting gain on the assumed business to 2.5% of premiums assumed.

Effective December 31, 2004, Farmers Re and ZIC entered into a 12% All Lines Quota Share reinsurance treaty under which they each assume a percentage of all lines of business written by the Farmers Exchanges, prospectively. Under this treaty, which amended the 10% All Lines Quota Share reinsurance treaty in effect since December 31, 2002, Farmers Re and ZIC assume a 2.4% and 9.6% respective quota share of the premiums written and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges after the APD reinsurance agreement has been applied. Underwriting results assumed are subject to a maximum combined ratio of 112.5% and a minimum combined ratio of 93.5%. In addition, under this treaty the Farmers Exchanges' catastrophe losses are subject to a maximum of USD 800 million. Farmers Re and ZIC assumed USD 19.2 million and USD 76.8 million respectively of maximum annual catastrophe losses. This reinsurance agreement, which can be terminated after 60 days' notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 22% of premiums for acquisition expenses, 8.8% of premiums for unallocated loss adjustment expenses and 5.3% of premiums for other expenses with additional experience commissions potentially payable depending on loss experience. For the year ended December 31, 2005, Group companies assumed USD 1,153 million of gross written premiums (USD 1,269 million in the prior year) from the Farmers Exchanges under the All Lines Quota Share reinsurance agreement.

29. Commitments and contingencies

The Group has provided guarantees or commitments to external parties, associates, partnerships and joint ventures. These arrangements include commitments under certain conditions to make liquidity advances to cover delinquent principal and interest payments, make capital contributions or provide equity financing.

Table 29.1

Quantifiable commitments and contingencies	in USD millions, as of December 31	
	2005	2004
Commitments under investment agreements	3,917	3,642
Less funded	(3,184)	(2,785)
Remaining commitments under investment agreements	733	857
Guarantees, surety bonds, letters of credit ¹	1,645	3,168
Future rent commitments	1,415	1,619
Undrawn loan commitments (capital markets and banking activities)	509	570
Other commitments and contingent liabilities	312	271

¹ Guarantee features embedded in life insurance products are not included. For such guarantee features refer to note 11 on insurance reserves.

Commitments under investment agreements

The Group has committed to contribute capital to subsidiaries, associates and third parties that engage in making investments in direct private equity, private equity funds, emerging market funds and hedge funds. Included in the remaining commitments is USD 331 million to Capital Z Investments II, L.P., USD 110 million to Capital Z Investments, L.P. and USD 71 million to Gresham. Part of these commitments may be called at any time and in any amount, based on various criteria. The remaining commitments also include a minimum allocation for hedge fund investments.

Guarantees, surety bonds, letters of credit

The Group knows of no event of default that would require it to satisfy guarantees. Irrevocable letters of credit and surety bonds were issued to secure certain reinsurance contracts.

Future rent commitments

The Group has entered into various operating leases as lessee for office space and certain computer and other equipment. Rent expenses for these items totaled USD 155 million and USD 190 million for the years ended December 31, 2005 and 2004, respectively.

Table 29.2

Future payments under non-cancelable operating leases with terms in excess of one year	in USD millions	
		Rental payments
2006		185
2007		175
2008		165
2009		146
2010		125
2011 and thereafter		619
Total		1,415

The Group leases its real estate held for investment to outside parties under operating leases.

Indemnity agreements

The Group, through certain of its subsidiaries, has agreed to arrangements that cap Converium's net exposure for losses arising out of the September 11, 2001 event at USD 289 million. Additionally, the Group has provided Converium with coverage for net losses in excess of USD 59 million, including non-performance of the retrocessionaire, related to Amerisafe/Unicover pool business. As of December 31, 2005, the Group has recorded provisions in respect of both arrangements of USD 128 million and USD 24 million, respectively.

Pledged assets

Total assets pledged including securities pledged in respect of securities repurchase agreements amounted to USD 5,679 million and USD 5,048 million as of December 31, 2005 and December 31, 2004, respectively. Assets pledged were financial assets.

Other contingent liabilities

The Group has received notices from various tax authorities asserting deficiencies in taxes for various years. The Group is of the view that the ultimate outcome of these reviews would not materially affect the Group's consolidated financial position.

In common with other groups with life assurance businesses in the United Kingdom, the Group remains exposed to a number of Conduct of Business issues, some of which are currently under review by the Financial Services Authority in the United Kingdom. While provisions are maintained which reflect management's best evolving estimate of the probable costs and expenses of resolving these matters, significant uncertainty regarding the ultimate cost remains. The main area of uncertainty concerns sales advice related complaints. The key assumptions used to derive the complaint provision are the volume of complaints, both those already recorded and an assumption as to the level of future complaints, the percentage of complaints which will be successful (the uphold rate), the average redress payable per complaint and the expenses of reviewing each case or complaint. The assumptions used to set the provision have been based on actual experience over the past three years weighted towards more recent experience.

In 2003, the Group completed the divestment of various asset management operations. As part of these agreements, the Group has guaranteed certain minimum levels of "assets under management" to the acquirers. The guarantees provide that if the "assets under management" fall below those defined levels under certain conditions, the Group may be required to compensate for these shortfalls. The compensation is limited to the considerations received and the Group does not believe any such compensation to be probable.

On December 11, 2001, the Group divested its third party reinsurance business operated under the "Zurich Re" brand name by offering the shares of the newly established Converium Holding AG to the public. As part of the formation of Converium Holding AG and the subsequent public offering of its shares, the Group entered into various contracts with Converium Holding AG and its subsidiaries, including certain Quota Share Retrocession Agreements. These Quota Share Retrocession Agreements, together with subsequent amendments, provide for the reinsurance premium to Converium to be retained by the Group on a "funds withheld" basis. Converium may call for payment in cash certain amounts of the funds withheld on pre-determined dates. If Converium calls for such payments on July 1, 2006, the maximum amount that would be payable by the Group is estimated to be in the range of approximately USD 200 million to USD 250 million.

Litigation and regulatory investigations

The Group and its subsidiaries are continuously involved in legal proceedings, claims and litigation arising, for the most part, in the ordinary course of their business operations. The Group and its subsidiaries are also involved in a number of industry-wide civil and criminal investigations by various State Insurance Departments and State Attorneys General in the United States, the United States Attorney's Office for the Southern District of New York, the United States Securities and Exchange Commission, other United States authorities and supervisory bodies and other non-United States authorities regarding certain business practices involving insurance brokers and insurance companies, the purchase and sale of "non-traditional" products, certain reinsurance transactions engaged in by the Group and its subsidiaries, and other matters, such as financing hedge funds engaged in mutual-fund market-timing activities. The Group has been conducting its own internal reviews with respect to some of these matters and is cooperating fully in these investigations.

Various Group subsidiaries are also defendants in corporate class action litigation, and they intend to defend such actions vigorously. Certain of these putative class actions consolidated before a US District Court were brought by private parties based on matters that have been the subject of the investigation regarding business practices involving insurance brokers and insurance carriers. By entering into a Memorandum of Understanding with the plaintiffs in this consolidated class action subject to various contingencies, Zurich Financial Services and certain of its United States subsidiaries have created a platform to negotiate a settlement with these plaintiffs that could be terminated or changed in material respects if efforts to negotiate satisfactory separate settlements with State Insurance Departments and State Attorneys General in the United States are unsuccessful. Zurich Financial Services is also a defendant in class action lawsuits brought on behalf of the holders of securities issued by Converium Holding AG.

The outcome of such current legal proceedings, claims, litigation and investigations could have a material effect on operating results and/or cash flows when resolved in a future period. At this time the Group is unable to predict the potential effects, if any, that the investigations and related actions may have upon the insurance and the reinsurance markets and industry business practices or what, if any, changes may be made to laws and regulations regarding the industry. Any of the foregoing could adversely affect the Group's business, results of operations and financial condition. Management is, however, not aware that these matters would materially affect the Group's consolidated financial position.

30. Segment information

Operating statements by business segment

in USD millions, for the years ended December 31

	General Insurance		Life Insurance		
	2005	2004	2005	2004	
Revenues					
Direct written premiums and policy fees	32,194	32,796	10,447	10,845	
Assumed written premiums	1,207	1,059	88	103	
Gross written premiums and policy fees	33,401	33,855	10,535	10,948	
Less premiums ceded to reinsurers	(5,456)	(6,677)	(721)	(690)	
Net written premiums and policy fees	27,945	27,178	9,814	10,258	
Net change in reserves for unearned premiums	(376)	(241)	1	(1)	
Net earned premiums and policy fees	27,569	26,937	9,815	10,257	
Farmers management fees	–	–	–	–	
Net investment income	2,738	2,320	6,481	6,343	
Net capital gains/(losses) on investments and impairments	327	86	11,518	5,070	
Net gain/(loss) on divestments of businesses	(17)	(16)	(7)	37	
Other income	439	516	922	870	
Total revenues	31,056	29,843	28,729	22,577	
Intersegment transactions	(1,006)	(576)	(160)	(95)	
Benefits, losses and expenses					
Losses and loss adjustment expenses, net of reinsurance	20,961	21,323	109	89	
Life insurance death and other benefits, net of reinsurance	100	123	9,781	11,995	
(Decrease)/increase in future life policyholders' benefits, net of reinsurance	7	9	(790)	(2,327)	
Insurance benefits and losses, net of reinsurance	21,068	21,455	9,100	9,757	
Policyholder dividends and participation in profits, net of reinsurance	4	9	13,655	7,643	
Underwriting and policy acquisition costs, net of reinsurance	4,506	4,100	1,561	1,508	
Administrative and other operating expenses	2,884	2,583	1,538	1,376	
Amortization and impairments of intangible assets	93	106	105	212	
Interest expense on debt	205	140	20	33	
Interest credited to policyholders and other interest	204	154	716	755	
Total benefits, losses and expenses	28,964	28,547	26,695	21,284	
Net income/(loss) before income taxes	2,092	1,296	2,034	1,293	
Income tax expense attributable to policyholders					
Income tax expense attributable to shareholders					
Net income attributable to minority interests					
Net income attributable to shareholders					

Supplementary segment information

Purchases of fixed and intangible assets	219	83	122	153	
Significant non-cash expenses:					
Depreciation and impairments of fixed assets	83	100	42	68	
Amortization and impairments of intangible assets	93	106	105	213	

Farmers Management Services		Other Businesses		Corporate Functions		Eliminations		Total	
2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
-	-	357	474	8	11	10	28	43,016	44,154
-	-	2,647	4,230	174	128	(335)	(438)	3,781	5,082
-	-	3,004	4,704	182	139	(325)	(410)	46,797	49,236
-	-	(358)	(486)	(167)	(127)	325	410	(6,377)	(7,570)
-	-	2,646	4,218	15	12	-	-	40,420	41,666
-	-	411	366	1	-	-	-	37	124
-	-	3,057	4,584	16	12	-	-	40,457	41,790
2,058	1,985	-	-	-	-	-	-	2,058	1,985
152	119	757	713	614	498	(977)	(940)	9,765	9,053
(1)	1	1,280	1,271	258	114	-	-	13,382	6,542
-	-	9	14	13	53	-	-	(2)	88
1	12	242	269	785	681	(863)	(592)	1,526	1,756
2,210	2,117	5,345	6,851	1,686	1,358	(1,840)	(1,532)	67,186	61,214
(23)	(32)	149	(493)	(800)	(336)	1,840	1,532	-	-
-	-	1,544	2,093	9	19	(17)	(31)	22,606	23,493
-	-	631	736	17	10	7	7	10,536	12,871
-	-	(10)	86	68	(23)	2	3	(723)	(2,252)
-	-	2,165	2,915	94	6	(8)	(21)	32,419	34,112
-	-	773	1,100	-	-	-	-	14,432	8,752
-	-	1,192	1,777	(6)	5	-	-	7,253	7,390
944	915	319	414	997	757	(822)	(551)	5,860	5,494
46	92	2	12	8	8	-	-	254	430
-	-	169	161	872	812	(820)	(784)	446	362
-	-	212	248	114	25	(190)	(176)	1,056	1,006
990	1,007	4,832	6,627	2,079	1,613	(1,840)	(1,532)	61,720	57,546
1,220	1,110	513	224	(393)	(255)	-	-	5,466	3,668
								(772)	(318)
								(1,364)	(778)
								(116)	(106)
								3,214	2,466
88	64	4	4	72	117	-	-	505	421
43	40	5	11	20	28	-	-	193	247
46	92	2	12	8	7	-	-	254	430

30. Segment information (continued)

Table 30.2

in USD millions, as of December 31

**Assets and liabilities
by business segment**

	General Insurance		Life Insurance		
	2005	2004	2005	2004	
Total investments	74,401	71,623	174,428	179,957	
Reinsurers' share of reserves for insurance contracts	13,974	14,753	1,561	1,609	
Deposits made under assumed reinsurance contracts	45	190	9	24	
Deferred policy acquisition costs	2,641	2,143	8,441	8,932	
Deferred origination costs	–	–	690	736	
Goodwill	152	164	448	514	
Other related intangible assets ¹	–	–	740	860	
Other assets	12,673	14,286	9,008	11,097	
Total assets after consolidation of investments in subsidiaries	103,886	103,159	195,325	203,729	
Liabilities for investment contracts	–	–	41,244	39,502	
<i>Reserves for losses and loss adjustment expenses, gross</i>	54,716	52,162	130	116	
<i>Reserves for unearned premiums, gross</i>	12,973	13,293	125	146	
<i>Future life policyholders' benefits, gross</i>	149	174	68,624	78,733	
<i>Policyholders' contract deposits and other funds, gross</i>	862	1,038	13,854	14,603	
<i>Reserves for unit-linked contracts, gross</i>	–	–	39,283	35,947	
Reserves for insurance contracts, gross	68,700	66,667	122,016	129,545	
Debt related to capital markets and banking activities	–	–	–	–	
Senior debt	6,176	8,680	637	679	
Subordinated debt	2,315	–	–	–	
Other liabilities	16,329	18,521	21,453	23,459	
Total liabilities	93,520	93,868	185,350	193,185	
Supplementary segment information					
Reserves for losses and loss adjustment expenses, net	42,196	39,344	110	95	
Reserves for unearned premiums, net	11,315	11,166	121	143	
Future life policyholders' benefits, net	149	174	67,200	77,169	
Policyholders' contract deposits and other funds, net	846	1,011	13,741	14,582	
Reserves for unit-linked contracts, net	–	–	39,283	35,947	
Reserves for insurance contracts, net	54,506	51,695	120,455	127,936	

¹ Other related intangible assets consists of the present value of profits of acquired insurance contracts and attorney-in-fact relationships.

Farmers Management Services		Other Businesses		Corporate Functions		Eliminations		Total	
2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
3,588	3,037	32,523	36,711	19,225	17,095	(26,872)	(26,268)	277,293	282,155
202	199	6,291	6,368	73	84	(1,607)	(1,845)	20,494	21,168
-	-	2,488	3,122	6	7	(98)	(61)	2,450	3,282
-	-	97	206	-	-	-	-	11,179	11,281
-	-	-	-	-	-	-	-	690	736
-	-	-	60	5	6	-	-	605	744
1,024	1,024	-	-	-	-	-	-	1,764	1,884
1,070	950	2,797	3,933	2,113	1,566	(2,524)	(2,195)	25,137	29,637
5,884	5,210	44,196	50,400	21,422	18,758	(31,101)	(30,369)	339,612	350,887
-	-	-	-	-	-	(245)	(242)	40,999	39,260
-	-	6,278	6,350	165	158	(864)	(1,021)	60,425	57,765
-	-	448	880	33	48	(48)	(136)	13,531	14,231
-	-	2,757	2,642	439	470	(677)	(669)	71,292	81,350
-	-	4,288	7,197	-	-	(19)	(75)	18,985	22,763
-	-	16,408	15,973	-	-	-	-	55,691	51,920
-	-	30,179	33,042	637	676	(1,608)	(1,901)	219,924	228,029
-	-	3,833	5,009	-	-	(1,694)	(1,129)	2,139	3,880
-	-	408	1,247	17,823	16,655	(22,111)	(23,906)	2,933	3,355
-	-	-	-	5,360	3,749	(3,068)	(1,233)	4,607	2,516
1,778	1,367	6,780	9,058	1,805	2,045	(2,375)	(1,958)	45,770	52,492
1,778	1,367	41,200	48,356	25,625	23,125	(31,101)	(30,369)	316,372	329,532
-	-	-	-	-	-	-	-	-	-
-	-	3,767	3,938	119	113	2	(3)	46,194	43,487
-	-	415	817	7	9	(2)	(1)	11,856	12,134
(202)	(199)	2,399	2,313	439	471	2	4	69,987	79,932
-	-	896	3,631	-	-	(2)	(55)	15,481	19,169
-	-	16,408	15,973	-	-	-	-	55,691	51,920
(202)	(199)	23,885	26,672	565	593	-	(55)	199,209	206,642

Table 30.3

in USD millions

Gross written premiums and policy fees, total revenues and total assets by geographical segment

	Gross written premiums and policy fees for the years ended December 31		Total revenues for the years ended December 31		Total assets as of December 31	
	2005	2004	2005	2004	2005	2004
North America	17,897	19,405	17,572	17,585	68,436	64,167
Europe	25,618	25,874	42,751	36,333	225,174	236,085
International Businesses	3,390	3,444	3,506	3,394	12,747	11,684
Centrally Managed Businesses	1,302	2,004	4,603	4,840	55,156	57,673
Eliminations	(1,410)	(1,491)	(1,246)	(938)	(21,901)	(18,722)
Total	46,797	49,236	67,186	61,214	339,612	350,887

Table 30.4

in USD millions, for the years ended December 31

Purchases of fixed and intangible assets by geographical segment

	Fixed assets		Intangible assets	
	2005	2004	2005	2004
North America	87	66	44	53
Europe	160	60	113	95
International Businesses	19	16	6	11
Centrally Managed Businesses	61	97	15	23
Total	327	239	178	182

31. Subsequent events

On February 10, 2006 the Group announced that it has exercised its option to redeem EUR 300 million of Series A Preference Shares issued by Zurich Financial Services (Jersey) Ltd. in December 1999 on the Euromarket. The 12,000,000 Preference Shares of EUR 25 par value each carry a coupon of 7.125% and are listed on the Luxembourg Stock Exchange. The Preference Shares will be repaid on March 16, 2006 together with the preference dividend accrued up to and including the redemption date.



Report of the Group Auditors

Report of the Group auditors

To the General Meeting of Zurich Financial Services, Zurich

As auditors of the Group, we have audited the consolidated financial statements (operating statement, balance sheet, statement of cash flows, statement of changes in equity and notes on pages 3 to 85) of Zurich Financial Services for the year ended December 31, 2005.

These consolidated financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards and with the International Standards on Auditing, which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG

R Marshall

M Humphreys

Zurich, February 15, 2006



Significant Subsidiaries

Significant subsidiaries		as of December 31, 2005				Book value of common stock (in local currency millions)	
	Domicile	Segment ¹	Voting rights %	Ownership interest %			
Australia							
Zurich Australia Limited	Sydney	Life Insurance	100.00	100.00	AUD	10.0	
Zurich Australian Insurance Limited	Sydney	General Insurance	100.00	100.00	AUD	97.1	
Austria							
Zürich Versicherungs-Aktiengesellschaft	Vienna	General Insurance	99.98	99.98	EUR	12.0	
Bermuda							
B G Investments Ltd.	Hamilton	Corporate Functions	100.00	100.00	USD	0.3	
Centre Group Holdings Limited	Hamilton	Other Businesses	100.00	100.00	USD	0.3	
CMSH Limited	Hamilton	Other Businesses	100.00	100.00	USD	0.3	
ZCM Holdings (Bermuda) Limited	Hamilton	Other Businesses	100.00	100.00	USD	158.9	
ZG Investments Ltd.	Hamilton	Corporate Functions	100.00	100.00	USD	0.01	
ZG Investments II Ltd.	Hamilton	Corporate Functions	100.00	100.00	USD	0.01	
ZG Investments III Ltd.	Hamilton	Corporate Functions	100.00	100.00	USD	0.01	
ZG Investments IV Ltd.	Hamilton	Corporate Functions	100.00	100.00	USD	0.01	
Zurich International (Bermuda) Ltd.	Hamilton	Other Businesses	100.00	100.00	USD	9.9	
Chile							
Chilena Consolidada Seguros de Vida S.A.	Santiago	Life Insurance	98.95	98.95	CLP	24,484.0	
France							
Zurich International (France) Cie d'Assurances S.A. ²	Levallois-Perret	General Insurance	99.99	99.99	EUR	20.2	
Germany							
BONNSECUR GmbH & Co. Liegenschaften Deutscher Herold KG	Bonn	Life Insurance	76.83	76.83	EUR	170.0	
DA Deutsche Allgemeine Versicherung Aktiengesellschaft	Oberursel	General Insurance	100.00	100.00	EUR	24.5	
Deutscher Herold Aktiengesellschaft	Bonn	Life Insurance	76.83	76.83	EUR	18.4	
Deutscher Herold Allgemeine Versicherung Aktiengesellschaft	Bonn	General Insurance	76.83	76.83	EUR	20.5	
Deutscher Herold Lebensversicherung Aktiengesellschaft	Bonn	Life Insurance	76.83	76.83	EUR	46.2	
Zürich Beteiligungs-Aktiengesellschaft (Deutschland)	Frankfurt / Main	General Insurance	100.00	100.00	EUR	152.9	
Zürich Lebensversicherung AG (Deutschland)	Frankfurt / Main	Life Insurance	100.00	100.00	EUR	13.4	
Zürich Versicherung Aktiengesellschaft (Deutschland)	Frankfurt / Main	General Insurance	100.00	100.00	EUR	106.5	


¹ The segments are defined in the notes to the Consolidated Financial Statements, note 1, Basis of presentation.

² Liquidated on January 5, 2006.

as of December 31, 2005					
Significant subsidiaries (continued)	Domicile	Segment	Voting rights %	Ownership interest %	Book value of common stock (in local currency millions)
Ireland					
Zurich Financial Services EUB Holdings Limited	Dublin	Other Businesses	100.00	100.00	GBP 0.001
Zurich Insurance Ireland Ltd.	Dublin	General Insurance	100.00	100.00	EUR 4.6
Eagle Star Life Assurance Company of Ireland Limited	Dublin	Life Insurance	100.00	100.00	EUR 17.5
Orange Stone Holdings	Dublin	Other Businesses	100.00	100.00	USD 1,609.3
Orange Stone Reinsurance	Dublin	Other Businesses	100.00	100.00	USD 1,524.8
Italy					
Zurich Investments Life S.p.A.	Milan	Life Insurance	100.00	100.00	EUR 34.0
Zurich Life Insurance Italia S.p.A.	Milan	Life Insurance	100.00	100.00	EUR 25.9
Portugal					
Zurich, Companhia de Seguros, S.A.	Lisbon	General Insurance	100.00	100.00	EUR 10.0
South Africa					
South African Eagle Insurance Company Limited ³	Bryanston	General Insurance	73.61	73.61	ZAR 3.0
Spain					
Zurich España, Compañía de Seguros y Reaseguros, S.A.	Barcelona	General Insurance	99.78	99.78	EUR 33.6
Zurich Vida, Compañía de Seguros y Reaseguros, S.A.	Madrid	Life Insurance	100.00	100.00	EUR 50.4
Switzerland					
Assuricum Company Limited	Zurich	Corporate Functions	100.00	100.00	CHF 610.0
Genevoise, Compagnie d'Assurances sur la Vie SA	Geneva	Life Insurance	100.00	100.00	CHF 17.0
Zurich Group Holding	Zurich	Corporate Functions	100.00	100.00	CHF 1,600.0
Zurich Insurance Company	Zurich	Corporate Functions	100.00	100.00	CHF 825.0
Zurich Life Insurance Company Limited	Zurich	Corporate Functions	100.00	100.00	CHF 60.0
Taiwan					
Zurich Insurance (Taiwan) Ltd.	Taipei	General Insurance	91.87	91.87	TWD 2,000.0
United Kingdom					
Allied Dunbar Assurance p.l.c.	Swindon, England	Life Insurance	100.00	100.00	GBP 0.05
Allied Zurich Holdings Limited	Jersey, Channel Islands	Corporate Functions	100.00	100.00	GBP 90.7
Allied Zurich Limited	Swindon, England	Corporate Functions	100.00	100.00	GBP 378.1
Eagle Star Holdings Limited	Swindon, England	Corporate Functions	100.00	100.00	GBP 553.7
Eagle Star Insurance Company Limited	Fareham, England	General Insurance	100.00	100.00	GBP 591.7
Openwork Holdings Limited	Swindon, England	Life Insurance	100.00	25.00	GBP 0.01

³ Listed on the Johannesburg Stock Exchange. On December 31, 2005, the company had a market capitalization of ZAR 2,253 million (ISIN Number 000006243).

Significant subsidiaries (continued)	as of 31 December 2005					Book value of common stock (in local currency millions)
	Domicile	Segment	Voting rights %	Ownership interest %		
ZPC (Construction) Company Limited	Fareham, England	General Insurance	100.00	100.00	GBP	54.0
Zurich Assurance Ltd.	Swindon, England	Life Insurance	100.00	100.00	GBP	879.9
Zurich Employment Services Limited	Fareham, England	Life Insurance	100.00	100.00	GBP	9.0
Zurich Financial Services (Jersey) Limited	Jersey, Channel Islands	Corporate Functions	100.00	100.00	GBP	0.01
Zurich Financial Services (UKISA) Limited	Swindon, England	Corporate Functions	100.00	100.00	GBP	1,492.1
Zurich Holdings (UK) Limited	Fareham, England	Corporate Functions	100.00	100.00	GBP	87.1
Zurich International (UK) Limited	Portsmouth, England	General Insurance	100.00	100.00	GBP	40.0
Zurich International Life Limited	Douglas, Isle of Man	Life Insurance	100.00	100.00	GBP	55.6
Zurich Invest (Jersey) Ltd.	Jersey, Channel Islands	General Insurance	100.00	100.00	GBP	0.1
Zurich Specialties London Limited	London, England	General Insurance	100.00	100.00	GBP	150.0
Zurich Whiteley Investment Trust Limited	Fareham, England	General Insurance	100.00	100.00	GBP	10.2
United States of America						
Centre Reinsurance Holdings (Delaware) Limited	Wilmington, DE	Other Businesses	100.00	100.00	USD	0.0196
Crown Management Services Limited	Wilmington, DE	Other Businesses	100.00	100.00	USD	0.00003
Farmers Group, Inc.	Reno, NV	Farmers Management Services	96.63	100.00	USD	0.001
Farmers New World Life Insurance Company	Mercer Island, WA	Life Insurance	100.00	100.00	USD	6.6
Farmers Reinsurance Company	Los Angeles, CA	Other Businesses	100.00	100.00	USD	5.0
Kemper Corporation	Schaumburg, IL	Corporate Functions	100.00	100.00	USD	220.0
Kemper Investors Life Insurance Company	Mercer Island, WA	Other Businesses	100.00	100.00	USD	2.5
Universal Underwriters Insurance Company	Overland Park, KA	General Insurance	100.00	100.00	USD	15.0
Universal Underwriters Life Insurance Company	Overland Park, KA	General Insurance	100.00	100.00	USD	2.5
Zurich American Insurance Company (and subsidiaries)	New York, NY	General Insurance	100.00	100.00	USD	5.0
Zurich Finance (USA), Inc.	Wilmington, DE	Corporate Functions	100.00	100.00	USD	0.000001
Zurich Holding Company of America, Inc.	Dover, DE	Corporate Functions	100.00	100.00	USD	0.6



Embedded Value Statistics

Consulting actuaries review

Deloitte & Touche LLP (“Deloitte”), our consulting actuaries, have reviewed the choice of methodology together with the assumptions and calculations made by Zurich Financial Services Group (“the Group”) in the calculation of the embedded value results of its Life Insurance business as of December 31, 2005. Deloitte have reported to the Group that they consider that the methodology is appropriate, the Group’s assumptions are together reasonable and that the embedded value results as published above have been properly compiled on the basis of the methodology and assumptions chosen. For the purpose of this report, Deloitte have performed certain checks on data provided by the Group, but have not verified and have relied on financial information underlying the Group’s financial statements.

Embedded value methodology

The embedded value represents the shareholders’ interest, excluding any value from future new business, in the entities included in the Life Insurance segment as set out in the Group financial statements. It is the total of the shareholders’ interests in the net assets of these life insurance entities and the present value of the projected future releases to shareholders arising from the business in-force, less a charge for the cost of capital supporting the solvency requirements of the business. The discount rate used to value the in-force business in each country reflects long term government bond rates at the valuation date plus a risk margin. The assumptions for mortality, persistency and expenses reflect recent and expected experience. All changes in assumptions not classified as “economic” are included in the “Operating assumption changes” line item. Gross new business annual premium equivalent (APE) is calculated as new annual premiums plus 10% of single premiums.

Embedded value profit is the change in the embedded value over the year, after adjustment for any dividends and capital movements. The profit is calculated on an after-tax basis.

Embedded value profit consists of the following components, the first two of which in aggregate are referred to as operating profit:

- new business profit, after tax, which represents the value added by new business written during the period, including allowance for the cost of holding solvency capital, and is valued at point of sale using the applicable discount rate;
- the operating profit from existing business, which is equal to:
 - the profit expected from in-force business and net assets, after tax, including allowance for the cost of holding solvency capital,
 - the experience variances caused by the differences between the actual experience during the period and the expected experience assumed in the prior year embedded value, and
 - the impact of changes in assumptions of future operating experience;
- the economic variance, which is equal to:
 - the investment variance caused by differences between the actual and the expected experience over the reporting period, and
 - the change in future economic assumptions, such as changes in discount rates and future investment rates including, where appropriate, the effect of changes in legislation.

The calculation of embedded values necessarily makes numerous assumptions with respect to economic conditions, operating conditions, taxes, and other matters, many of which are beyond the Group’s control. Although the assumptions used represent estimates which the Group and Deloitte believe are together reasonable, actual future experience may vary from that assumed in the calculation of the embedded value results, and such variation may be material. Deviations from assumed experience are normal and are to be expected. The embedded value results have been prepared using generally accepted actuarial methods that use deterministic projections which do not allow for all of the cost of options and guarantees on a market consistent basis.

Embedded Value Results – Life Insurance (unaudited)

in USD millions, for the years ended December 31

	USA	
	2005	2004
Gross new business premiums including deposits, of which:	192	252
<i>Annual premiums</i>	102	106
<i>Single premiums</i>	90	146
Gross new business annual premiums equivalent (APE)	111	120
Embedded value information:		
Opening embedded value	2,402	2,555
Operating profit expected from in-force business and net assets, after tax	151	176
New business profit, after tax	47	74
Operating variance, after tax	58	(1)
Operating assumptions changes	11	81
Total operating profit, after tax	267	330
Economic variance:		
Investment variance	5	4
Change in economic assumptions	(32)	(15)
Embedded value profit, after tax	240	319
Dividends and capital movements	(622)	(472)
Closing embedded value before currency translation effects	2,020	2,402
Currency translation effects	–	–
Closing embedded value after currency translation effects, of which:	2,020	2,402
<i>Shareholders' net assets</i>	612	1,012
<i>Value of business in-force</i>	1,408	1,390
Operating return, after tax and before currency translation effects	14.1%	15.0%
Return, after tax, on opening embedded value before currency translation effects	12.7%	14.5%
New business profit margin (as % of APE)	42.0%	61.0%
Embedded value economic assumptions:		
Discount rate	8.0%	8.0%
Investment returns before tax:		
Fixed interest	5.1%	5.4%
Equities	8.0%	8.0%
Property	–	–
Expense inflation	2.3%	2.3%
Attributed tax rate	35.0%	35.0%

The above information should be read in conjunction with the notes on the following pages.

	Europe								International Businesses		Total	
	United Kingdom		Germany		Switzerland		Rest of Europe		2005	2004	2005	2004
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	5,773	5,322	815	1,116	395	478	2,558	1,578	337	1,189	10,070	9,935
	489	399	493	757	73	74	168	132	115	98	1,440	1,566
	5,284	4,923	322	359	322	404	2,390	1,446	222	1,091	8,630	8,369
	1,017	891	525	794	105	114	407	277	138	207	2,303	2,403
	6,146	4,270	1,214	814	1,026	433	1,107	1,601	862	739	12,757	10,412
	459	426	93	65	77	33	78	67	84	75	942	842
	90	49	87	95	16	11	70	38	23	6	333	273
	(162)	(130)	(29)	(99)	64	(23)	43	22	24	(1)	(2)	(232)
	(12)	(113)	(3)	211	67	19	(2)	12	10	24	71	234
	375	232	148	272	224	40	189	139	141	104	1,344	1,117
	171	29	18	(3)	391	96	125	49	(3)	30	707	205
	(106)	16	(131)	7	(164)	152	(21)	1	10	(35)	(444)	126
	440	277	35	276	451	288	293	189	148	99	1,607	1,448
	(1,067)	1,175	25	38	12	223	349	(762)	(26)	–	(1,329)	202
	5,519	5,722	1,274	1,128	1,489	944	1,749	1,028	984	838	13,035	12,062
	(562)	424	(160)	86	(196)	82	(220)	79	(15)	24	(1,153)	695
	4,957	6,146	1,114	1,214	1,293	1,026	1,529	1,107	969	862	11,882	12,757
	2,349	3,823	742	672	845	390	836	380	626	596	6,010	6,873
	2,608	2,323	372	542	448	636	693	727	343	266	5,872	5,884
	6.2%	4.4%	10.9%	33.8%	21.9%	9.2%	17.1%	16.2%	15.8%	13.7%	10.9%	10.8%
	7.3%	5.2%	2.6%	34.3%	43.9%	66.4%	26.4%	22.1%	16.7%	13.1%	13.0%	14.0%
	8.9%	5.4%	16.6%	12.0%	15.7%	10.0%	17.1%	13.9%	17.0%	3.1%	14.5%	11.4%
	7.4%	7.6%	7.0%	7.3%	7.5%	7.5%	6.6%	7.1%	9.2%	9.4%	7.5%	7.7%
	4.6%	4.9%	3.3%	3.9%	2.9%	3.5%	3.3%	3.8%	5.9%	5.7%	3.8%	4.3%
	6.8%	7.0%	6.8%	7.3%	7.0%	7.0%	6.4%	6.7%	8.5%	8.9%	6.8%	7.1%
	6.5%	6.8%	4.3%	4.8%	4.5%	4.8%	5.1%	5.5%	8.5%	8.5%	4.7%	5.0%
	3.0%	3.0%	1.6%	1.6%	1.0%	1.0%	2.8%	2.8%	3.3%	3.1%	2.6%	2.4%
	26.7%	30.0%	39.9%	39.9%	22.0%	25.0%	22.3%	25.2%	28.9%	29.2%	28.5%	30.9%

Embedded Value Results – Rest of Europe by country (unaudited)

in USD millions, for the years ended December 31

	Italy	
	2005	2004
Gross new business premiums including deposits, of which:	906	706
<i>Annual premiums</i>	14	12
<i>Single premiums</i>	892	694
Gross new business annual premiums equivalent (APE)	103	81
New business profit, after tax	18	15
Total operating profit, after tax	44	37
After-tax operating return before currency translation effects	12.5%	12.9%
New business profit margin (as % of APE)	17.2%	18.5%

The above information should be read in conjunction with the notes below and on the following pages.

Notes to the embedded value results

1. To improve transparency and to reflect management responsibilities, the presentation of the embedded value results has been enhanced. In particular, additional information on the countries within Europe has been disclosed. The information for the United Kingdom includes the Isle of Man.
2. The after-tax operating return and after-tax return on opening embedded value have been calculated reflecting the incidence of capital movements in and out of the embedded value.
3. Life Insurance includes some non-insurance service companies and our distribution units in the United Kingdom and Germany. In line with our embedded value methodology, we have included the present value of future profits of these companies in both the Group's embedded value and new business profit. New business profit arises in these companies through servicing of the Group's life insurance business as well as that of general insurance Group companies and third parties. The contribution to new business profit from servicing of general and third party business is USD 15 million in Germany, and a loss of USD 2 million in the United Kingdom. There is however no contribution to the annual premium equivalent in respect of general and third party new business. Removing the value of this new business from the new business profit would reduce the new business margin in Germany to 13.8%, increase the new business margin in the United Kingdom to 9.0% and reduce the new business margin of the Group to 13.9%.
4. For several companies in Life Insurance, no embedded value has been calculated but these companies have been included in the embedded value results at their shareholders' equity value, as calculated in accordance with IFRS. The contribution from these companies to the Group's total published embedded value is approximately 2%.
5. Following the launch during 2005 of our United Kingdom distribution unit, Openwork, the results of this entity have been fully consolidated within our UK embedded value results. 25% of the operating loss, after excluding one-off costs, is attributable to new business, in line with the Group's long term financial interest in this entity. The remainder of the operating loss has been allowed for in the operating result for the United Kingdom.

	Spain		Ireland		Other European Countries		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
	862	342	668	448	122	82	2,558	1,578
	20	14	111	90	23	16	168	132
	842	328	557	358	99	66	2,390	1,446
	104	47	167	126	33	23	407	277
	15	10	34	11	3	2	70	38
	55	41	80	32	10	29	189	139
	29.1%	31.2%	19.2%	9.6%	6.7%	27.8%	17.1%	16.2%
	14.5%	22.1%	20.2%	8.5%	9.4%	10.2%	17.1%	13.9%

6. Where the Group has a majority interest in a subsidiary company, the new business profit and new business premium information are shown gross of minority holdings although the embedded value is shown net of minority holdings. The minorities' share of new business profit is eliminated through "Operating variance, after tax". The minorities' share of new business profit mostly relates to our subsidiaries in Germany. For Life Insurance in total, the new business profit and gross new business annual premium equivalent (APE) net of minority holdings for 2005 are USD 315 million and USD 2'198 million, respectively.
7. Effective January 1, 2005, in the USA there was a transfer of capital of USD 512 million from Life Insurance to Farmers Management Services, including USD 490 million of surplus notes. The embedded value operating profit includes a net benefit of USD 60 million due to the reduction in cost of capital associated with the transfer of these surplus notes.
8. In April 2004, the Group changed the organizational structure of its business units in line with its strategy. As a result, certain life insurance operations have been reclassified as Other Businesses. One of these, Kemper Investors Life Insurance Company (KILICO), has written variable annuity contracts that provide annuitants with certain guarantees related to minimum death and income benefits. The Group has recorded provisions for these embedded guarantee features in accordance with its accounting policy. The embedded value related to KILICO as of January 1, 2004 was USD 357 million. The Group has not determined embedded value results for this company since its reclassification into Other Businesses.
9. In 2005, wholesale investment products, for which only administration services are provided, have not been classified as new business and hence have been excluded from both the new business profit and the annual premium equivalent. This has impacted the results in our International Businesses.
10. The published embedded value assumes that at least the locally required minimum statutory capital is held to support the business. In some countries, a higher amount has been locked-in where this is in line with management strategy or market practice. In 2005, the amount of shareholder capital used to meet these requirements was USD 4.2 billion, which produced an associated shareholder economic cost of USD 1.2 billion.
11. In 2005, the capital strain on writing new business was approximately USD 0.9 billion. The after-tax internal rate of return on new business was approximately 11% and the new business profit before cost of solvency was USD 396 million.

Embedded value sensitivities

The following tables show the sensitivity of our 2005 embedded value and value of new business to changes in several key assumptions:

Change in embedded value	in USD millions							
	Discount rate 1% increase	Discount rate 1% decrease	Investment return 1% increase	Investment return 1% decrease	Market value of equities 10% decrease	Renewal expenses 10% decrease	Demography 10% worsening	Lapses 10% worsening
Change in embedded value	(581)	674	544	(679)	(282)	183	(565)	(206)

Change in new business value	in USD millions							
	Discount rate 1% increase	Discount rate 1% decrease	Investment return 1% increase	Investment return 1% decrease	Initial expenses 10% decrease	Renewal expenses 10% decrease	Demography 10% worsening	Lapses 10% worsening
Change in new business value	(68)	81	53	(69)	101	25	(37)	(39)

The figures shown above are "sensitivities" - for each assumption change, all other assumptions have remained unchanged.

The exceptions to this are the investment return sensitivities which assume a change to future new money rates for fixed interest securities and a change to returns on both existing assets and future new money rates for equities and properties. These sensitivities reflect the change to embedded value in such a changed investment environment. For example, where appropriate, changes to statutory valuation bases or policyholder bonuses have been reflected accordingly. In addition, changes to the market values of fixed interest assets have been reflected where appropriate. However, these investment return sensitivities assume that the risk discount rates remain unaffected.



Holding
Company

Principal activity and review of the year

Zurich Financial Services is the holding company of the Group with a primary listing on the SWX Swiss Exchange and a secondary listing on the London Stock Exchange. Zurich Financial Services was incorporated on April 26, 2000, with a share capital of CHF 100,000. As of December 31, 2005, the shareholders' equity totaled CHF 16,472,848,630 (December 31, 2004: CHF 16,267,755,044).

Its principal activity is the holding of subsidiaries. Revenues consist mainly of dividends and interests. The net income of Zurich Financial Services was CHF 781,121,406 for 2005 (CHF 530,597,277 for 2004).

Statements of income

in CHF thousands, for the years ended December 31	Notes	2005	2004
Revenues			
Interest income		213,610	207,527
Dividend income		600,000	350,000
Other financial income		5,247	21
Total revenues		818,857	557,548
Expenses			
Administrative expense	3	(12,325)	(4,064)
Other financial expense		(6,283)	(178)
Tax expense	4	(19,128)	(22,709)
Total expenses		(37,736)	(26,951)
Net income		781,121	530,597

Balance sheets

Assets		Notes	2005	2004
in CHF thousands as of December 31				
Non-current assets				
Investments in subsidiaries	5		10,662,917	10,662,917
Subordinated loans to subsidiaries			4,000,000	4,000,000
Total non-current assets			14,662,917	14,662,917
Current assets				
Cash and cash equivalents			1,550,577	500,229
Loans to subsidiaries			204,226	1,015,791
Accrued income from third parties			43	4
Accrued income from subsidiaries			101,951	104,094
Total current assets			1,856,797	1,620,118
Total assets			16,519,714	16,283,035
Liabilities and shareholders' equity				
Short-term liabilities				
Loans from subsidiaries			22,270	–
Other liabilities to subsidiaries			17,749	1,042
Other liabilities to third parties			6,500	13,800
Other liabilities to shareholders			238	389
Accrued liabilities			109	49
Total short-term liabilities			46,866	15,280
Shareholders' equity (before appropriation of available earnings)				
Share capital	7		360,017	936,045
Legal reserves:				
<i>General legal reserve</i>			9,215,782	9,215,782
<i>Reserve for treasury stock</i>	8		49,623	77,235
Free reserve			5,404,209	5,376,597
Retained earnings:				
<i>Beginning of year</i>			662,096	131,499
<i>Net income</i>			781,121	530,597
Retained earnings, end of year			1,443,217	662,096
Total shareholders' equity (before appropriation of available earnings)			16,472,848	16,267,755
Total liabilities and shareholders' equity			16,519,714	16,283,035

Notes to the financial statements

1. Basis of Presentation

Zurich Financial Services presents its financial statements in accordance with Swiss law.

2. Summary of significant accounting policies

a) Exchange rates

Assets and liabilities expressed in currencies other than Swiss francs are translated at year-end exchange rates. Revenues and expenses are translated using the exchange rate at the date of the transaction. Unrealized exchange losses are recorded in the statement of income and unrealized exchange gains are deferred until realized.

b) Investments in subsidiaries

Investments in subsidiaries are equity interests, which are held on a long-term basis for the purpose of the holding company's business activities. They are carried at a value no higher than their cost price less adjustments for impairment.

3. Administrative expense

Administrative expense consists mainly of directors' fees of CHF 2,634,268 (prior year CHF 2,455,679), and Management fees of CHF 8,000,000.

4. Taxes

The tax expense consists mainly of income and capital taxes.

5. Investments in subsidiaries

Investments in subsidiaries include a 57% interest in Zurich Group Holding with a carrying value of CHF 6,064,302,120 (prior year CHF 6,064,302,120) and a 100% interest in Allied Zurich p.l.c., with a carrying value of CHF 4,595,865,096 (prior year CHF 4,595,865,096). Allied Zurich p.l.c. holds the remaining 43% interest in Zurich Group Holding. Additionally, Zurich Financial Services holds 49,000 shares of Zurich Insurance Company with a book carrying value of CHF 2,750,190 (prior year CHF 2,750,192).

6. Commitments and contingencies

Zurich Financial Services has provided an unlimited guarantee in support of various entities belonging to the Zurich Capital Markets group of companies. In addition, Zurich Financial Services has agreed with the Superintendent of Financial Institutions, Canada, to provide additional capital in case the applicable capital adequacy tests for the Canadian business are not met and to provide assistance in case of liquidity issues.

Furthermore, Zurich Financial Services has entered into various support agreements and a guarantee for the benefit of its subsidiaries. These contingencies amounted to CHF 4,118 million as of December 31, 2005 (CHF 319 million as of December 31, 2004).

Zurich Financial Services knows of no event that would require it to satisfy the guarantees or to take action under a support agreement.

7. Shareholders' equity

a) Issued share capital

At the Annual General Meeting on April 19, 2005, shareholders approved a share capital reduction in the form of a nominal value reduction of each registered share from CHF 6.50 to CHF 2.50. As a result of this reduction, the share capital was reduced by CHF 576,027,820 from CHF 936,045,207.50 to a new total of CHF 360,017,387.50. In the previous year, shareholders approved, at the Annual General Meeting on April 16, 2004, a share capital reduction in the form of a nominal value reduction of each registered share from CHF 9 to CHF 6.50. As a result of that reduction, the share capital was reduced by CHF 360,017,387.50 from CHF 1,296,062,595 to CHF 936,045,207.50.

As of December 31, 2005 and 2004, Zurich Financial Services had 144,006,955 issued and fully paid registered shares of CHF 2.50 par value and CHF 6.50 par value, respectively.

b) Authorized share capital

Until June 1, 2007, the Board of Zurich Financial Services is authorized to increase the share capital by an amount not exceeding CHF 15,000,000 by issuing up to 6,000,000 fully paid registered shares with a nominal value of CHF 2.50 each. An increase in partial amounts is permitted. The Board determines the date of issue of such new shares, the issue price, type of payment, conditions for exercising pre-emptive rights, and the beginning of the dividend entitlement. The Board may issue such new shares by means of a firm underwriting by a banking institution or syndicate with subsequent offer of those shares to the current shareholders. The Board may allow the expiry of pre-emptive rights which have not been exercised, or it may place these rights as well as shares, the pre-emptive rights of which have not been exercised, at market conditions.

The Board is further authorized to restrict or withdraw the pre-emptive rights of shareholders and to allocate them to third-parties if the shares are to be used (i) for the take-over of an enterprise, or parts of an enterprise or of participations or if issuing shares for the financing including re-financing of such transactions; or (ii) for the purpose of expanding the scope of shareholders in connection with the quotation of shares on foreign stock exchanges.

c) Contingent share capital

Capital market instruments and option rights to shareholders:

The share capital of Zurich Financial Services may be increased by an amount not exceeding CHF 13,704,570 by issuing up to 5,481,828 fully paid registered shares with a nominal value of CHF 2.50 each (1) through the exercise of conversion and/or option rights which are granted in connection with the issuance of bonds or similar debt instruments by Zurich Financial Services or one of its Group companies in national or international capital markets and/or (2) by the exercise of option rights which are granted to the shareholders. When issuing bonds or similar debt instruments connected with conversion and/or option rights, the pre-emptive rights of the shareholders will be excluded. The current owners of conversion and/or option rights shall be entitled to subscribe for the new shares. The conversion and/or option conditions are to be determined by the Board.

The Board of Directors is authorized, when issuing bonds or similar debt instruments connected with conversion and/or option rights, to restrict or withdraw the right of shareholders for advance subscription in cases where such bonds are issued for the financing or re-financing of a takeover of an enterprise, of parts of an enterprise, or of participations. If the right for advance subscription is withdrawn by the Board, the convertible bond or warrant issues are to be offered at market conditions (including standard dilution protection provisions in accordance with market practice) and the new shares are issued at then current convertible bond or warrant issue conditions. The conversion rights may be exercisable during a maximum of 10 years and option rights for a maximum of seven years from the time of the respective issue. The conversion or option price or its calculation methodology shall be determined in accordance with market conditions, whereby for shares of Zurich Financial Services the quoted share price is to be used as a basis.

Employee participation:

The share capital may be increased by an amount not exceeding CHF 3,750,000 by issuing up to 1,500,000 fully paid registered shares with a nominal value of CHF 2.50 each to employees of Zurich Financial Services and Group companies. The pre-emptive rights of the shareholders, as well as the right for advance subscription, are excluded. The issuance of shares or respective option rights to employees shall be subject to one or more regulations to be issued by the Board of Directors and taking into account performance, functions, levels of responsibility and criteria of profitability. Shares or option rights may be issued to the employees at a price lower than that quoted on the stock exchange.

8. Reserve for treasury shares

This reserve fund corresponds to the purchase value of all Zurich Financial Services shares held by Group companies of Zurich Financial Services as shown in the table below.

**Reserve for
treasury shares**

	Number of shares 2005	Purchase value 2005¹	Number of shares 2004	Purchase value 2004 ¹
As of January 1 (opening balance)	298,113	77,235	762,507	150,814
Additions during the year	532,682	112,077	–	–
Sales during the year	(638,768)	(138,636)	(464,394)	(72,415)
Decrease due to nominal value reduction of share capital		(1,053)	–	(1,164)
As of December 31 (closing balance)	192,027	49,623	298,113	77,235
Average purchase price of additions, in CHF		210		–
Average selling price, in CHF		204		182

¹ in CHF thousands

9. Shareholders

The shares registered in the share ledger as of December 31, 2005, were owned by 116,098 shareholders of which 110,205 were private individuals holding 20.3% of the shares (or 12.5% of all outstanding shares), 2,271 were foundations and pension funds holding 8.7% of the shares (or 5.4% of all outstanding shares), and 3,622 were other legal entities holding 71% of the shares (or 43.95% of all outstanding shares).

According to the information available to us on December 31, 2005, no shareholder of Zurich Financial Services held more than 5% of the issued share capital.

Proposed/approved appropriation of available earnings

	2005	2004
Registered shares eligible for dividends		
Shares eligible as of February 15, 2006 and February 16, 2005, respectively	144,006,955	144,006,955

in CHF thousands	2005 (Proposed)	2004 (Approved)
Appropriation of available earnings as proposed by the Board of Directors		
Net income	781,121	530,597
Balance brought forward	662,096	131,499
Available earnings	1,443,217	662,096
Dividend	(662,432) ¹	–
Transfer to general legal reserve	–	–
Balance carried forward	780,785 ¹	662,096

The Board of Directors proposes to the Annual General Meeting a total payout of CHF 7.00 per registered share for 2005. The proposed total payout to shareholders of CHF 7.00 per registered share is comprised of a regular dividend of CHF 4.60 and a payout of CHF 2.40 in form of a reduction of the nominal value of each share from CHF 2.50 to CHF 0.10.

- Subject to the approval of the dividend, the payment of CHF 4.60 per share, after deductions of 35% Swiss withholding tax, is expected around the beginning of July 2006, free of charge and in accordance with dividend payment instructions.
- Subject to the approval of the nominal value reduction and the fulfilment of all necessary requirements, the payment of CHF 2.40 per share is expected around the beginning of July 2006, free of charge and in accordance with dividend payment instructions. The proposed nominal value reduction would reduce the share capital by CHF 345,616,692¹.

Zurich, February 15, 2006

On behalf of the Board of Directors of Zurich Financial Services

Manfred Gentz

¹ These figures are based on the current issued and outstanding share capital. They may change due to a resolution of the Board of Directors dated February 15, 2006 according to which, out of contingent share capital, up to 1,000,000 shares are allocated for issuance to share based incentive plans.



Statutory Auditor's Report

Report of the statutory auditors

To the General Meeting of Zurich Financial Services, Zurich

As statutory auditors, we have audited the accounting records and the financial statements (statements of income, balance sheets and notes on page 102 to 106 of Zurich Financial Services for the year ended December 31, 2005.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of available earnings on page 107 comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers AG

M Humphreys C Stöckli

Zurich, February 15, 2006

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American Depositary Receipts	Zurich Financial Services has an American Depositary Receipt program with The Bank of New York (BNY). For more information call BNY's ADR Services Center in the USA +1-888-bny-adrs or outside the USA on +1-610-382-7836. ADR holder assistance may also be obtained from BNY at www.adrbny.com .

The Annual Report 2005 of Zurich Financial Services Group consists of the two publications: the Corporate Review and the Financial Report.

Both reports are available on our Web site and can be downloaded at www.zurich.com

Disclaimer & Cautionary Statement

Certain statements in this Annual Report are forward-looking statements, including, but not limited to, statements that are predicated on or indicate future events, trends, plans or objectives. Forward-looking statements include statements regarding our targeted profit improvement, return on equity targets, expense reductions, pricing conditions, dividend policy and underwriting claims improvements. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results and Zurich Financial Services' plans and objectives to differ materially from those expressed or implied in the forward looking statements (or from past results). Factors such as (i) general economic conditions and competitive factors, particularly in our key markets; (ii) performance of financial markets; (iii) levels of interest rates and currency exchange rates; (iv) frequency, severity and development of insured claims events; (v) mortality and morbidity experience; (vi) policy renewal and lapse rates; (vii) changes in laws and regulations and in the policies of regulators may have a direct bearing on Zurich Financial Services' results of operations and on whether Zurich Financial Services will achieve its targets. Zurich Financial Services undertakes no obligation to publicly update or revise any of these forward-looking statements, whether to reflect new information, future events or circumstances or otherwise.

It should be noted that past performance is not a guide to future performance.

Persons requiring advice should consult an independent adviser.

Zurich Financial Services Group (Zurich) is an insurance-based financial services provider with a global network of subsidiaries and offices in North America and Europe as well as in Asia Pacific, Latin America and other markets. Founded in 1872, the Group is headquartered in Zurich, Switzerland. It employs approximately 55,000 people serving customers in more than 120 countries.

The Financial Report is published in English and German. In the case of inconsistencies in the German translation, the English original version shall prevail.

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The paper used in this report is manufactured from pulp sourced from fully sustainable forests, and has been produced without the use of elemental chlorine.

