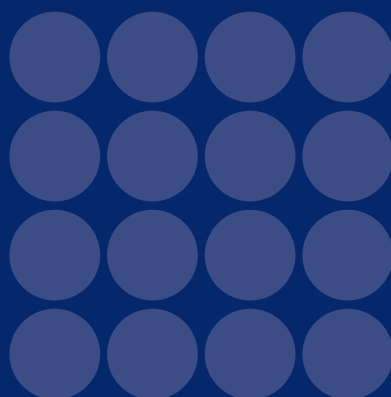


Annual Report 2012



Zurich Insurance Company Group



About Zurich

Zurich is a leading multi-line insurance provider with a global network of subsidiaries and offices. With about 60,000 employees, we deliver a wide range of general insurance and life insurance products and services for individuals, small businesses, and mid-sized and large companies, including multinational corporations, in more than 170 countries.

Contents

Operating and financial review	2
Risk review	15
Consolidated financial statements	52
Financial statements – statutory accounts	168
Key data of Zurich Insurance Company Ltd	186

Operating and financial review

Zurich Insurance Company Ltd (ZIC) and its subsidiaries (collectively the “Zurich Insurance Company Group” or “ZIC Group”) is a provider of insurance-based products. The ZIC Group also distributes non-insurance products, such as mutual funds, mortgages and other financial services products, from selected third-party providers. The ZIC Group operates mainly in Europe, the USA, Latin America and Asia-Pacific through subsidiaries, branch offices and representations.

The holding company, Zurich Insurance Company Ltd, is incorporated in Zurich, Switzerland. The address of the registered office is Mythenquai 2, 8002 Zurich, Switzerland. Zurich Insurance Company Ltd is a wholly owned subsidiary of Zurich Insurance Group Ltd and together with its subsidiaries forms part of the Zurich Insurance Group.

The Operating and financial review is the management analysis of the business performance of the ZIC Group for the year ended December 31, 2012 compared with 2011. It also explains key aspects of the ZIC Group’s financial position as of the end of 2012.

Contents

Financial highlights	3
Performance overview	4
General Insurance	6
Global Life	7
Farmers	8
Other Operating Businesses	10
Non-Core Businesses	10
Investment performance	11
Balance Sheet highlights	13
Currency translation impact	14

The information contained within the Operating and financial review is unaudited and presents the consolidated results of the ZIC Group for the years ended December 31, 2012 and 2011 and the financial position as of December 31, 2012 and December 31, 2011. All amounts are shown in U.S. dollars and rounded to the nearest million unless otherwise stated with the consequence that the rounded amounts may not add up to the rounded total in all cases. All ratios and variances are calculated using the underlying amount rather than the rounded amount. This document should be read in conjunction with the entire Annual Report 2012 of the ZIC Group in particular with its Consolidated financial statements as of December 31, 2012. Certain comparative figures have been restated, as set out in note 1 of the Consolidated financial statements. Details of the financial results from the dates of acquisition to December 31, 2012, for the Latin American insurance operations of Banco Santander S.A. (Zurich Santander) and for other acquisitions and divestments are set out in note 5 of the Consolidated financial statements.

In addition to the figures stated according to the International Financial Reporting Standards (IFRS), the ZIC Group uses business operating profit (BOP) and other performance indicators to enhance the understanding of its results. Details of these additional measures are set out in the Glossary. These should be viewed as complementary to, and not as substitute to the IFRS figures. For a reconciliation of BOP to net income after income taxes see note 29 of the Consolidated financial statements.

Financial highlights

in USD millions, for the years ended December 31, unless otherwise stated	2012	2011 ¹	Change ²
Business operating profit	4,118	4,273	(4%)
Net income attributable to shareholders	3,963	3,871	2%
General Insurance gross written premiums and policy fees	35,610	34,572	3%
Global Life gross written premiums, policy fees and insurance deposits	30,259	27,711	9%
Farmers Management Services management fees and other related revenues	2,846	2,767	3%
Farmers Re gross written premiums and policy fees	4,361	3,529	24%
General Insurance business operating profit	2,097	2,247	(7%)
General Insurance combined ratio	98.4%	98.9%	0.5 pts
Global Life business operating profit	1,328	1,345	(1%)
Farmers business operating profit	1,348	1,438	(6%)
Farmers Management Services gross management result	1,378	1,333	3%
Farmers Management Services managed gross earned premium margin	7.3% ³	7.3%	–
Average Group investments	202,952	197,145	3%
Net investment result on Group investments	8,987	9,470	(5%)
Net investment return on Group investments ⁴	4.4%	4.8%	(0.4 pts)
Total return on Group investments ⁴	7.1%	5.3%	1.7 pts
Shareholders' equity	33,885	31,229	9%

¹ December 31, 2011 has been restated as set out in note 1 of the Consolidated financial statements.

² Parentheses around numbers represent an adverse variance.

³ Calculated based on gross earned premiums of the Farmers Exchanges of USD 18.8 billion, which is net of the return of USD 74 million in premiums as a result of the anticipated settlement of a lawsuit with the State of Texas.

⁴ Calculated on average Group investments.

Operating and financial review *continued*

Performance overview for the year ended December 31, 2012

The ZIC Group delivered solid results and generated stable cash flows while maintaining its strong capital position.

The execution of the ZIC Group's strategy and focus on its core insurance business enabled strong growth and improved underlying profitability, which are critical to offset lower investment income due to a persisting low yield environment. Improved underlying profitability was sustained by contributions from Global Life and Farmers, as well as the strong underlying underwriting performance in General Insurance. The overall performance of General Insurance was negatively impacted by above average levels of catastrophe, large and weather-related losses, including Storm Sandy, as well as the extraordinary adverse impact relating to a review in Germany.

The ZIC Group's capital and solvency positions remain strong, underpinned by continued focus on risk management, in both its disciplined investment and underwriting strategies. Shareholders' equity has increased by USD 2.7 billion to USD 33.9 billion since December 31, 2011, after recording the total cost of USD 3.0 billion for dividends paid in April 2012.

The strategic acquisitions towards the end of 2011 have now been integrated into the ZIC Group where Zurich Santander contributed USD 5.2 billion to the growth of gross written premiums and insurance deposits and a business operating profit of USD 165 million.

Business operating profit decreased by USD 155 million to USD 4.1 billion, or by 4 percent in U.S. dollar terms.

- **General Insurance** business operating profit decreased by USD 150 million to USD 2.1 billion, or by 7 percent in U.S. dollar terms. Progress on strategic targets was reflected by an improvement in the underlying results, underpinned by disciplined underwriting and expense management. However, this improvement was offset by overall declining investment income and decreases in favorable development of reserves established in prior years, mainly in Germany.
- **Global Life** business operating profit remained broadly flat at USD 1.3 billion in U.S. dollar terms, with a positive contribution from Zurich Santander. This was largely offset by a lower contribution from Europe, primarily as a result of one-off expenses in Germany included in special operating items. Other movements in sources of profit were largely neutral in aggregate, with improved risk and expense margins benefiting from the continued shift to protection and unit-linked products, offset by reductions in the investment margin due to lower investment yields.
- **Farmers** business operating profit decreased by USD 90 million to USD 1.3 billion, or by 6 percent, primarily due to a net underwriting loss incurred by Farmers Re. **Farmers Management Services** business operating profit of USD 1.4 billion increased by USD 51 million, or by 4 percent, mainly driven by the increase in gross earned premiums in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Zurich Insurance Group. **Farmers Re** business operating profit deteriorated by USD 141 million to a loss of USD 27 million, mainly reflecting the absence of favorable development of loss reserves established in prior years compared with 2011 as well as weather-related losses that were once again well above historical levels. This was partially offset by a year over year improvement in the underlying loss ratio.

Other Operating Businesses reported an increase in its business operating loss of USD 10 million to USD 855 million, mainly driven by the absence of favorable impacts from foreign currency movements compared with 2011.

Non-Core Businesses reported a business operating profit of USD 200 million compared with USD 89 million in 2011. This improvement came mainly from an increased profit from other run-off businesses.

Business volumes for the core business segments, comprising gross written premiums, policy fees, insurance deposits and management fees, increased by USD 4.5 billion to USD 73.1 billion, or by 7 percent in U.S. dollar terms. This growth arose as follows:

- **General Insurance** gross written premiums and policy fees increased by USD 1.0 billion to USD 35.6 billion, or by 3 percent in U.S. dollar terms, primarily as a result of rate increases. Selective and profitable growth remains the key focus area and leading premium indicators were favorable even as average rates increased by 4 percent. Overall premium growth was strong, particularly in International Markets through both organic growth and acquisitions, as well as in North America, while European results continued to be affected by lower levels of economic activity.
- **Global Life** gross written premiums, policy fees and insurance deposits increased by USD 2.5 billion to USD 30.3 billion, or by 9 percent in U.S. dollar terms, benefiting from the contribution from Zurich Santander as well as higher volumes of single premium products in Corporate Life & Pensions and Private Banking Client Solutions, partially offset by a reduction in Spain where the product mix continued to shift from savings towards higher margin protection products.
- **Farmers Management Services** management fees and other related revenues of USD 2.8 billion increased by USD 79 million, or by 3 percent, driven by the 3 percent increase in gross earned premiums in the Farmers Exchanges. The 24 percent increase to USD 4.4 billion in gross written premiums of **Farmers Re** reflected the changes in the All Lines quota share reinsurance agreement with the Farmers Exchanges (All Lines agreement) as well as the 3 percent gross written premiums growth in the Farmers Exchanges.

Net income attributable to shareholders increased by USD 91 million to USD 4.0 billion or by 2 percent. The benefit from net capital gains on investments as well as the absence of litigation and other one-off expenses which negatively impacted 2011, more than offset the decrease in business operating profit.

The **shareholders' effective tax rate** was 23.9 percent for 2012, compared with 23.7 percent for 2011, primarily as a result of adverse fluctuations in the geographic profit mix in 2012, which also impacted 2011 albeit to a lesser extent.

Operating and financial review *continued*

General Insurance

in USD millions, for the years ended December 31	2012	2011 ¹	Change
Gross written premiums and policy fees	35,610	34,572	3%
Net earned premiums and policy fees	29,195	29,076	–
Insurance benefits and losses, net of reinsurance	(20,527)	(20,939)	2%
Net underwriting result	463	324	43%
Net investment income	2,516	2,799	(10%)
Net non-technical result (excl. items not included in BOP)	(901)	(886)	(2%)
Business operating profit	2,097	2,247	(7%)
Loss ratio	70.3%	72.0%	1.7 pts
Expense ratio	28.1%	26.9%	(1.2 pts)
Combined ratio	98.4%	98.9%	0.5 pts

¹ Restated as set out in note 1 of the Consolidated financial statements.

in USD millions, for the years ended December 31	Business operating profit (BOP)		Combined ratio	
	2012	2011	2012	2011
Global Corporate	496	169	99.1%	105.6%
North America Commercial	699	1,048	99.7%	95.9%
Europe	687	946 ¹	97.4%	97.2% ¹
International Markets	166	(156)	98.7%	107.8%
GI Global Functions including Group Reinsurance	49	240	nm	nm
Total	2,097	2,247	98.4%	98.9%

¹ Restated as set out in note 1 of the Consolidated financial statements.

Business operating profit decreased by USD 150 million to USD 2.1 billion or by 7 percent driven by a decline in investment income, partly offset by the improved net underwriting result. The net underwriting result benefitted from an improved underlying loss ratio, which more than compensated for the decrease in favorable development on reserves established in prior years, mainly arising in Germany from an increase of loss reserves for certain long-tail lines of business written in prior years, and higher commission expenses as the mix of business shifts toward products with higher commissions. Investment income decreased by USD 283 million or by 10 percent mainly due to lower yields and capital repatriation to the ZIC Group. This was partially compensated by an increase in hedge fund gains in the U.S.

Gross written premiums and policy fees increased by USD 1.0 billion to USD 35.6 billion, or by 3 percent in U.S. dollar terms and 7 percent on a local currency basis. The business remained focused on profitable growth and continued to capitalize on the favorable rate environment across all regions, achieving average rate increases of 4 percent. Premiums continued to increase in the mature North American market and, while part of this increase was attributable to adjustments to premiums for prior year policies as initial estimated insured risks were increased to reflect actual exposures, there have also been improvements in both customer retention and new business. In International Markets, Zurich Santander and Zurich Insurance Malaysia Berhad (ZIMB) contributed to the growth in premiums along with organic growth from the existing businesses. In Europe, premium volumes remain under pressure as a result of the economic environment in all significant markets as well as profit improvement efforts in selected portfolios such as personal lines motor.

The **net underwriting result** increased by USD 139 million to USD 463 million reflected in the improvement of 0.5 percentage points in the combined ratio to 98.4 percent. Across the portfolio, the business continued to execute against its strategic targets with an improvement in the underlying loss ratio of 2.9 percentage points following sustained increases in rates and focused actions to defend profit margins. Additionally, while the impact of Storm Sandy was significant, the overall catastrophe, large and weather-related events experienced throughout 2011 were more severe. Zurich Santander also contributed favorably to the overall result, improving the loss ratio by 0.7 percentage points. These improvements were partially offset by adverse development of reserves established in prior years mainly for certain long tail lines of business written in Germany. The expense ratio deteriorated by 1.2 percentage points to 28.1 percent. This was mainly driven by a higher commission ratio attributable to fluctuations in the business mix including business from Zurich Santander which carries a higher commission rate. The other underwriting expense ratio was virtually flat compared with 2011 in spite of continued investment in International Markets as well as higher pension expenses, as pension calculation assumptions were changed at the beginning of 2012 to recognize the economic environment. These increases were mostly offset by the continued execution of the strategic goal to reduce the expense base in mature markets.

Global Life

in USD millions, for the years ended December 31	2012	2011	Change
Insurance deposits	16,670	16,127	3%
Gross written premiums and policy fees	13,590	11,583	17%
Net investment income on Group investments	3,991	4,146	(4%)
Insurance benefits and losses, net of reinsurance	(9,592)	(9,503)	(1%)
Business operating profit¹	1,328	1,345	(1%)
Total reserves for life insurance contracts, net of reinsurance, and liabilities for investment contracts (net reserves) ²	214,676	195,951	10%
Assets under management ^{2, 3}	254,828	232,335	10%
Net policyholder flows ⁴	1,402	2,769	(49%)

¹ Business operating profit for 2012 included USD 105 million of profit from Zurich Santander earned between the dates of acquisition and December 31, 2012, calculated after deducting non-controlling interests and USD 21 million for an increase to the liability for future earn-out payments. Details of the overall IFRS impact are set out in note 5 to the Consolidated financial statements.

² Restated as set out in note 1 of the Consolidated financial statements.

³ Assets under management comprise Group and unit-linked investments that are included in the Global Life balance sheet plus assets that are managed by third parties, on which fees are earned.

⁴ Net policyholder flows are defined as the sum of gross written premiums and policy fees and deposits, less policyholder benefits.

Business operating profit remained broadly flat at USD 1.3 billion in U.S. dollars terms, and increased on a local currency basis, with a positive contribution from Zurich Santander, which was largely offset by a decrease in Europe, primarily as a result of special operating items in Germany. Other sources of profit remained largely flat in aggregate, with improvements in the risk and expense margins benefiting from the continued shift to protection and unit-linked products, offset by reductions in the investment margin due to lower investment yields.

The expense margin improved due to increased fee income arising from an ongoing shift towards unit-linked products. The net risk margin slightly improved, with the positive impact from the increasing level of protection products offset by currency translation effects. The net investment margin reduced, significantly impacted by currency translation effects, with the decrease in local currency driven by lower yields in North America. Other profit margins improved significantly, mainly driven by the contribution from Zurich Santander. Furthermore the impact of acquisition deferrals decreased due to a change in the method for deferring commissions introduced as of September 2011 primarily in Germany, offset by lower interest, depreciation and amortization costs.

The result was adversely impacted by a charge related to recent rulings by the German Federal Court of Justice, which impacted the local insurance industry, clarifying the application and effect of certain policyholder terms and conditions in the event of early contract termination.

Insurance deposits increased by USD 542 million to USD 16.7 billion, or by 3 percent in U.S. dollar terms. An increase of USD 2.5 billion relating to the inclusion of Zurich Santander was partially offset by lower insurance deposits in Spain as product mix shifted from savings to higher margin protection products.

Gross written premiums and policy fees increased by USD 2.0 billion to USD 13.6 billion, or by 17 percent in U.S. dollar terms, with the increase resulting from the inclusion of Zurich Santander.

Net reserves increased by USD 18.7 billion, or by 10 percent in U.S. dollar terms compared with December 31, 2011, driven by favorable market movements in Europe. **Assets under management** increased by USD 22.5 billion, or by 10 percent in U.S. dollar terms compared with December 31, 2011, also benefiting from favorable market movements in Europe. **Net policyholder flows** remained positive at USD 1.4 billion with net outflows in Europe being more than offset by net inflows in all other regions.

Operating and financial review *continued*

Farmers

Farmers business operating profit decreased by USD 90 million to USD 1.3 billion, or by 6 percent, primarily reflecting the absence of favorable development of loss reserves established in prior years in Farmers Re compared with 2011. This deterioration was partially offset by higher business operating profit in Farmers Management Services due to higher management fee revenues driven by a 3 percent increase in gross earned premiums in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Zurich Insurance Group.

Farmers Management Services

in USD millions, for the years ended December 31	2012	2011	Change
Management fees and other related revenues	2,846	2,767	3%
Management and other related expenses	(1,467)	(1,434)	(2%)
Gross management result	1,378	1,333	3%
Other net income	(3)	(10)	65%
Business operating profit	1,375	1,324	4%
Managed gross earned premium margin	7.3% ¹	7.3%	–

¹ Calculated based on gross earned premiums of the Farmers Exchanges of USD 18.8 billion, which is net of the return of USD 74 million in premiums as a result of the anticipated settlement of a lawsuit with the State of Texas.

Business operating profit of USD 1.4 billion increased by USD 51 million, or by 4 percent, primarily driven by an increase in management fee revenues.

Management fees and other related revenues of USD 2.8 billion increased by USD 79 million, or by 3 percent, driven by the higher management fee income from increased gross earned premiums in the Farmers Exchanges, which grew across all lines of business. **Management and other related expenses** of USD 1.5 billion increased by USD 34 million, or by 2 percent, compared with 2011. This increase was primarily due to higher costs associated with employee benefits and business transformation.

The **gross management result** of USD 1.4 billion increased by USD 45 million, while the **managed gross earned premium margin** remained constant at 7.3 percent.

Farmers Re

in USD millions, for the years ended December 31	2012	2011	Change
Gross written premiums and policy fees	4,361	3,529	24%
Net underwriting result	(163)	(23)	nm
Business operating profit	(27)	115	nm
Loss ratio	72.4%	70.5%	(1.8 pts)
Expense ratio	31.3%	30.2%	(1.1 pts)
Combined ratio	103.7%	100.8%	(2.9 pts)

Business operating profit deteriorated by USD 141 million to a loss of USD 27 million. This deterioration was primarily due to the absence of favorable development of reserves established in prior years, which benefited Farmers Re during 2011. Investment income and other income decreased slightly, primarily due to lower yields which have more than offset the increase from the larger asset base created by the higher All Lines agreement participation rate.

Gross written premiums and policy fees increased by USD 832 million, or by 24 percent, to USD 4.4 billion mainly as a result of the changes in the All Lines agreement as well as the 3 percent gross written premiums growth in the Farmers Exchanges. The changes were an increase to 20 percent effective December 31, 2011 from 12 percent throughout 2011 and a decrease to 18.5 percent effective December 31, 2012, subject to the approval of the California Department of Insurance.

The **net underwriting result** deteriorated by USD 140 million to a loss of USD 163 million. This deterioration, which was exacerbated by the increased participation rate in the All Lines agreement, was mainly due to higher assumed losses from the Farmers Exchanges in 2012. Despite the impact of Storm Sandy the underwriting result returned to profit in the second half of 2012.

The **loss ratio** increased by 1.8 percentage points compared with 2011. The 2011 result reflected favorable development of reserves established in prior years. Although weather-related losses were only slightly higher than 2011 they remained significantly above historical levels. This arose from high weather-related losses during the first half of 2012 relating to a series of tornados and hailstorms in the Midwest U.S. and severe wildfires in Colorado. However, weather-related losses were significantly lower in the second half of the year despite Storm Sandy. These adverse effects were partially offset by an improved underlying loss ratio in 2012 when compared with 2011. The **expense ratio** increased by 1.1 percentage points driven by a change in the reinsurance commissions.

Farmers Exchanges

Farmers Exchanges	in USD millions, for the years ended December 31	2012	2011	Change
	Gross written premiums	18,935	18,297	3%
	Gross earned premiums	18,703	18,149	3%

Gross written premiums in the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Zurich Insurance Group, increased by USD 637 million to USD 18.9 billion, or by 3 percent. This increase was driven by continued premium growth in all lines of business primarily as a result of ongoing rate actions undertaken to improve profitability, which resulted in a small decrease in policies in force. Furthermore, the 2012 results are net of the return of USD 74 million of premiums as a result of the anticipated settlement of a lawsuit with the State of Texas and excluding this return gross written premiums were USD 19.0 billion, or 4 percent higher than 2011.

Gross earned premiums in the Farmers Exchanges increased by USD 554 million to USD 18.7 billion, or by 3 percent, driven by continued increases in gross written premiums in all lines of business during the year. Furthermore, the 2012 results are net of the return of USD 74 million of premiums as a result of the anticipated settlement of a lawsuit with the State of Texas. Excluding this return gross earned premiums were USD 18.8 billion, or 3 percent higher than 2011.

Operating and financial review *continued*

Other Operating Businesses

in USD millions, for the years ended December 31	2012	2011	Change
Business operating profit:			
Holding and financing	(688)	(599)	(15%)
Headquarters	(167)	(246)	32%
Total business operating profit	(855)	(846)	(1%)

Other operating businesses loss increased by USD 10 million to USD 855 million in 2012. **Holding and financing** business operating loss increased by USD 89 million to USD 688 million driven by benefits from foreign currency movements in 2011, which did not recur in 2012, as well as reduced income on short term deposits. The reduction of USD 80 million in the business operating loss at **Headquarters** was driven by lower staff related costs and media spend combined with an increase in revenues due to higher license fee charge outs to units.

Non-Core Businesses

in USD millions, for the years ended December 31	2012	2011	Change
Business operating profit:			
Centrally managed businesses:	101	86	18%
Centre	75	60	25%
Other centrally managed businesses	26	26	–
Other run-off	100	3	nm
Total business operating profit	200	89	nm

Centrally managed businesses, which comprise run-off portfolios that are managed with the intention to pro-actively reduce risk and release capital, reported a business operating profit of USD 101 million compared with USD 86 million in 2011. Business operating profit for **Centre** improved by USD 15 million to USD 75 million mainly driven by reserve releases from the settlement of claims, partially offset by reduced favorable movements in financial markets on Centre's insurance portfolio where both assets and liabilities are carried at fair value.

Other run-off, which largely comprises U.S. life insurance and annuity portfolios, reported a business operating profit of USD 100 million. This profit was mainly driven by a reassessment of liabilities on certain life run-off policies as well as by favorable reserve movements reflecting reduced market volatility.

Investment performance

Performance of Group investments	in USD millions, for the years ended December 31		
	2012	2011	Change
Net investment income ¹	6,674	7,142	(7%)
Net capital gains/(losses) on investments and impairments	2,313	2,328	(1%)
of which: net capital gains/(losses) on investments and impairments attributable to shareholders	1,800	1,661	8%
Net investment result on Group investments ¹	8,987	9,470	(5%)
Net investment return on Group investments	4.4%	4.8%	(0.4 pts)
Movements in net unrealized gains/(losses) on investments included in total equity	5,393	1,050	nm
Total investment result on Group investments¹	14,380	10,520	37%
Average Group investments ²	202,952	197,145	3%
Total return on Group investments	7.1%	5.3%	1.7 pts

¹ After deducting investment expenses of USD 253 million for the years ended December 31, 2012 and 2011.

² Restated as set out in note 1 of the Consolidated financial statements.

Total **net investment income** decreased by 7 percent in U.S. dollar terms to USD 6.7 billion and by 2 percent on a local currency basis compared with 2011, due to lower reinvestment yields on debt securities.

Total **net capital gains on investments and impairments** remained stable at USD 2.3 billion driven by higher net capital gains from active management.

Net capital gains from active management contributed USD 2.1 billion compared with USD 1.2 billion in 2011, which included a gain of USD 441 million from the sale of part of the ZIC Group's share in New China Life Insurance Co. Ltd.

Investments booked at fair value through profit or loss, including derivatives used for hedging, contributed gains of USD 285 million in 2012 compared with gains of USD 1.5 billion in 2011.

Impairments at USD 116 million in 2012 were USD 214 million lower than in 2011.

Net investment return on Group investments was 4.4 percent, 0.4 percentage points lower compared with 2011.

Net unrealized gains/losses on investments included in total equity increased by USD 5.4 billion since December 31, 2011. This mainly reflects higher net unrealized gains on debt securities of USD 4.7 billion resulting from the tightening of credit spreads and falling yields on government securities. Rising equity markets contributed net unrealized gains on equities of USD 650 million since December 31, 2011.

Total return, net of investment expenses, on average Group investments was a strong 7.1 percent, an increase of 1.7 percentage points compared with 2011.

Debt securities, which are invested to match the ZIC Group's insurance liability profiles, returned 7.9 percent. Equity securities returned 12.1 percent and other investments returned 3.2 percent.

Operating and financial review *continued*

Performance of unit-linked investments	in USD millions, for the years ended December 31		
	2012	2011	Change
Net investment income	1,836	1,757	5%
Net capital (losses)/gains on investments and impairments	8,431	(5,302)	nm
Net investment result, net of investment expenses ¹	10,268	(3,544)	nm
Average investments ²	119,751	111,112	8%
Total return on unit-linked investments	8.6%	(3.2%)	11.8 pts

¹ After deducting investment expenses of USD 508 million and USD 610 million for the years ended December 31, 2012 and 2011, respectively.

² Restated as set out in note 1 of the Consolidated financial statements.

Total return on unit-linked investments was a positive 8.6 percent compared with a negative 3.2 percent in 2011. The improvement in the total return was due to net capital gains of USD 8.4 billion compared with net capital losses of USD 5.3 billion in 2011, reflecting stronger equity and debt markets in 2012 compared with those in 2011. Net investment income increased by USD 79 million.

Balance Sheet highlights

in USD millions, as of December 31	2012	2011 ¹	Change
Total Group investments	208,460	197,443	6%
Investments for unit-linked contracts	125,226	114,276	10%
Total investments	333,687	311,719	7%
Net reserves for losses and loss adjustment expenses	57,385	55,341	4%
Net reserves for unearned premiums	14,634	15,129	(3%)
Net other reserves for insurance contracts, including unit-linked insurance products	173,334	163,020	6%
Net reserves for insurance contracts ²	245,353	233,490	5%
Liabilities for investment contracts (primarily unit-linked)	58,131	50,958	14%
Total equity	36,556	33,972	8%

¹ Restated as set out in note 1 of the Consolidated financial statements.

² Gross of allowance for uncollectible amounts of USD 125 million and USD 132 million as of December 31, 2011, and 2010, respectively.

Group investments increased by USD 11.0 billion to USD 208.5 billion, or by 6 percent in U.S. dollar terms since December 31, 2011. On a local currency basis, total Group investments increased by USD 7.8 billion, or by 4 percent, mainly due to positive revaluations of debt securities and cash flows invested in debt securities.

Investments for unit-linked contracts increased by USD 11.0 billion to USD 125.2 billion, or by 10 percent in U.S. dollar terms and 7 percent on a local currency basis, mostly benefiting from favorable market movements in Europe.

Net reserves for losses and loss adjustment expenses for the ZIC Group increased by USD 2.0 billion to USD 57.4 billion compared with December 31, 2011 of which USD 693 million related to the effects of foreign currency translation. Acquisitions/(divestments) and transfers include USD 1.2 billion from the reclassification of annuity reserves related to claims that were previously included as policyholders contract deposits and other funds. Details of reserve development emerging from reserves established in prior years are set out in note 8 of the Consolidated financial statements.

Net other reserves for insurance contracts, including unit-linked insurance products increased by USD 10.3 billion or by 6 percent in U.S. dollar terms. This increase was mainly driven by the impact of favorable market movements on investments in Europe.

Liabilities for investment contracts (primarily unit-linked) increased by USD 7.2 billion or by 14%. This increase was also mainly driven by the impact of favorable market movements on investments in Europe.

Total equity increased by USD 2.6 billion to USD 36.6 billion, or by 8 percent. This increase was mainly driven by the contribution of net income after taxes.

Operating and financial review *continued*

Currency translation impact

The ZIC Group operates worldwide in multiple currencies and seeks to match foreign exchange exposures on an economic basis.

As the ZIC Group has chosen the U.S. dollar as its presentation currency, differences arise when functional currencies are translated into the ZIC Group's presentation currency. The table below shows the effect of foreign currency rates on the translation of selected line items.

Selected ZIC Group income statement line items	variance over the prior period, for the year ended December 31, 2012	in USD	
		millions	in %
	Gross written premiums and policy fees	(2,176)	(4%)
	Insurance benefits and losses, gross of reinsurance	1,522	4%
	Net income attributable to shareholders	(48)	(1%)
	Business operating profit	(75)	(2%)

The Consolidated income statements are translated at average exchange rates. Throughout 2012, the U.S. dollar has on average been stronger against the euro, Swiss franc and British pound, compared with 2011. The net impact on the result has been a reduction in U.S. dollar terms with a decrease in gross written premiums and policy fees partially offset by a decrease in U.S. dollar terms in insurance benefits and losses.

Selected ZIC Group balance sheet line items		in USD	
		millions	in %
	Total investments	5,562	2%
	Reserves for insurance contracts, gross	3,555	1%
	Cumulative translation adjustment in shareholders' equity	351	2%

The Consolidated balance sheets are translated at end-of-period rates. The U.S. dollar has weakened against the British pound, Swiss franc and the euro as of December 31, 2012 compared with December 31, 2011, resulting in an increase in U.S. dollar terms for most balance sheet items. The effects of changes of the major currencies were partially offset by U.S. dollar appreciation against the Brazilian real.

Risk review

The Risk review is an integral part of the Consolidated financial statements. Risks are managed at the Zurich Insurance Group, segment, region and business unit level according to our risk management framework. The principles of the Zurich Insurance Group's enterprise risk management described in the "Risk Management" section are equally applicable to the Zurich Insurance Company Ltd (ZIC) and its consolidated subsidiaries (collectively the "ZIC Group"). The figures presented are prepared on a ZIC Group-basis.

Contents

Risk management

Mission and objectives of risk management	16
Risk management framework	16
External perspectives	17
Risk governance and risk management organization	18

Analysis by risk type

Risk type description	21
Strategic risk	21
Insurance risk	22
Market risk	29
Credit risk	37
Liquidity risk	44
Operational risk	46
Risks to Zurich Insurance Group's reputation	47

Capital management and analysis of capital adequacy

Capital management	48
Analysis of capital adequacy	49

Risk review *continued*

Risk management

The Risk review is an integral part of the Consolidated financial statements. Risks are managed at the Zurich Insurance Group, segment, region and business unit level according to our risk management framework. The principles of the Zurich Insurance Group's enterprise risk management described in the "Risk Management" section are equally applicable to the Zurich Insurance Company Ltd (ZIC) and its consolidated subsidiaries (collectively the "ZIC Group"). The figures presented are prepared on a ZIC Group-basis.

Mission and objectives of risk management

The mission of risk management at Zurich Insurance Group is to promptly identify, measure, manage, report and monitor risks that affect the achievement of strategic, operational and financial objectives. This includes adjusting the risk profile in line with the Zurich Insurance Group's stated risk tolerance to respond to new threats and opportunities in order to optimize returns.

The Zurich Insurance Group's major risk management objectives are to:

- Protect the capital base by monitoring that risks are not taken beyond Zurich Insurance Group's risk tolerance
- Enhance value creation and contribute to an optimal risk-return profile by providing the basis for an efficient capital deployment
- Support Zurich Insurance Group's decision-making processes by providing consistent, reliable and timely risk information
- Protect Zurich Insurance Group's reputation and brand by promoting a sound culture of risk awareness and disciplined and informed risk taking

Risk management framework

In order to achieve its mission and objectives, the Zurich Insurance Group relies on its risk management framework.

At the heart of the risk management framework is a governance process with clear responsibilities for taking, managing, monitoring and reporting risks. The Zurich Insurance Group articulates the roles and responsibilities for risk management throughout the organization, from the Board of Directors and the Chief Executive Officer (CEO) to its businesses and functional areas, thus embedding risk management in the business (see the "Risk governance and risk management organization" section in the Risk review).

To support the governance process, Zurich Insurance Group relies on documented policies and guidelines. The Zurich Risk Policy is the Zurich Insurance Group's main risk governance document; it specifies Zurich Insurance Group's risk tolerance, risk limits and authorities, reporting requirements, procedures to approve any exceptions and procedures for referring risk issues to senior management and the Board of Directors. Limits are specified per risk type, reflecting Zurich Insurance Group's willingness and ability to take risk, considering earnings stability, economic capital adequacy, financial flexibility and liquidity, franchise value and reputation, Zurich Insurance Group's strategic direction and operational plan, and a reasonable balance between risk and return, aligned with economic and financial objectives. Zurich Insurance Group regularly enhances the Zurich Risk Policy to reflect new insights and changes in Zurich Insurance Group's environment and to reflect changes to the Zurich Insurance Group's risk tolerance. In 2012, the Zurich Risk Policy was updated and strengthened for various areas, including actuarial reserving in General Insurance, reinsurance, receivables and operational risk management, particularly outsourcing and business continuity management. Related procedures and risk controls were strengthened or clarified for these areas. As an ongoing process, adherence to requirements stated in the Zurich Risk Policy is assessed.

One of the key elements of Zurich Insurance Group's risk management framework is to foster risk transparency by establishing risk reporting standards throughout Zurich Insurance Group. Zurich Insurance Group regularly reports on its risk profile, current risk issues, adherence to its risk policies and improvement actions both at a local and on a Zurich Insurance Group level. Zurich Insurance Group has procedures in place for the timely referral of risk issues to senior management and the Board of Directors.

Various governance and control functions coordinate to help ensure that objectives are being achieved, risks are identified and appropriately managed and internal controls are in place and operating effectively. This coordination is referred to as "integrated assessment and assurance."

Risk management is not only embedded in Zurich Insurance Group's business but is also aligned with Zurich Insurance Group's strategic and operational planning process. Zurich Insurance Group assesses risks systematically and from a strategic perspective through its proprietary Total Risk Profiling™ (TRP) process, which allows Zurich Insurance Group to identify and then evaluate the probability of a risk scenario occurring, as well as the severity of the consequences should it occur. Zurich Insurance Group then develops, implements and monitors appropriate improvement actions. The TRP process is integral to how Zurich Insurance Group deals with change, and is particularly suited for evaluating strategic risks as well as risks to its reputation. At Zurich Insurance Group level this process is performed annually, reviewed regularly and tied to the planning process.

In addition to this qualitative approach Zurich Insurance Group regularly measures and quantifies material risks to which it is exposed. Zurich Insurance Group's Zurich Economic Capital Model (Z-ECM) provides a key input into the Zurich Insurance Group's strategic planning process as it allows an assessment as to whether the Zurich Insurance Group's risk profile is in line with Zurich Insurance Group's risk tolerance. In particular, Z-ECM forms the basis for optimizing Zurich Insurance Group's risk-return profile by providing consistent risk measurement across Zurich Insurance Group.

An important element of Zurich Insurance Group's risk management framework is a well-balanced and effectively managed remuneration program. This includes a Zurich Insurance Group-wide remuneration philosophy, robust short- and long-term incentive plans, strong governance and links to the business planning, performance management and risk policies of Zurich Insurance Group. Based on the Zurich Insurance Group's Remuneration Rules, the Zurich Insurance Group's Board establishes the structure and design of the remuneration arrangements so that they do not encourage inappropriate risk taking. The Zurich Insurance Group Chief Risk Officer (Group CRO) consults with the other assurance, control and governance functions to provide the Zurich Insurance Group CEO with a review of risk factors to consider in the annual process to determine variable compensation. In 2012, the Zurich Insurance Group CRO strengthened the process through which the assurance, control and governance functions provide risk and compliance information about each Zurich Insurance Group Key Risk Taker as part of the annual individual performance assessment.

Through these processes, responsibilities and policies, Zurich Insurance Group embeds a culture of disciplined risk taking across Zurich Insurance Group. Zurich Insurance Group continues to consciously take risks for which it expects an adequate return. This approach requires sound judgment and an acceptance that certain risks can and will materialize in the future.

External perspectives

Various external stakeholders, among them regulators, rating agencies, investors and accounting bodies, place emphasis on the importance of sound risk management in the insurance industry.

Regulatory regimes, such as the Swiss Solvency Test in Switzerland and the regulatory principles of Solvency II in the European Union, emphasize a risk-based and economic approach, based on comprehensive quantitative and qualitative assessments and reports.

Rating agencies are interested in risk management as a factor in evaluating companies. Standard & Poor's, a rating agency with a separate rating for Enterprise Risk Management, has rated Zurich Insurance Group's overall Enterprise Risk Management as "strong." Reinsurance and credit risk controls remain "excellent." Market, asset/liability management, reserving, catastrophe and operational risk controls, as well as strategic and emerging risk management, are seen as "strong." Zurich Insurance Group is rated either "excellent" or "strong" in all of Standard & Poor's dimensions for Enterprise Risk Management.

Zurich Insurance Group also seeks external expertise from its International Advisory Council and Natural Catastrophe Advisory Council to better understand and assess risks, particularly regarding areas of complex change. For more information on these councils, see the "Corporate governance report (unaudited)." In addition, the Investment Management Advisory Council provides feedback to Investment Management on achieving superior risk-adjusted returns versus liabilities for Zurich Insurance Group's invested assets.

Risk review *continued*

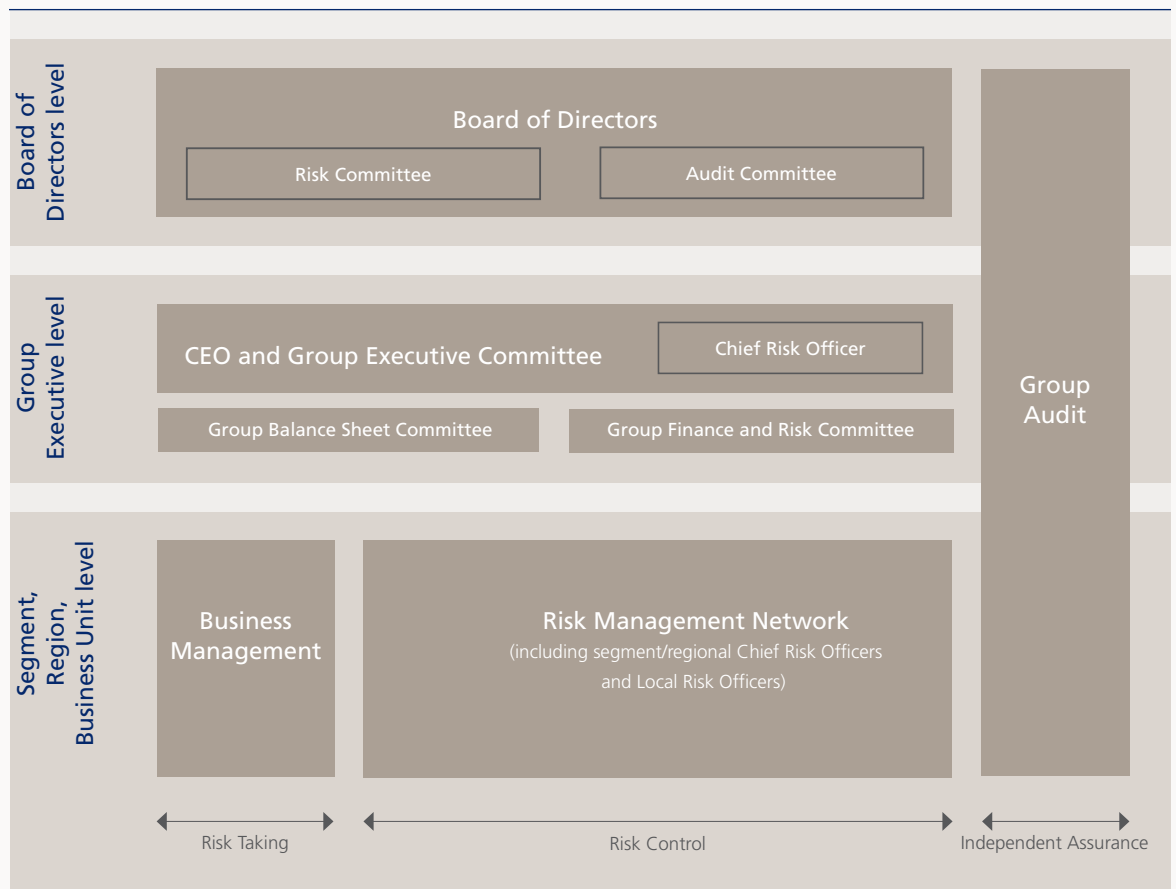
Zurich Insurance Group is also involved in a number of international industry organizations engaged in advancing the regulatory dialogue and sound risk management practices pertaining to insurance. Zurich Insurance Group is also a standing member of and actively contributes to the Emerging Risk Initiative of the CRO Forum (an organization composed of the chief risk officers of major insurance companies and financial conglomerates that focuses on developing and promoting industry best practices in risk management).

Zurich Insurance Group is a main contributor to the Global Risk Report that is produced by the World Economic Forum in cooperation with external partners (Swiss Re, Marsh & McLennan Companies and the Wharton Center for Risk Management). The report's assessment of the most pressing global risks and the interconnections among them provides valuable information for risk mitigation across the globe. Supporting the report is also part of the Zurich Insurance Group's commitment to corporate responsibility by sharing Zurich Insurance Group's expertise to help businesses, nations and society.

Risk governance and risk management organization

The section below gives an overview of the Zurich Insurance Group's risk governance and risk management organization.

Risk governance overview



The overview above highlights only key elements of the governance framework that specifically relate to risk management.

Board of Directors level

The Board of Directors of Zurich Insurance Group has ultimate oversight responsibility for Zurich Insurance Group's risk management. It establishes the guidelines for Zurich Insurance Group's risk management framework and key principles, particularly as articulated in the Zurich Risk Policy, and decides on changes to such guidelines and key principles, as well as transactions reaching specified thresholds.

The Risk Committee of the Board serves as a focal point for oversight regarding the Zurich Insurance Group's risk management, in particular the Zurich Insurance Group's risk tolerance, including agreed limits that the Board regards as acceptable for Zurich Insurance Group to bear, the aggregation of these limits across Zurich Insurance Group, the measurement of adherence to risk limits, and the Zurich Insurance Group's risk tolerance in relation to anticipated capital levels. The Risk Committee further oversees the Zurich Insurance Group-wide risk governance framework, including risk management and control, risk policies and their implementation, as well as risk strategy and the monitoring of operational risks. The Risk Committee also reviews the methodologies for risk measurement and the Zurich Insurance Group's adherence to risk limits. The Risk Committee further reviews, with business management and Zurich Insurance Group Risk Management function, Zurich Insurance Group's general policies and procedures and satisfies itself that effective systems of risk management are established and maintained. It receives regular reports from Zurich Insurance Group Risk Management and assesses whether significant issues of a risk management and control nature are being appropriately addressed by management in a timely manner. The Risk Committee assesses the independence and objectivity of the Zurich Insurance Group Risk Management function, approves its terms of reference, reviews the activities, plans, organization and quality of the function, and reviews key risk management principles and procedures.

To facilitate information exchange between the Audit Committee of the Board and the Risk Committee of the Board, at least one board member is a member of both committees. The Risk Committee met seven times in 2012 (once jointly with the Remuneration Committee).

Zurich Insurance Group Executive level

The Chief Executive Officer, together with the Zurich Insurance Group Executive Committee (GEC), oversees Zurich Insurance Group's performance with regard to risk management and control, strategic, financial and business policy issues of Zurich Insurance Group-wide relevance. This includes monitoring adherence to and further development of Zurich Insurance Group's risk management policies and procedures. The Zurich Insurance Group's Group Balance Sheet Committee and Zurich Insurance Group's Group Finance and Risk Committee regularly review and make recommendations on the Zurich Insurance Group's risk profile and significant risk-related issues.

The Chief Risk Officer is a member of the GEC and reports directly to the CEO and the Risk Committee of the Board. He is a member of each of the management committees listed below, in order to provide a common and integrated approach to risk management, to allow for appropriate quantification and, where necessary, mitigation of risks identified in these committees.

At a Zurich Insurance Group level the management committees dealing with risks are:

- Zurich Insurance Group's Group Balance Sheet Committee (GBSC) – acts as a cross-functional body whose main function is to control the activities that materially affect the balance sheets of Zurich Insurance Group and its subsidiaries. The GBSC is charged with setting the annual capital and balance sheet plans for Zurich Insurance Group based on Zurich Insurance Group's strategy and financial plans, as well as recommending specific transactions or unplanned business changes to the Zurich Insurance Group's balance sheet. The GBSC has oversight of all main levers of the balance sheet, including capital management, reinsurance, asset/liability management, and liquidity. The GBSC reviews and recommends Zurich Insurance Group's overall risk tolerance. It is chaired by the CEO.
- Zurich Insurance Group's Group Finance and Risk Committee (GFRC) – acts as a cross-functional body for financial and risk management matters in the context of the strategy and the overall business activity of Zurich Insurance Group. The GFRC oversees financial implications of business decisions and the effective management of the Zurich Insurance Group's overall risk profile, including risks related to insurance, financial markets and asset/liability, credit and operational risks as well as their interactions. The GFRC proposes remedial actions based on regular briefings from Zurich Insurance Group Risk Management on the risk profile of Zurich Insurance Group. It reviews and formulates recommendations for future courses of action with respect to potential merger and acquisition (M&A) transactions, changes to the Zurich Risk Policy, internal insurance programs for Zurich Insurance Group, material changes to the Zurich Insurance Group's risk-based capital methodology and the overall risk tolerance. The GFRC is chaired by the Chief Financial Officer, while the Chief Risk Officer acts as deputy.

Risk review *continued*

The management committees rely on output provided by technical committees, including:

- Asset/Liability Management and Investment Committee (ALMIC) – deals with Zurich Insurance Group's asset/liability exposure and investment strategies and is chaired by Zurich Insurance Group's Chief Investment Officer.
- General Insurance Global Underwriting Committee (GUC) – acts as a focal point for underwriting policy and related risk controls for General Insurance and is chaired by the Global Chief Underwriting Officer for General Insurance.
- Zurich Insurance Group Reinsurance Committee (GRC) – defines Zurich Insurance Group's reinsurance strategy in alignment with the Zurich Insurance Group's risk framework and is chaired by the Global Head of Zurich Insurance Group Reinsurance.

Representatives of Zurich Insurance Group Risk Management are members of all these technical committees.

Zurich Insurance Group Risk Management organization

The Chief Risk Officer leads the Zurich Insurance Group Risk Management function, which develops methods and processes for identifying, measuring, managing, monitoring and reporting risks throughout Zurich Insurance Group. Zurich Insurance Group Risk Management proposes changes to the risk management framework and Zurich Insurance Group's risk policies; it makes recommendations on the Zurich Insurance Group's risk tolerance and assesses the risk profile. The Chief Risk Officer is responsible for the oversight of risks across Zurich Insurance Group; he regularly reports risk matters to the Chief Executive Officer, senior management committees and the Risk Committee of the Board.

The Zurich Insurance Group Risk Management organization consists of central functions at Corporate Center and a decentralized risk management network at segment, regional, business unit and functional levels.

At Zurich Insurance Group level there are two centers of expertise: risk analytics and risk and control. The risk analytics department quantitatively assesses insurance, financial market and asset/liability, credit and operational risks and is Zurich Insurance Group's center of excellence for risk quantification and modeling. The risk and control department includes operational risk management, internal control framework, risk reporting, risk governance, and risk operations. The risk management network consists of the Chief Risk Officers (CROs) of Zurich Insurance Group's segments and regions, and the Local Risk Officers (LROs) of the business units and functions and their staff. While their primary focus is on operational and business-related risks, they are responsible for providing a holistic view of risk for their area. The risk officers are part of the management teams in their respective businesses and therefore are embedded in the business. The LROs also report to the segment or regional CROs, who in turn report to Zurich Insurance Group's Chief Risk Officer. The CROs of the Zurich Insurance Group's segments and regions are members of the leadership team of Zurich Insurance Group's Chief Risk Officer.

In addition to the risk management network, Zurich Insurance Group has audit and oversight committees at the major business and regional levels. The committees are responsible for providing oversight of the risk management and control functions. This includes monitoring adherence to policies and periodic risk reporting. At the local level, these oversight activities are conducted through risk and control committees or quarterly meetings between senior executives and the local heads of governance functions.

Analysis by risk type

Risk type description

In order to enable a consistent, systematic and disciplined approach to risk management, Zurich Insurance Group categorizes its main risks as follows:

- Strategic – the unintended risk that can result as a by-product of planning or executing a strategy
- Insurance – risk associated with the inherent uncertainty regarding the occurrence, amount or timing of insurance liabilities
- Market – risk associated with Zurich Insurance Group's balance sheet positions where the value or cash flow depends on financial markets
- Credit – risk associated with a loss or potential loss from counterparties failing to fulfill their financial obligations
- Liquidity – risk that Zurich Insurance Group does not have sufficient liquidity to meet its obligations when they fall due, or would have to incur excessive costs to do so
- Operational – risk associated with the people, processes and systems of Zurich Insurance Group, and external events such as outsourcing, catastrophes, legislation, or external fraud
- Reputation – risk that an act or omission by Zurich Insurance Group or any of its employees could result in damage to the Zurich Insurance Group's reputation or loss of trust among its stakeholders

Strategic risk

Strategic risk corresponds to the unintended risk that can result as a by-product of planning or executing the strategy. A strategy is a long term plan of action designed to allow Zurich Insurance Group to achieve its goals and aspirations. Strategic risks can arise from:

- Inadequate assessment of strategic plans
- Improper implementation of strategic plans
- Unexpected changes to assumptions underlying strategic plans

Risk considerations are a key element in the strategic decision-making process. Zurich Insurance Group assesses the implications of strategic decisions on risk-based return measures and risk-based capital in order to optimize the risk-return profile and to take advantage of economically profitable growth opportunities as they arise.

Zurich Insurance Group works on reducing the unintended risks of strategic business decisions through its risk assessment processes and tools, including the Total Risk Profiling™ process. Zurich Insurance Group Executive Committee regularly assesses key strategic risk scenarios for Zurich Insurance Group as a whole, including scenarios for emerging risks and their strategic implications.

Zurich Insurance Group specifically evaluates the risks of M&A transactions both from a quantitative and a qualitative perspective. Zurich Insurance Group conducts risk assessments of M&A transactions to evaluate risks specifically related to the integration of acquired businesses.

Risk review *continued*

Insurance risk

Insurance risk is the inherent uncertainty regarding the occurrence, amount or timing of insurance liabilities. The exposure is transferred to Zurich Insurance Group through the underwriting process. Zurich Insurance Group actively seeks to write those risks it understands and that provide a reasonable opportunity to earn an acceptable profit. As Zurich Insurance Group assumes certain customer risks, it aims to manage that transfer of risk, and minimize unintended underwriting risks, through such means as:

- Establishing limits for underwriting authority
- Requiring specific approvals for transactions involving new products or where established limits of size and complexity may be exceeded
- Using a variety of reserving and modeling methods to address the various insurance risks inherent in Zurich Insurance Group's insurance business
- Ceding insurance risk through proportional, non-proportional and specific risk reinsurance treaties. Zurich Insurance Group centrally manages reinsurance treaties.

General insurance risk

General insurance risk includes the reasonable possibility of significant loss due to uncertainty in the frequency of the occurrence of the insured events as well as in the severity of the resulting claims. The following provides an overview of Zurich Insurance Group's main lines of business:

- Motor includes automobile physical damage, loss of the insured vehicle and automobile third party liability insurance.
- Property includes fire risks (for example fire, explosion and business interruption), natural perils (for example earthquake, windstorm and flood), engineering lines (for example boiler explosion, machinery breakdown and construction) and marine (cargo and hull).
- Liability includes general/public and product liability, excess and umbrella liability, professional liability including medical malpractice, and errors and omissions liability.
- Special lines include directors and officers, credit and surety, crime and fidelity, accident and health, and crop.
- Worker injury includes workers compensation and employers liability.

Zurich Insurance Group's underwriting strategy is to take advantage of the diversification of general insurance risks across industries and geographic regions in which Zurich Insurance Group operates. Zurich Insurance Group seeks to optimize shareholder value by achieving its mid-term return on equity goals. Doing so necessitates a prudent, stable underwriting philosophy that aims to take advantage of its competitive strengths while avoiding risks with disruptive volatility. At the core of Zurich Insurance Group's underwriting is a robust governance process. Zurich Insurance Group's four major processes for underwriting governance – underwriting strategy, authorities, referrals and reviews – are implemented at Zurich Insurance Group and local levels.

A fundamental component of managing insurance risk is underwriting discipline. Zurich Insurance Group sets limits on underwriting capacity, and cascades authority to individuals based on their specific expertise. Through The Zurich Way, Zurich Insurance Group sets appropriate pricing guidelines with a focus on consistent technical pricing across the organization. As part of these guidelines, Zurich Insurance Group requires the setting of a technical price according to common standards. The technical price is set in a way that allows producing a return on risk-based capital in line with Zurich Insurance Group's target. The ratio of actual premium to technical price is a key performance metric, which is monitored regularly. Technical reviews confirm whether underwriters perform within authorities and adhere to underwriting philosophies and policies. Zurich Insurance Group's global line of business networks share best practices across the globe, providing additional guidance and governance. Zurich Insurance Group has governance procedures to review and approve potential new products to evaluate whether the risks are well understood and justified by the potential rewards.

Zurich Insurance Group faces the risk that actual losses emerging on claims provisions may be higher than anticipated. Because of this uncertainty, general insurance reserves are regularly measured, reviewed and monitored. The total loss and loss adjustment expense reserves are based on work performed by qualified and experienced actuaries at the local, regional and Zurich Insurance Group level. To arrive at their reserve estimates, the actuaries take into consideration, among other things, the latest available facts, historical trends and patterns of loss payments, exposure growth, court decisions, economic conditions, in particular inflation, and public attitudes that may affect the ultimate cost of settlement. Inflation is monitored on a country basis; the monitoring process relies on both Zurich Insurance Group's economic view on inflation and specific claims activity, and feeds into actuarial models and Zurich Insurance Group's underwriting processes such as technical price reviews.

In most instances these actuarial analyses are made at least twice a year for on-going business according to agreed timetables. Analyses are performed by product line, type and extent of coverage and year of occurrence. Zurich Insurance Group has reserve committees to facilitate communications and reporting regarding reserve opinions. A series of reserve committees feeds from the local level to regions and segments and into a Zurich Insurance Group reserve committee, where the Zurich Insurance Group's total loss and loss adjustment expense reserves are consolidated and recommended for approval by Zurich Insurance Group management. As with any projection there is an inherent uncertainty in the estimation of claim reserves due to the fact that the ultimate liability for claims will be impacted by trends as yet unknown including future changes in the likelihood of claimants bringing suit, the size of court awards, and the attitudes of claimants toward settlement of their claims.

Zurich Insurance Group closely monitors potential new emerging risk exposures. Zurich Insurance Group has an Emerging Risk Group (ERG), with cross-functional expertise from core insurance functions such as underwriting, claims and risk engineering in order to identify, assess and recommend actions for such risks on a Zurich Insurance Group level. In 2012, Zurich Insurance Group Risk Management also established a Zurich Insurance Group-wide network of functional experts to support the ERG in covering topics outside the underwriting scope such as political, legal and macro-economic trends or scenarios that may trigger the emergence of risks.

In addition to the specific risks insured, each line of business could expose Zurich Insurance Group to losses that could arise from natural and man-made catastrophes. The main concentrations of risks arising from such potential catastrophes are regularly reported to senior management. The most important peril regions and risks are United States and Caribbean tropical cyclone, Europe windstorm and California earthquake, as well as potential terrorism exposures.

Tables 1.a and 1.b show ZIC Group's concentration of risk within the General Insurance business by region and line of business based on direct written premiums before reinsurance. The ZIC Group's exposure to general insurance risks varies significantly by geographic region and may change over time. General insurance premiums ceded to reinsurers (including retrocessions) amounted to USD 5.9 billion and USD 5.3 billion for the years ended December 31, 2012 and 2011, respectively. Reinsurance programs such as catastrophe covers are managed on a global basis, and therefore, net premium after reinsurance is monitored on an aggregated basis.

Table 1.a

General Insurance – Direct written premiums and policy fees by line of business and by region – current period	in USD millions, for the year ended December 31, 2012	Motor	Property	Liability	Special lines	Worker injury	Total
	North America	1,372	3,225	3,313	1,628	2,463	12,000
Europe	5,854	4,613	2,400	2,029	437	15,333	
Other regions ¹	2,364	1,943	462	1,114	176	6,060	
Total	9,590	9,782	6,175	4,771	3,075	33,393	

¹ Including intercompany eliminations

Table 1.b

General Insurance – Direct written premiums and policy fees by line of business and by region – prior period	in USD millions, for the year ended December 31, 2011	Motor	Property	Liability	Special lines	Worker injury	Total
	North America	1,371	2,965	3,059	1,588	2,255	11,239
Europe	6,322	4,768	2,493	2,229	450	16,261	
Other regions ¹	2,043	1,661	446	581	148	4,880	
Total	9,736	9,394	5,998	4,399	2,853	32,379	

¹ Including intercompany eliminations

Risk review *continued*

Sensitivities analysis for general insurance risk

Tables 2.a and 2.b show the sensitivity of net income before tax and the sensitivity of net assets, using ZIC Group effective income tax rate, as a result of adverse development in the net loss ratio by one percentage point. Such an increase could arise from either higher frequency of the occurrence of the insured events or from an increase in the severity of resulting claims or from a combination of frequency and severity. The sensitivities do not indicate a probability of such an event and do not consider any non-linear effects of reinsurance. Based on the assumptions applied in the presentation of the sensitivity analysis in tables 2.a and 2.b, each additional percentage point increase in the loss ratio would lead to a linear impact on net income before tax and net assets. In addition, Zurich Insurance Group monitors insurance risk by evaluating extreme scenarios, taking into account non-linear effects of reinsurance contracts.

Table 2.a

Insurance risk sensitivity for the General Insurance business – current period		Global Corporate	North America Commercial	Europe	International Markets
in USD millions, for the year ended December 31, 2012					
+1% in net loss ratio					
Net income before tax		(55)	(76)	(118)	(43)
Net assets		(42)	(58)	(90)	(33)

Table 2.b

Insurance risk sensitivity for the General Insurance business – prior period		Global Corporate	North America Commercial	Europe	International Markets
in USD millions, for the year ended December 31, 2011					
+1% in net loss ratio					
Net income before tax		(54)	(76)	(126)	(34)
Net assets		(41)	(58)	(96)	(26)

Modeling natural catastrophes

Understanding the potential effects of natural catastrophes is a critical component of risk management for general insurance. While specific catastrophes are unpredictable, modeling helps to determine potential losses should catastrophes occur. Zurich Insurance Group uses a combination of third-party and in-house models to manage its underwriting and accumulations in modeled areas to stay within intended exposure limits and to guide the levels of reinsurance Zurich Insurance Group buys.

Zurich Insurance Group models exposures in a center of excellence for consistency in approach and to form a global perspective on accumulations. The center of excellence for catastrophe modeling works with the local businesses to help improve the overall quality of data, by analyzing and comparing data quality levels, providing priorities for data quality improvements and supporting implementation with advice and external data, where required. Zurich Insurance Group models potential losses from property policies located in hazard-prone areas with material exposure and adjusts for non-property related losses. These assessments principally address climate-induced perils such as windstorms, river floods, tornadoes and hail, and geologically induced perils such as earthquakes. Zurich Insurance Group constantly seeks to improve its modeling, fill in gaps in models with additional assessments and increase the granularity of data collection in order to increase the accuracy and utility of the information.

Zurich Insurance Group continues to improve the “Zurich view” of catastrophe risk by using output from multiple catastrophe models, by using internal and external expertise, for instance through the Natural Catastrophe Advisory Council, a group of scientists associated with research organizations such as the U.S. National Center for Atmospheric Research, the United States Geological Survey and the Intergovernmental Panel on Climate Change. Zurich Insurance Group further validates modeling results through comparisons with claims experience. In addition, Zurich Insurance Group continues its effort to extend assessments by evaluating potential non-modeled catastrophe hotspots and including appropriate modeling or loadings for non-modeled lines.

Risks from man-made catastrophes

Man-made catastrophes include such risks as industrial accidents and all types of terrorism attacks. Zurich Insurance Group's experience in monitoring potential exposures from natural catastrophes is also applicable to threats posed by man-made catastrophes, particularly terrorism.

Zurich Insurance Group reviews and aggregates worker injury and property exposures to identify areas of significant concentration. Zurich Insurance Group also assesses other lines of business, such as liability and auto, although the potential exposure is not as significant. The resulting data allows underwriters to evaluate how insuring a particular customer's risk might affect Zurich Insurance Group's overall exposure. In North America, Zurich Insurance Group uses a vendor-provided catastrophe model to evaluate potential exposures in every major U.S. city. Zurich Insurance Group undertakes more detailed and frequent analytics for cities in which Zurich Insurance Group has greater exposure.

Although Zurich Insurance Group's analysis has shown its exposures outside North America are lower, in large part due to government-provided pools, Zurich Insurance Group has extended its approach to improve its view of the risk for countries with the next greatest potential net exposure. Zurich Insurance Group periodically monitors accumulation limits for these and other areas, and continues to refine its analytics.

Life insurance risk

The risks associated with life insurance include:

- Mortality risk is the risk that actual policyholder death experience on life insurance policies is higher than expected.
- Longevity risk is the risk that annuitants live longer than expected.
- Morbidity risk is the risk that policyholder health-related claims are higher than expected.
- Policyholder behavior risk is the risk that policyholders' behavior in discontinuing and reducing contributions or withdrawing benefits prior to the maturity of the contract is worse than expected. Poor persistency rates may lead to fewer policies remaining on the books to defray future fixed expenses and therefore reduce the future positive cashflows from the business written, potentially impacting its ability to recover deferred acquisition expenses.
- Expense risk is the risk that expenses incurred in acquiring and administering policies are higher than expected.
- Market risk is the risk associated with the Zurich Insurance Group's balance sheet positions where the value or cash flow depends on financial markets, which is analyzed in the "Market risk" section in the Risk review.
- Credit risk is the risk associated with a loss or potential loss from counterparties failing to fulfill their financial obligations, which is analyzed in the "Credit risk" section in the Risk review.

A more diversified portfolio of risks is less likely to be affected across the board by a change in any subset of the risks. As a result, the offsetting effects between unit-linked and traditional business reduce some of the risk associated with the Global Life business.

Zurich Insurance Group has local product development committees and a Zurich Insurance Group-level product approval committee, under the leadership of the Global Life Chief Risk Officer, for potential new life products that could significantly increase or change the nature of its risks. Such reviews allow Zurich Insurance Group to manage new risks inherent in its new business propositions. The Zurich Insurance Group regularly reviews the continued suitability and the potential risks of existing products.

Zurich Insurance Group's use of market-consistent embedded value reporting principles allows Zurich Insurance Group to further understand and report on the risk profile of its life products and how risks would change in differing market conditions. Embedded value is the measure that markets use to value life businesses and is considered industry best practice.

From a risk-management perspective, unit-linked products have been designed in order to reduce much of the market and credit risk associated with traditional business for Zurich Insurance Group. Those risks inherent in these products are largely passed on to the policyholder, although a portion of Zurich Insurance Group's management fees are linked to the value of funds under management and hence are at risk if the fund values decrease. Unit-linked products carry mortality risk and market risk to the extent that there are guarantees built into the product design. Contracts may have minimum guaranteed death benefits where the sum at risk depends on the fair value of the underlying investments. For certain contracts these risks are mitigated by explicit mortality and morbidity charges.

Risk review *continued*

Other life insurance liabilities include traditional life insurance products, which include protection products and life annuity products. Protection products carry mortality, longevity and morbidity risk as well as market and credit risk. The most significant factors that could increase the frequency of mortality claims are epidemics, such as strains of influenza, or lifestyle changes such as eating, drinking and exercise habits, resulting in earlier or more claims than expected. Morbidity claims experience would not only be affected by the factors mentioned above, but because disability is defined in terms of the ability to perform an occupation, it could also be affected by economic conditions. In order to reduce cross-subsidies in the pricing basis, premiums are differentiated, where permitted, for example by product, age, gender and smoker status. The policy terms and conditions and the disclosure requirements contained in insurance applications are designed to mitigate the risk arising from non-standard and unpredictable risks that may result in severe financial loss.

In the life annuity business, the most significant insurance risk is continued medical advances and improvement in social conditions that lead to increases in longevity. Annuitant mortality assumptions include allowance for future mortality improvements.

In addition to the specific risks listed above, Zurich Insurance Group is exposed to policyholder behavior and expense risks. Policyholder behavior risk is mitigated by product designs that match revenue and expenses associated with the contract as closely as possible. Expense risk is mitigated by careful control of expenses and by regular expense analyses and allocation exercises.

Certain life insurance contracts contain guarantees for which liabilities have been recorded for additional benefits and minimum guarantees. These arise primarily in the subsidiary Zurich American Life Insurance Company (ZALICO) (formerly known as KILICO) which in the past wrote variable annuity contracts that provide policyholders with certain guarantees related to minimum death and income benefits. After 2001, ZALICO no longer issued new policies with such features. Zurich Insurance Group has a dynamic hedging strategy to manage its economic exposure and reduce the volatility associated with its closed book of variable annuities products within its U.S. life business. New Life products developed with financial guarantees are subject to review and approval by the Zurich Insurance Group-level product approval committee.

Zurich Insurance Group defines concentration risk in the Global Life business as the risk of exposure to increased losses associated with inadequately diversified portfolios of assets or obligations. Concentration risk for a life insurer may arise with respect to investments in a geographical area, economic sector, or individual issuers, or due to a concentration of business written within a geographical area, of a policy type, or of underlying risks covered.

Zurich Insurance Group is exposed to two main types of concentration risk in its Global Life business:

- From a market risk perspective, interest rate guarantees in Germany and Switzerland expose Zurich Insurance Group to financial losses that may arise as a result of adverse movements in financial markets. Zurich Insurance Group also wrote a small book of variable annuity business in the U.S. with minimum guaranteed death benefits, but ceased writing new business in 2012. The management of these guarantees is a combination of asset-liability matching and hedging; see the "Market Risk" section in the Risk Review.
- From an insurance risk perspective, the main factors that would affect concentration risk include mortality risk, morbidity risk, longevity risk, policyholder behavior risk (lapse, anti-selection) and expense risk. There is diversification across geographical regions, lines of business and even across the different insurance risk factors such that Zurich Insurance Group is not exposed to significant concentrations of insurance risk.

Table 3 shows the ZIC Group's concentration of risk within the life business by region and line of business based on reserves for life Insurance on a net basis. Zurich Insurance Group's exposure to life insurance risks varies significantly by geographic region and line of business and may change over time.

See note 8 of the Consolidated financial statements for additional information on reserves for insurance contracts.

Sensitivities analysis for life insurance risk

The ZIC Group reports sensitivities for the Global Life business on Embedded Value and New Business Value to changes in economic and operating risk factors. The operating factors include discontinuance rates, expenses, mortality and morbidity. The embedded value methodology adopted by Zurich Insurance Group is based on a market-consistent approach to allow explicitly for market risks. See the "Embedded value report" in the Zurich Insurance Group Annual Report 2012 (section 9. Sensitivities) for more information on the sensitivities for the Global Life business to economic and operating risk factors.

Reserves, net of reinsurance, by region

Table 3

in USD millions, as of December 31

	Unit-linked insurance contracts		Other life insurance liabilities		Total reserves	
	2012	2011	2012	2011	2012	2011
	Global Life					
North America	627	525	5,307	5,214	5,934	5,739
Latin America	10,256	10,165	5,204	3,400	15,460	13,565
Europe	47,979	44,218	80,468	75,763	128,447	119,981
United Kingdom	28,719	27,064	5,200	5,056	33,919	32,120
Germany	11,095	9,166	43,084	40,004	54,179	49,170
Switzerland	708	639	19,741	18,672	20,450	19,311
Ireland	1,731	880	1,727	1,519	3,458	2,399
Spain	4,808	5,416	5,981	6,007	10,789	11,423
Rest of Europe	918	1,053	4,734	4,505	5,652	5,559
Asia-Pacific and Middle East	3,371	2,420	3,035	3,005	6,406	5,424
Other	10	9	284	273	294	281
Eliminations	–	–	4	2	4	2
Subtotal	62,243	57,337	94,302	87,656	156,545	144,993
Other segments ¹	11,874	11,507	4,915	6,520	16,789	18,027
Total	74,117	68,844	99,217	94,176	173,334	163,020

¹ See note 29 of the Consolidated financial statements for additional information on Zurich Insurance Group's segments.

Reinsurance for general insurance and life insurance

Zurich Insurance Group's objectives for purchasing reinsurance are to provide market-leading capacity for customers while protecting the balance sheet and optimizing Zurich Insurance Group's capital efficiency. Zurich Insurance Group follows a centralized purchasing strategy for both segments, General Insurance and Global Life, and bundles programs where appropriate to benefit from diversification and economies of scale. These efforts for General Insurance have led to a decreasing expenditure for treaty reinsurance while growth in the General Insurance Global Corporate business has increased premium cessions to captives and co-reinsurers, resulting in an overall stable cession rate.

Due to its strong balance sheet, Zurich Insurance Group is able to structure and align its reinsurance programs to achieve an optimum risk/reward ratio. Zurich Insurance Group has managed its central reinsurance purchasing according to these principles for General Insurance since 2003 and for Global Life since 2008. Zurich Insurance Group is therefore able to manage its risks to retain a significant and stable portion of premium.

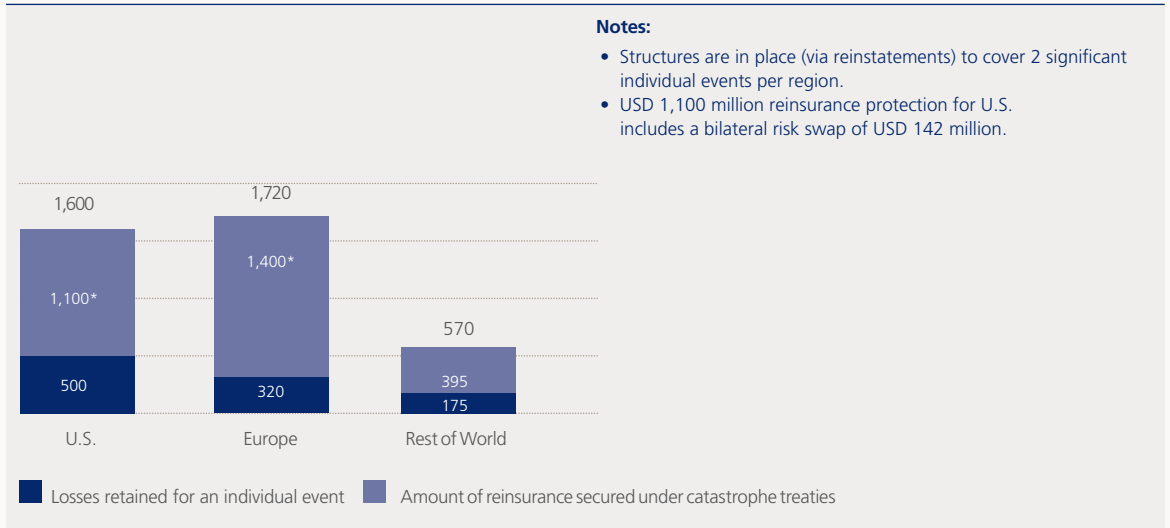
Zurich Insurance Group continues to use traditional reinsurance markets and other alternatives, such as catastrophe bonds, to protect against extreme single events and increased frequency of events. Zurich Insurance Group is able to use its global reach in particular for catastrophe protection, where it has in place a combination of per event and annual aggregate covers, which protects Zurich Insurance Group's business both per event and by region, and also for multiple events across regions. This helps to reduce the risks posed by the frequency of catastrophes, as well as their severity.

Zurich Insurance Group uses reinsurance to manage risk to unusually severe or unusually frequent events through the main in-force reinsurance covers as of December 31, 2012 for natural catastrophe events. Zurich Insurance Group participates in the underlying risks through its retention and through its participation in the excess layers. The contracts are on a risk-occurrence basis except the aggregate catastrophe cover which operates on an annual aggregate basis. In addition to these covers, Zurich Insurance Group has per risk programs, local catastrophe covers, bilateral risk swaps and catastrophe bonds in place. These covers are reviewed continuously and are subject to change going forward. The current covers are placed annually, January 1 for the U.S. Program and the Global Aggregate Catastrophe Cover; April 1 for the European Program and July 1 for the Rest of the World Program.

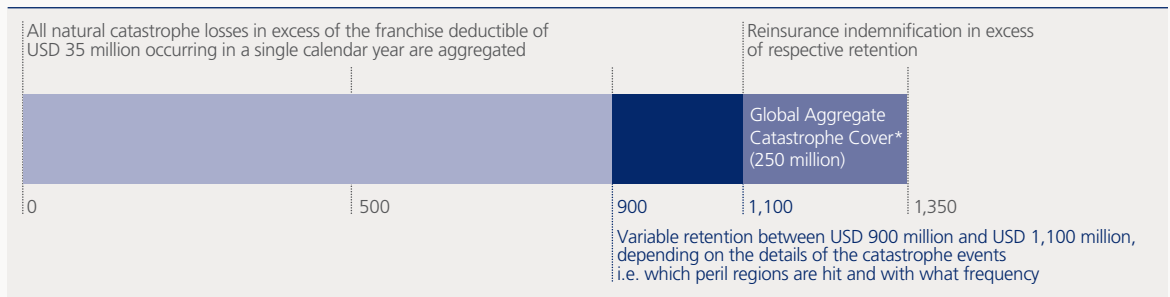
In 2012, the only major natural catastrophe event to affect Zurich Insurance Group was Storm Sandy; Zurich Insurance Group's reinsurance covers allowed Zurich Insurance Group to limit the pre-tax net impact to USD 756 million. (This figure includes the reinstatement premium payable to reinsurers and the impact from Farmers Re.)

Risk review *continued*

Reinsurance for natural catastrophes – unusually severe natural catastrophe events
(in USD millions, as of December 31, 2012)



Reinsurance for natural catastrophes – unusually frequent natural catastrophe events
(in USD millions, as of December 31, 2012)



*On a co-participation basis, as summarized below:

U.S. Catastrophe Treaty (USD 1,100 million)	Co-participation varies by layer and is approximately 36% overall.
European Catastrophe Treaty (USD 1,400 million)	Co-participation varies by layer and is approximately 39% overall.
Global Aggregate Catastrophe Cover (USD 250 million)	Cover operates on an annual aggregate basis. Co-participation is 30%.

Market risk

Market risk is the risk associated with the Zurich Insurance Group's balance sheet positions where the value or cash flow depends on financial markets. Fluctuating risk drivers resulting in market risk include:

- Equity market prices
- Real estate market prices
- Interest rates and credit spreads
- Currency exchange rates

Zurich Insurance Group manages the market risk of assets relative to liabilities on an economic total balance sheet basis. It strives to maximize the economic risk-adjusted excess return of assets relative to the liability benchmark taking into account Zurich Insurance Group's risk tolerance as well as local regulatory constraints.

Zurich Insurance Group has policies and limits to manage market risk. Zurich Insurance Group aligns its strategic asset allocation to its risk-taking capacity. Zurich Insurance Group centralizes management of certain asset classes to control aggregation of risk, and provides a consistent approach to constructing portfolios and selecting external asset managers. Zurich Insurance Group also diversifies portfolios, investments and asset managers. Zurich Insurance Group regularly measures and manages market risk exposure. Zurich Insurance Group has established limits on concentration in investments by single issuers and certain asset classes as well as deviations of asset interest rate sensitivities from liability interest rate sensitivities, and Zurich Insurance Group limits investments that are illiquid.

The Zurich Insurance Group's Group Balance Sheet Committee reviews and recommends Zurich Insurance Group's capital allocation to market risk, while the Asset/Liability Management and Investment Committee reviews and monitors Zurich Insurance Group's strategic asset allocation and tactical boundaries and monitors the Zurich Insurance Group's asset/liability exposure. Zurich Insurance Group oversees the activities of local Asset/Liability Management and Investment Committees and regularly assesses market risks both at a Zurich Insurance Group and at a local business level. Risk assessment includes quantification of the contributions to financial market risk from major risk drivers. The economic effect of potential extreme market moves is regularly examined and considered when setting the asset allocation.

Risk assessment reviews include the analysis of the management of interest rate risk for each major maturity bucket and adherence to the aggregated positions with risk limits.

Zurich Insurance Group applies processes to manage market risk scenarios to test and analyze market hotspots, and risk mitigation actions are taken if necessary to manage fluctuations affecting asset/liability management and risk-based capital.

Zurich Insurance Group uses derivative financial instruments to limit market risks arising from changes in currency exchange rates, interest rates, equity prices and credit quality of assets and liabilities and commitments to third parties. Zurich Insurance Group enters into derivative financial instruments mostly for economic hedging purposes and, in limited circumstances, the instruments may also meet the definition of an effective hedge for accounting purposes. The latter include cross-currency interest rate swaps in fair value hedges and cross-currency swaps in cash flow hedges of Zurich Insurance Group's borrowings, in order to mitigate exposure to foreign currency and interest rate risk. In compliance with Swiss insurance regulation, Zurich Insurance Group's policy prohibits speculative trading in derivatives, meaning a pattern of "in and out" activity without reference to an underlying position. Derivatives are complex financial transactions; therefore, Zurich Insurance Group addresses the risks arising from derivatives through a stringent policy that requires approval of a derivative program before transactions are initiated, and by subsequent regular monitoring by Zurich Insurance Group Risk Management of open positions and annual reviews of derivative programs.

For more information on Zurich Insurance Group's investment result, including impairments and the treatment of selected financial instruments, see note 6 of the Consolidated financial statements. For more information on derivative financial instruments and hedge accounting, see note 7 of the Consolidated financial statements.

Risk from equity securities and real estate

Zurich Insurance Group is exposed to various risks resulting from price fluctuations on equity securities and real estate. Risks arising from equity securities and real estate could affect Zurich Insurance Group's liquidity, reported income, surplus and regulatory capital position. The exposure to equity risk includes common stocks, including equity unit trusts; common stock portfolios backing participating-with-profit policyholder contracts, and equities held for

Risk review *continued*

employee benefit plans. The exposure to real estate risk includes direct holdings in real estate, listed real estate company shares and funds, as well as real estate debt securities such as commercial and residential mortgages, commercial and residential mortgage-backed securities and mezzanine debt. Returns on unit-linked contracts, whether classified as insurance or investment contracts, may be exposed to risks from equity and real estate, but these risks are borne by policyholders. However, the Zurich Insurance Group is indirectly exposed to market movements from unit-linked contracts both with respect to earnings and with respect to economic capital. Market movements impact the amount of fee income earned when the fee income level is dependent on the valuation of the asset base. Therefore, the value of in-force business for unit-linked business can be negatively impacted by adverse movements in equity and real estate markets.

Zurich Insurance Group manages its risks from equity securities and real estate as part of the overall investment risk management process, and applies limits as expressed in policies and guidelines. Specifically, Zurich Insurance Group has limits for holdings in equities, real estate and alternative investments.

For additional information on equity securities and real estate held for investment, see note 6 of the Consolidated financial statements.

Risk from interest rate and credit spread

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. Zurich Insurance Group is exposed to interest rate risk including from debt securities, reserves for insurance contracts, liabilities for investment contracts, employee benefit plans and loans and receivables. Changes in interest rates affect Zurich Insurance Group's held-to-maturity floating-rate debt securities and unhedged floating-rate borrowings through fluctuations in interest income and interest expense. Changes in interest rates affect Zurich Insurance Group's held-for-trading debt securities and fair value hedged borrowings through periodic recognition of changes in their fair values through the income statement. Changes in interest rates affect the Zurich Insurance Group's available-for-sale debt securities through periodic recognition of changes in their fair values through shareholders' equity. Zurich Insurance Group also manages credit spread risk, which describes the sensitivity of the values of assets and liabilities due to changes in the level or the volatility of credit spreads over the risk-free interest rate yield curves.

Returns on unit-linked contracts, whether classified as insurance or investment contracts, are at the risk of the policyholder; however, Zurich Insurance Group is exposed to fluctuations in interest rates in so far as they impact the amount of fee income earned if the fee income level is dependent on the valuation of the asset base.

Risk management initiatives during 2012

Throughout the year, Zurich Insurance Group closely monitored the investment risk taken in a challenging financial market environment, and several actions were taken in order to reduce risks from equities, interest rates, and credit spreads. On equity risk, macro hedges have been implemented to reduce the tail risk to Asian, European and U.S. markets. On interest rate risk, duration mismatch has been further reduced through duration lengthening, in particular in Europe.

In addition, changes in the economic, legal and regulatory environment in Germany have been reflected in the modeling and contributed to the significant reduction in interest rate exposures from the German life business. These changes are driving the movements in the interest rate and credit spread sensitivities from the euro (EUR) in tables 5.a, 5.b, 11.a and 11.b.

Analysis of market risk sensitivities

Basis of presentation – General Insurance and rest of the businesses

The basis of the presentation below is an economic valuation represented by the fair value for ZIC Group investments, IFRS insurance liabilities discounted at risk-free market rates (Zurich Insurance Group describes risk-free market rates as swap rates) to reflect the present value of insurance liability cash flows and other liabilities, for example own debt. In the sensitivities, own debt does not include subordinated debt, which Zurich Insurance Group considers available to protect policyholders in a worst-case situation.

Tables 4.a, 4.b, 6.a and 6.b show the estimated economic market risk sensitivities of ZIC Group investments, including real estate for own use, liabilities, including insurance and financial liabilities, and the net impact for General Insurance and the rest of the businesses. Positive values represent an increase of the balance, whereas values in parentheses represent a decrease of the balance. Increases in the value of liabilities and decreases in the value of assets represent an economic risk for the ZIC Group. The net impact is the difference between the impact on ZIC Group investments

and liabilities. The net impact represents the economic risk the ZIC Group faces related to changes in market risk factors. This is in line with management's monitoring of the Zurich Insurance Group's investment and liabilities base. In order to limit the economic impact of interest rate, equity and real estate risk, Zurich Insurance Group has limits on holdings in real assets and limits on deviations of asset interest rate sensitivities from liability interest rate sensitivities.

For determining the sensitivities, investments and liabilities are fully re-valued in the given scenarios. Each instrument is re-valued separately taking the relevant product features into account. Non-linear effects, where they exist, are fully reflected in the model. The sensitivities are shown after tax. They do not include the impact of Zurich Insurance Group-internal transactions.

Tables 6.a and 6.b on sensitivities for the rest of the businesses include Farmers, Other Operating Businesses and Non-Core Businesses. Where Non-Core Businesses includes business with life insurance characteristics, the analysis is based on market-consistent embedded value market risk sensitivities. See the "Embedded value report" in the Zurich Insurance Group Financial Report 2012 (section 12. Embedded Value methodology, (r) Sensitivities and section 13. Embedded Value assumptions, (a) Economic assumptions) for more details on the market risk sensitivities specifications.

Limitations of the analysis:

- The sensitivity analysis does not take into account actions that might be taken to mitigate losses, as Zurich Insurance Group uses an active strategy to manage these risks. This strategy may involve changing the asset allocation, for example through selling and buying assets.
- The sensitivities show the effects of a change of certain risk factors, while other assumptions remain unchanged.
- The interest rate scenarios assume a parallel shift of all interest rates in the respective currencies. They do not take into account the possibility that interest rate changes might differ by rating class; these are disclosed separately as credit spread risk sensitivities.
- The equity market scenarios assume a concurrent movement of all stock markets.
- The sensitivities do not indicate a probability of such events occurring in the future. They do not necessarily represent Zurich Insurance Group's view of expected future market changes. In addition to the sensitivities, management uses stress scenarios to assess the impact of more severe market movements on the ZIC Group's financial condition.
- The sensitivity analysis is based on economic net assets, and not on IFRS equity or on IFRS profit and loss.
- The sensitivity analysis is calculated after tax; the ZIC Group effective tax rate is assumed to be 23.9 percent for 2012. For 2011, it is calculated at 23.7 percent. For the Non-Core Businesses with life insurance characteristics, specific tax rates have been applied.

Basis of presentation – Global Life

Tables 5.a and 5.b show the estimated economic sensitivity of the Embedded Value of the Global Life business to financial market movements. In modeling these exposures, where appropriate, allowance has been made for dynamic actions that would be taken by management or by policyholders. For contracts with financial options and guarantees, such as some participating business, movements in financial markets can change the nature and value of these benefits. The dynamics of these liabilities are captured so that this exposure is quantified, monitored, managed and where appropriate, mitigated.

Limitations of the analysis:

- The sensitivities show the effects of a change in certain risk factors, while other assumptions remain unchanged, except where they are directly affected by the revised conditions.
- The market risk scenarios assume a concurrent movement of all stock markets and an unrelated parallel shift of all interest rates in different currencies.
- The assumptions on policyholder behavior, such as lapsing of policies, included in the sensitivity analysis for Global Life may be different from actual behavior. Therefore, the actual impact may deviate from the analysis.

Analysis of economic sensitivities for interest rate risk

Tables 4.a through 6.b show the estimated impacts of a 100 basis point increase/decrease in yield curves of the major currencies U.S. dollar (USD), euro (EUR), British pound (GBP), Swiss franc (CHF) and "other currencies" after consideration of hedges in place, as of December 31, 2012 and 2011, respectively.

Risk review *continued*

Table 4.a						
Economic interest rate sensitivities for the General Insurance business – current period	in USD millions, as of December 31, 2012					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Group investments	(1,314)	(578)	(352)	(341)	(186)	(2,772)
Liabilities	(1,146)	(411)	(368)	(364)	(109)	(2,397)
Net impact before tax	(168)	(167)	16	22	(78)	(375)
Tax impact	40	40	(4)	(5)	19	90
Net impact after tax	(128)	(127)	12	17	(59)	(285)
100 basis points decrease in the interest rate yield curves						
Group investments	1,005	490	351	237	184	2,266
Liabilities	1,049	342	391	334	111	2,228
Net impact before tax	(44)	147	(41)	(97)	73	38
Tax impact	11	(35)	10	23	(17)	(9)
Net impact after tax	(34)	112	(31)	(74)	55	29

Table 4.b						
Economic interest rate sensitivities for the General Insurance business – prior period	in USD millions, as of December 31, 2011					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Group investments	(1,082)	(469)	(302)	(318)	(160)	(2,331)
Liabilities	(1,141)	(361)	(348)	(352)	(100)	(2,301)
Net impact before tax	59	(108)	45	34	(61)	(30)
Tax impact	(14)	25	(11)	(8)	14	7
Net impact after tax	45	(82)	35	26	(46)	(23)
100 basis points decrease in the interest rate yield curves						
Group investments	877	449	266	195	149	1,936
Liabilities	999	337	339	297	99	2,070
Net impact before tax	(122)	112	(73)	(102)	51	(134)
Tax impact	29	(27)	17	24	(12)	32
Net impact after tax	(93)	86	(56)	(78)	39	(102)

Table 5.a						
Economic interest rate sensitivities for the Global Life business – current period	in USD millions, as of December 31, 2012					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Total impact on Embedded Value	(130)	(165)	(98)	142	(100)	(350)
100 basis points decrease in the interest rate yield curves						
Total impact on Embedded Value	61	365	111	(140)	68	465

Table 5.b						
Economic interest rate sensitivities for the Global Life business – prior period	in USD millions, as of December 31, 2011					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Total impact on Embedded Value	(79)	520	(17)	255	(100)	578
100 basis points decrease in the interest rate yield curves						
Total impact on Embedded Value	(9)	(1,095)	(19)	(309)	83	(1,349)

Table 6.a						
Economic interest rate sensitivities for the rest of the businesses – current period	in USD millions, as of December 31, 2012					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Group investments	(831)	(146)	(21)	(36)	(1)	(1,034)
Liabilities	(585)	(166)	(18)	(117)	–	(887)
Net impact before tax	(245)	21	(3)	81	(1)	(147)
Tax impact	64	(5)	1	(19)	–	40
Net impact after tax	(182)	16	(2)	62	–	(107)
100 basis points decrease in the interest rate yield curves						
Group investments	895	109	23	26	1	1,054
Liabilities	642	140	20	34	–	837
Net impact before tax	252	(31)	3	(8)	1	217
Tax impact	(62)	7	(1)	2	–	(54)
Net impact after tax	190	(24)	2	(6)	–	163

Table 6.b						
Economic interest rate sensitivities for the rest of the businesses – prior period	in USD millions, as of December 31, 2011					
	USD	EUR	GBP	CHF	Other currencies	Total
100 basis points increase in the interest rate yield curves						
Group investments	(731)	(113)	(15)	(5)	(1)	(865)
Liabilities	(588)	(5)	(9)	(3)	–	(605)
Net impact before tax	(143)	(107)	(6)	(2)	(1)	(260)
Tax impact	34	25	2	1	–	61
Net impact after tax	(109)	(82)	(5)	(2)	(1)	(199)
100 basis points decrease in the interest rate yield curves						
Group investments	896	105	17	6	1	1,024
Liabilities	759	6	8	2	–	774
Net impact before tax	136	99	9	5	1	250
Tax impact	(31)	(23)	(2)	(1)	–	(58)
Net impact after tax	105	75	7	4	1	192

Risk review *continued*

Analysis of economic sensitivities for equity risk

Tables 7 through 9 show the estimated impacts from a 10 percent decline in stock markets, after consideration of hedges in place, as of December 31, 2012 and 2011, respectively.

Table 7				
Economic equity price sensitivities for the General Insurance business	in USD millions, as of December 31		2012	2011
	10% decline in stock markets			
	Group investments		(456)	(473)
	Liabilities		–	–
	Net impact before tax		(456)	(473)
	Tax impact		109	112
	Net impact after tax		(347)	(361)

Table 8				
Economic equity price sensitivities for the Global Life business	in USD millions, as of December 31		2012	2011
	10% decline in stock markets			
	Total impact on Embedded Value		(246)	(298)

Table 9				
Economic equity price sensitivities for the rest of the businesses	in USD millions, as of December 31		2012	2011
	10% decline in stock markets			
	Group investments		(171)	(117)
	Liabilities		34	57
	Net impact before tax		(205)	(174)
	Tax impact		48	42
	Net impact after tax		(157)	(133)

Analysis of economic sensitivities for credit spread risk

Tables 10.a through 12.b show the estimated impacts from a 100 basis points increase in corporate credit spreads, as of December 31, 2012 and 2011, respectively. Credit spread risk is modeled on ZIC Group investments only, and does not impact the liabilities. Zurich Insurance Group uses a risk-free rate for the valuation of its liabilities.

Table 10.a								
Economic credit spread sensitivities for the General Insurance business – current period	in USD millions, as of December 31, 2012							
		USD	EUR	GBP	CHF	Other currencies	Total	
	100 basis points increase in credit spreads							
	Net impact before tax							
	Tax impact							
	Net impact after tax							

Table 10.b								
Economic credit spread sensitivities for the General Insurance business – prior period	in USD millions, as of December 31, 2011							
		USD	EUR	GBP	CHF	Other currencies	Total	
	100 basis points increase in credit spreads							
	Net impact before tax							
	Tax impact							
	Net impact after tax							

Table 11.a							
Economic credit spread sensitivities for the Global Life business – current period	in USD millions, as of December 31, 2012	USD	EUR	GBP	CHF	Other currencies	Total
	100 basis points increase in credit spreads						
	Total Impact on Embedded Value	(189)	(282)	(100)	(250)	(130)	(951)

Table 11.b							
Economic credit spread sensitivities for the Global Life business – prior period	in USD millions, as of December 31, 2011	USD	EUR	GBP	CHF	Other currencies	Total
	100 basis points increase in credit spreads						
	Total impact on Embedded Value	(191)	(612)	(113)	(224)	(88)	(1,229)

Table 12.a							
Economic credit spread sensitivities for the rest of the businesses – current period	in USD millions, as of December 31, 2012	USD	EUR	GBP	CHF	Other currencies	Total
	100 basis points increase in credit spreads						
	Net impact before tax	(320)	(72)	2	(4)	–	(394)
	Tax impact	88	17	–	1	–	106
	Net impact after tax	(232)	(55)	1	(3)	–	(288)

Table 12.b							
Economic credit spread sensitivities for the rest of the businesses – prior period	in USD millions, as of December 31, 2011	USD	EUR	GBP	CHF	Other currencies	Total
	100 basis points increase in credit spreads						
	Net impact before tax	(521)	(15)	–	(3)	(1)	(540)
	Tax impact	156	4	–	1	–	160
	Net impact after tax	(365)	(12)	–	(2)	(1)	(380)

Risk review *continued*

Currency risk

Currency risk is the risk of loss resulting from changes in exchange rates. Zurich Insurance Group operates internationally and therefore is exposed to the financial impact arising from changes in the exchange rates of various currencies. Zurich Insurance Group's presentation currency is the U.S. dollar, but its assets, liabilities, income and expenses are denominated in many currencies, with significant amounts in the euro, Swiss franc, British pound, as well as the U.S. dollar.

On local balance sheets there is the risk that a currency mismatch may lead to fluctuations in a balance sheet's net asset value, either through income or directly through equity. Zurich Insurance Group manages this risk by matching foreign currency positions on local balance sheets within prescribed limits. Residual local mismatches are reported centrally in order to make use of the netting effect across Zurich Insurance Group. Zurich Insurance Group then hedges residual mismatches from local balance sheets through a central balance sheet within an established limit. The monetary currency risk exposure on local balance sheets is considered immaterial.

Because Zurich Insurance Group has chosen the U.S. dollar as its presentation currency, differences arise when functional currencies are translated into the presentation currency. In December 2012, Zurich Insurance Group started to apply net investment hedge accounting in order to protect against the effects of changes in certain exchange rates on selected net investments. Zurich Insurance Group does not take speculative positions on foreign currency market movements. Using constant exchange rates from one year to the next, the Zurich Insurance Group's 2012 net income attributable to shareholders would have been higher by USD 48 million (applying 2011 exchange rates to the 2012 result). In 2011 the result would have been lower by USD 130 million (applying 2010 exchange rates to the 2011 results).

Table 13 shows the sensitivity of the total IFRS equity to changes in exchange rates for the main functional currencies to which the ZIC Group is exposed. Positive values represent an increase in the value of ZIC Group's total equity. The sensitivity analysis does not take into account management actions that might be taken to mitigate such changes. The sensitivities show the effects of a change of the exchange rates only, while other assumptions remain unchanged. The sensitivities do not indicate a probability of such events occurring in the future. They do not necessarily represent Zurich Insurance Group's view of expected future market changes. While table 13 shows the effect of a 10 percent increase in currency exchange rates, a decrease of 10 percent would have the converse effect.

See notes 1, 3 and 7 of the Consolidated financial statements for additional information on foreign currency translation and transactions.

Table 13

Sensitivity of the ZIC Group's total IFRS equity to exchange rate fluctuations

in USD millions, as of December 31		2012	2011 ¹
10% increase in			
EUR/USD rate		904	769
GBP/USD rate		323	311
CHF/USD rate		(286)	(302)
Other currencies/USD rates		787	752

¹ Restated as set out in note 1 of the Consolidated financial statements.

Credit risk

Credit risk is the risk associated with a loss or potential loss from counterparties failing to fulfill their financial obligations. The Zurich Insurance Group's exposure to credit risk is derived from the following main categories of assets:

- Cash and cash equivalents
- Debt securities
- Reinsurance assets
- Mortgage loans and mortgage loans given as collateral
- Other loans
- Receivables
- Derivatives

Zurich Insurance Group manages individual exposures as well as credit risk concentrations. Zurich Insurance Group's objective in managing credit risk exposures is to maintain them within parameters that reflect Zurich Insurance Group's strategic objectives and risk tolerance. Sources of credit risk are assessed and monitored, and Zurich Insurance Group has policies to manage the specific risks within the various subcategories of credit risk. To assess counterparty credit risk, Zurich Insurance Group uses the ratings assigned by external rating agencies, qualified third parties, such as asset managers, and internal rating assessments. When there is a difference among external rating agencies, Zurich Insurance Group assesses the reasons for the inconsistencies and applies the lowest of the respective ratings unless other indicators of credit quality justify the assignment of alternative internal credit ratings. Zurich Insurance Group maintains counterparty credit risk databases, which record external and internal sources of credit intelligence.

Zurich Insurance Group regularly tests and analyzes credit risk scenarios and prepares possible contingency measures, which may be implemented should the credit risk environment worsen. Zurich Insurance Group adjusts the scenarios if market conditions warrant.

Although Zurich Insurance Group actively uses collateral to mitigate credit risks, the principle is nevertheless to manage the underlying credit risks independently from the collateral. Zurich Insurance Group has limits and quality criteria to identify acceptable letter of credit providers. Letters of credit enable Zurich Insurance Group to limit the risks embedded in reinsurance captives, deductibles, trade credit and surety.

Macro review of the credit risk environment

During 2012, the European government-debt crisis led to ongoing downgrades of governments and government-related financial institutions. Spain and Italy and their financial institutions were downgraded by several notches. The negative trend spilled over to stronger governments such as France, which was downgraded by Moody's in November and the UK, which was placed on watch negative. Nevertheless, credit risk pressures have diminished significantly as reflected in improved implied ratings for sovereign debt markets. Zurich Insurance Group continues to assess the potential effect of remaining uncertainties, as actions by policymakers are the main determinants of credit market valuations for governments and related institutions.

Credit risk concentration

Zurich Insurance Group regularly monitors and limits credit exposures by individual counterparty and related counterparties by the aggregated exposure across various types of credit risk for that counterparty. Zurich Insurance Group's exposure to counterparties' parent companies and subsidiaries across sources of credit risk is aggregated to include reinsurance assets, investments, certain insurance products and derivatives. Best estimates, based on statistical data and own assessments, are used to assign loss-given-default percentages and loss dependency factors reflecting, for example, double default events. The aggregated exposure information is compared with the Zurich Insurance Group's credit limits. The limits vary based on the underlying rating category of the counterparty. There was no material exposure in excess of the Zurich Insurance Group's limits for counterparty aggregation as of December 31, 2012 and December 31, 2011, respectively. The Chief Risk Officer routinely reports the largest exposures to the Risk Committee of the Board.

The maximum exposure to credit risk consists mainly of on-balance sheet exposures. Off-balance sheet exposures are primarily related to collateral, such as letters of credit, used to protect the underlying credit exposures on the balance sheet. ZIC Group also has off-balance sheet exposures related to undrawn loan commitments of USD 16 million and USD 35 million as of December 31, 2012 and 2011, respectively. See note 25 of the Consolidated financial statements for undrawn loan commitments.

Risk review *continued*

Credit risk related to cash and cash equivalents

Zurich Insurance Group has significant exposure to cash and cash equivalents across the globe. In order to mitigate concentration, settlement and operational risks related to cash and cash equivalents, Zurich Insurance Group limits the maximum cash amount that can be deposited with a single counterparty. In addition, Zurich Insurance Group maintains an authorized list of acceptable cash counterparties based on current ratings and outlook, taking the analysis of fundamentals and market indicators into account.

Cash and cash equivalents amounted to USD 8.7 billion as of both December 31, 2012 and 2011. The risk-weighted average rating of the overall cash portfolio has decreased from "A+" to "A" in 2012 due to downgrades of several large financial institutions. 60 percent of the total was with the ten largest global banks, whose average rating was "A+" as of December 31, 2012 and December 31, 2011, respectively.

Credit risk related to debt securities

ZIC Group is exposed to credit risk from third party counterparties where the ZIC Group holds securities issued by those entities. Table 14 shows the credit risk exposure on debt securities, by issuer credit rating.

Rating	2012		2011	
	USD millions	% of total	USD millions	% of total
AAA	48,595	31.3%	54,730	37.9%
AA	48,384	31.2%	37,395	25.9%
A	26,718	17.2%	35,470	24.6%
BBB	28,315	18.2%	13,626	9.4%
BB and below	2,494	1.6%	2,519	1.8%
Unrated	748	0.5%	551	0.4%
Total	155,255	100.0%	144,289	100.0%

As of December 31, 2012, investment grade securities comprise 98.1 percent of ZIC Group's debt securities, and 31.3 percent were rated "AAA." The downgrades of several Eurozone governments and related entities caused breaches of internal rating category limits, which were managed as circumstances allowed. As of December 31, 2011, investment grade securities comprised 97.9 percent of debt securities, and 37.9 percent were rated "AAA." Zurich Insurance Group's investment policy prohibits speculative grade investments, unless specifically authorized and under exceptional circumstances. Where the Zurich Insurance Group identifies investments expected to be downgraded to below investment grade, it implements appropriate corrective actions.

Zurich Insurance Group measures the average issuer credit rating both with a linear and a risk-weighted scale. Despite the ongoing de-risking of the fixed income portfolio, the risk-weighted average issuer credit rating of the ZIC Group's debt securities portfolio is "A-/BBB+" (2011: "A+"). This is mainly due to ongoing downgrades of governments and government-related financial institutions in 2012 and the increase in value of the affected investments. Based on the linear scale, the average rating is "AA-" (2011: "AA") and therefore in line with the "AA-" target rating as set out in Zurich Insurance Group's risk policy.

As of December 31, 2012 the largest concentration in ZIC Group's debt securities portfolio is in government and supranational debt securities at 48.4 percent. A total of USD 38.9 billion or 48.5 percent of the non-government and non-supranational debt securities are secured. As of December 31, 2011, 46.5 percent of ZIC Group's debt portfolio was invested in governments and supranationals and a total of USD 38.6 billion or 49.9 percent of the non-government and non-supranational debt securities were secured.

Table 15			
The ZIC Group's debt exposure to Eurozone government & supranationals & similar	in USD millions, as of December 31		
		2012	2011
	Germany	9,282	8,150
	France	4,638	3,895
	Austria	2,892	2,318
	Belgium	1,959	1,585
	Netherlands	2,122	1,711
	Peripheral	11,301	10,607
	Greece	–	8
	Ireland	243	310
	Italy	6,646	5,330
	Portugal	531	424
	Spain	3,881	4,536
	Rest of Eurozone	974	607
	Eurozone Supranationals & similar	1,058	782
	Total	34,226	29,656

As shown in table 15, ZIC Group had debt exposure to Eurozone nations of USD 34.2 billion and USD 29.7 billion as of December 31, 2012 and 2011, respectively. Exposure to Greece, Ireland, Italy, Portugal and Spain amounted to USD 11.3 billion and USD 10.6 billion as of December 31, 2012 and 2011, respectively, with the increase primarily driven by tightening credit spreads. In line with Zurich Insurance Group's risk strategy, the Zurich Insurance Group capped cross-border investments in governments in the peripheral countries of Europe, while retaining in those countries government exposures that back underlying business. In addition to the debt exposure, ZIC Group had sovereign loan exposure of USD 4.7 billion and USD 4.9 billion to Germany as of December 31, 2012 and 2011, respectively.

The second largest concentration in ZIC Group's debt securities portfolio is to financial institutions (including banks), at 22.0 percent, of which 48.7 percent is secured. In response to the European government-debt crisis, the Zurich Insurance Group identified and selectively reduced unsecured and subordinated credit exposure issued by banks with weak credit profiles, and credit exposure to banks supported by weaker governments.

The third largest concentration in ZIC Group's debt securities portfolio is to structured finance securities (mortgage backed securities (MBS)/asset backed securities (ABS) and similar). Although credit risks of the underlying securities are diverse in nature, Zurich Insurance Group also considers macro impacts that may affect structured finance sub-categories (e.g. auto or credit card ABS's) in its credit assessments. Structured finance exposures are assessed on a look-through basis prior to acquisition and not merely on the strength of prevailing credit ratings or credit profiles.

Credit risk related to reinsurance assets

As part of its overall risk management strategy, Zurich Insurance Group cedes insurance risk through proportional, non-proportional and specific risk reinsurance treaties. While these cessions mitigate insurance risk, the recoverables from reinsurers and receivables arising from ceded reinsurance expose Zurich Insurance Group to credit risk.

Zurich Insurance Group's Corporate Reinsurance Security Committee manages the credit quality of cessions and reinsurance assets. The Zurich Insurance Group typically cedes new business to authorized reinsurers with a minimum rating of "A–" 58 percent and 57 percent of the business ceded to reinsurers that fall below "A–" or are not rated are collateralized, as of December 31, 2012 and 2011, respectively. Of these percentages, 50 percent and 52 percent are ceded to captive insurance companies, in 2012 and 2011, respectively.

Reinsurance assets include reinsurance recoverables of USD 19.9 billion and USD 19.7 billion as of December 31, 2012 and 2011, respectively, which are the reinsurers' share of reserves for insurance contracts, and receivables arising from ceded reinsurance, gross of allowance for impairment, of USD 1.1 billion and USD 1.2 billion as of December 31, 2012 and 2011, respectively. Reserves for potentially uncollectible amounts of reinsurance assets amount to USD 206 million

Risk review *continued*

and USD 206 million as of December 31, 2012 and 2011, respectively. The Zurich Insurance Group's policy on impairment charges takes into account both specific charges for known situations (e.g. financial distress or litigation) and a general, prudent provision for unanticipated impairments.

Reinsurance assets in table 16 are shown before taking into account the fair value of collateral such as cash or letters of credit from banks rated at least "A", which can be converted into cash and deposits received under ceded reinsurance contracts.

Compared with December 31, 2011, collateral increased by USD 100 million to USD 8.1 billion.

The risk-weighted average credit quality of reinsurance assets (including receivables, but after deduction of collateral) was "A" as of December 31, 2012 and 2011. Credit factors to determine the risk-weighted average credit quality of reinsurance assets are based on historical insurance impairment statistics, consistent with the prior year. For credit risk assessment purposes, collateral has been taken into account at nominal value as an approximation for fair value. For collateral, Zurich Insurance Group applies minimum requirements, such as a minimum rating for the issuers of letters of credit and guarantees, and for pledged assets a minimum coverage ratio of 100 percent.

Table 16 shows reinsurance premiums ceded and reinsurance assets split by rating.

	2012				2011			
	Premiums ceded		Reinsurance assets		Premiums ceded		Reinsurance assets	
	USD millions	% of total	USD millions	% of total	USD millions	% of total	USD millions	% of total
Rating								
AAA	77	1.2%	42	0.2%	75	1.1%	91	0.4%
AA	1,434	22.1%	8,852	42.6%	1,109	16.9%	6,631	32.0%
A	2,279	35.2%	6,959	33.5%	3,260	49.8%	9,527	46.0%
BBB	800	12.4%	2,080	10.0%	708	10.8%	1,887	9.1%
BB	213	3.3%	425	2.0%	185	2.8%	417	2.0%
B	34	0.5%	42	0.2%	45	0.7%	103	0.6%
Unrated	1,644	25.4%	2,390	11.5%	1,168	17.8%	2,042	9.9%
Total	6,481	100.0%	20,791¹	100.0%	6,550	100.0%	20,698¹	100.0%

¹ The value of the collateral received amounts to USD 8.1 billion and USD 8.2 billion as of December 31, 2012 and 2011, respectively.

Credit risk related to mortgage loans and mortgage loans given as collateral

Mortgage loans and mortgage loans given as collateral expose the Zurich Insurance Group to credit risk. The mortgage business is dependent on local property market conditions and local legislation. Investment portfolio allocations made to mortgages consider these factors and are within the framework of the strategic asset allocation defined by Zurich Insurance Group and adapted and approved by local investment committees. Conservative lending criteria (i.e. maximum mortgage loan to property value ratios) and the diversification of loans across many single borrowers, particularly in Germany and in Switzerland, help reduce potential loss. Furthermore, business units are required to clearly state criteria for determining borrower and collateral quality in their local mortgage policies. Zurich Insurance Group specifies requirements for the local policies and sets monitoring and reporting standards. Zurich Insurance Group closely monitors the performance of the portfolios in terms of impairments and losses.

ZIC Group's largest mortgage loan portfolios are in Germany (USD 4.8 billion) and in Switzerland (USD 4.1 billion); these are predominantly secured against residential property. In Switzerland, the underlying properties of individual loans are revalued every 10 years. In Germany, the property valuation is not generally reassessed after the granting of the mortgage loan. A less frequent or no revaluation of the underlying property means that reported loan-to-value (LTV) ratios will be higher (lower) than they would be if property prices have risen (fallen) since their valuation.

In Switzerland, the residential property market has seen steady price growth since 2000 and fast growth in the past five years, raising concerns about the development of a price bubble. Residential property price increases have been strongest in the main economic centers and more moderate in the rest of the country; residential prices in the Lake Geneva region have more than doubled since 2000, and in the Cantons of Zurich and Zug have increased by 60% and

95% respectively in the same period. In 2012, outstanding mortgages in the Lake Geneva region represent approximately 32% of the Swiss portfolio, mortgages in the Canton of Zurich and in the Canton of Zug represent 35% and 1.6% of the Swiss portfolio respectively. The bulk of those mortgages was granted before 2008 and is therefore not affected by price developments in the last five years. In Germany, residential prices have started to rise in the major cities, and in line with Zurich Insurance Group's investment policy, mortgage exposure has been reduced. To mitigate the impact of potential bubbles in the portfolio, Zurich Insurance Group has a process to regularly review regional property markets, and to tighten underwriting standards in areas with strong price appreciation. Zurich's German and Swiss mortgage portfolios remain strong and well managed; LTV lending buffers are generally strong, and loss impairments and losses remain low.

Mortgage loans given as collateral were related to a single bank borrowing that expired in 2012. At the expiration date of the loan, the mortgages were returned to Zurich Deutscher Herold Lebensversicherung AG, and as of December 31, 2012 there are no mortgages given as collateral outstanding. See note 15 of the Consolidated financial statements.

Credit risk related to other loans

The credit risk arising from other loans is assessed and monitored together with the fixed income securities portfolio. 66.1 percent of the reported loans are to municipalities or government or supranational institutions, of which 97.6 percent are to the German Central Government or the German Federal States. Table 17 shows the composition of the loan portfolio by rating class. As of December 31, 2012, a total of USD 8.0 billion or 68.3 percent of loans are secured. As of December 31, 2011, a total of USD 7.6 billion or 72.9 percent of loans were secured.

Table 17

Other loans by
rating of issuer

as of December 31	2012		2011	
	USD millions	% of total	USD millions	% of total
Rating				
AAA	5,725	46.1%	6,761	56.6%
AA	1,934	15.6%	2,093	17.5%
A	1,805	14.5%	1,739	14.6%
BBB and below	1,281	10.3%	748	6.3%
Unrated	1,678	13.5%	501	4.2%
Total	12,423	100.0%	11,944	100.0%

Credit risk related to receivables

Zurich Insurance Group's largest credit risk exposure to receivables is from third party agents, brokers and other intermediaries; the risk arises where they collect premiums from customers to be paid to Zurich Insurance Group or pay claims to customers on behalf of Zurich Insurance Group. Zurich Insurance Group has policies and standards to manage and monitor credit risk from intermediaries with a focus on day-to-day monitoring of the largest positions. As part of these standards, Zurich Insurance Group requires that intermediaries maintain segregated cash accounts for policyholder money. Additionally, Zurich Insurance Group requires intermediaries to satisfy minimum requirements in terms of their capitalization, reputation and experience as well as providing short-dated business credit terms.

Past due but not impaired receivables should be regarded as unsecured, but some of these receivable positions may be offset by collateral. Zurich Insurance Group reports internally on Group past due receivable balances and strives to keep the balance of past due positions as low as possible, while taking into account customer satisfaction. In 2012, Zurich Insurance Group continued efforts to reduce past due receivables through both short- and long-term initiatives to improve processes and systems. In addition, a stricter policy and standardized monitoring were implemented.

Receivables from ceded reinsurance form part of the reinsurance assets and are managed accordingly.

See note 18 of the Consolidated financial statements for additional information on receivables.

Risk review *continued*

Credit risk related to derivatives

The positive replacement value of outstanding derivatives, such as interest rate, currency, total return and equity swaps, forward contracts and purchased options represents a credit risk to Zurich Insurance Group. In addition there is a potential exposure arising from possible changes in replacement value. Zurich Insurance Group regularly monitors credit risk exposures arising from derivative transactions. Outstanding positions with external counterparties are managed through an 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. In addition, it is Zurich Insurance Group standard to only transact derivatives with counterparties where Zurich Insurance Group has an ISDA Master Agreement with a Credit Support Annex in place. This mitigates credit exposures from over-the-counter transactions due to close-out netting and requires the counterparty to post collateral when the derivative position is beyond an agreed threshold. Zurich Insurance Group mitigates credit exposures from derivative transactions further by using exchange-traded instruments whenever possible.

Analysis of financial assets

Tables 18.a through 19.b provide an analysis, for non unit-linked businesses, of the age of financial assets that are past due but not impaired and of financial assets that are individually determined to be impaired.

Table 18.a

Analysis of
financial assets –
current period

in USD millions, as of December 31, 2012

	Debt securities	Mortgage loans	Mortgage loans given as collateral	Other loans	Receivables and other financial assets	Total
Neither past due nor impaired financial assets	154,843	9,240	–	13,680	14,496	192,259
Past due but not impaired financial assets.						
Past due by:						
1 to 90 days	–	92	–	–	1,206	1,299
91 to 180 days	–	15	–	–	290	305
181 to 365 days	–	21	–	–	223	244
> 365 days	–	24	–	–	305	328
Past due but not impaired financial assets	–	152	–	–	2,024	2,176
Financial assets impaired	412	22	–	–	248	683
Gross carrying value	155,255	9,414	–	13,681	16,768	195,118
Less: impairment allowance						
Impairment allowances on individually assessed financial assets	–	10	–	–	117	128
Impairment allowances on collectively assessed financial assets	–	10	–	–	210	220
Net carrying value	155,255¹	9,394	–	13,681	16,440	194,770

¹ Available-for-sale debt securities are included net of USD 12 million of impairment charges recognized during the year.

Analysis of
financial assets –
prior period

Table 18.b

in USD millions, as of December 31, 2011

	Debt securities	Mortgage loans	Mortgage loans given as collateral	Other loans	Receivables and other financial assets	Total
Neither past due nor impaired financial assets	143,828	9,499	215	13,214	14,173	180,930
Past due but not impaired financial assets.						
Past due by:						
1 to 90 days	–	91	4	1	1,086	1,182
91 to 180 days	–	14	1	–	261	276
181 to 365 days	–	15	1	–	189	205
> 365 days	–	23	2	–	312	337
Past due but not impaired financial assets	–	144	7	1	1,848	2,000
Financial assets impaired	461	20	–	–	198	679
Gross carrying value	144,289	9,663	223	13,215	16,219	183,608
Less: impairment allowance						
Impairment allowances on individually assessed financial assets	–	5	–	–	117	123
Impairment allowances on collectively assessed financial assets	–	9	–	–	203	211
Net carrying value	144,289¹	9,649	223	13,214	15,899	183,274

¹ Available-for-sale debt securities are included net of USD 55 million of impairment charges recognized during 2010.

Tables 19.a and 19.b show how the allowances for impairments of financial assets in tables 18.a and 18.b have developed over the 2011 and 2012 financial years.

Development of
allowance for
impairments –
current period

Table 19.a

in USD millions

	Mortgage loans	Other loans	Receivables
As of January 1, 2012	14	–	320
Increase/(Decrease) in allowance for impairments	8	13	39
Amounts written-off	(3)	(13)	(37)
Foreign currency translation effects	–	–	5
As of December 31, 2012	20	–	327

Risk review *continued*

Table 19.b

Development of allowance for impairments – prior period	in USD millions	Mortgage loans	Other loans	Receivables
As of January 1, 2011		15	1	323
Increase/(Decrease) in allowance for impairments		(26)	–	42
Amounts written-off		(8)	–	(31)
Transfers ¹		33	–	(2)
Foreign currency translation effects		–	–	(12)
As of December 31, 2011		14	–	320

¹ Due to the reclassification to held for sale of ZIC Group's operations in Bolivia (see note 5 of the Consolidated financial statements).

Liquidity risk

Liquidity risk is the risk that Zurich Insurance Group may not have sufficient liquid financial resources to meet its obligations when they fall due, or would have to incur excessive costs to do so. Zurich Insurance Group's policy is to maintain adequate liquidity and contingent liquidity to meet its liquidity needs under both normal and stressed conditions. To achieve this, Zurich Insurance Group assesses, monitors and manages its liquidity needs on an ongoing basis.

Zurich Insurance Group has Zurich Insurance Group-wide liquidity management policies and specific guidelines as to how local businesses have to plan, manage and report their local liquidity. These include regularly conducting stress tests for all major carriers within the Zurich Insurance Group. The stress tests use a standardized set of internally defined stress events, and are designed to provide an overview of the potential liquidity drain Zurich Insurance Group would face if it had to recapitalize local balance sheets.

At Zurich Insurance Group level, similar guidelines apply and detailed liquidity forecasts based on the local businesses' input and Zurich Insurance Group's own forecasts are regularly performed. As part of its liquidity management, Zurich Insurance Group maintains sufficient cash and cash equivalents and high quality, liquid investment portfolios to meet expected outflows including those for maturing debt obligations. In addition, Zurich Insurance Group maintains internal liquidity sources that cover Zurich Insurance Group's potential liquidity needs, including those that might arise under stressed conditions. Zurich Insurance Group takes into account the amount, permanence of availability and speed of accessibility of the sources. Zurich Insurance Group centrally maintains committed borrowing facilities, as well as access to diverse funding sources to cover contingencies. Funding sources include asset sales, external debt issuances and use of letters of credit. Zurich Insurance Group maintains a broad range of maturities for external debt securities. A possible concentration risk could arise from a downgrade of Zurich Insurance Group's credit rating. This could impact Zurich Insurance Group's commitments and guarantees, thus potentially increasing Zurich Insurance Group's liquidity needs.

Zurich Insurance Group limits the percentage of the investment portfolio that is not readily realizable, and regularly monitors exposures to take action if necessary to maintain an appropriate level of asset liquidity. During 2012, Zurich Insurance Group was within its limits for asset liquidity. The fair value hierarchy tables in note 26 to the Consolidated financial statements segregate financial assets into three levels to reflect the basis of the determination of fair value. These tables indicate the high liquidity of Zurich Insurance Group's investments.

See note 21 of the Consolidated financial statements for additional information on debt obligation maturities and on credit facilities and note 25 of the Consolidated financial statements for information on commitments and guarantees.

Zurich Insurance Group's regular liquidity monitoring includes monthly reporting to the executive management and quarterly reporting to the Zurich Insurance Group's Risk Committee of the Board, covering aspects such as the Zurich Insurance Group's actual and forecasted liquidity, possible adverse scenarios that could affect Zurich Insurance Group's liquidity and possible liquidity needs from Zurich Insurance Group's main subsidiaries, including under stressed conditions.

Tables 20.a and 20.b provide an analysis of the expected maturity profile of reserves for insurance contracts, net of reinsurance, based on expected cash flows without considering the surrender values as of December 31, 2012 and 2011. Reserves for unit-linked insurance contracts amounting to USD 74.1 billion and USD 68.8 billion as of December 31, 2012 and 2011, respectively, are not included, as policyholders can generally surrender their contracts at any time, at which point the underlying unit-linked assets would be liquidated. Risks from the liquidation of unit-linked assets are borne by the policyholders of unit-linked contracts.

Table 20.a					
Expected maturity profile for reserves for insurance contracts, net of reinsurance – current period	in USD millions, as of December 31, 2012				
	Reserves for losses and loss adjustment expenses	Future life policyholders' benefits	Policyholders' contract deposits and other funds	Total	
< 1 year	17,288	8,188	1,370	26,846	
1 to 5 years	23,688	20,807	2,208	46,704	
5 to 10 years	8,465	14,448	1,859	24,772	
10 to 20 years	5,612	18,896	2,361	26,869	
> 20 years	2,332	18,960	10,119	31,411	
Total	57,385	81,300	17,917	156,602	

Table 20.b					
Expected maturity profile for reserves for insurance contracts, net of reinsurance – prior period	in USD millions, as of December 31, 2011				
	Reserves for losses and loss adjustment expenses	Future life policyholders' benefits	Policyholders' contract deposits and other funds	Total	
< 1 year	14,395	6,231	1,551	22,176	
1 to 5 years	21,862	23,113	2,300	47,275	
5 to 10 years	8,783	14,556	1,829	25,168	
10 to 20 years	7,047	16,545	2,274	25,866	
> 20 years	3,255	17,557	8,221	29,032	
Total	55,341	78,001	16,175	149,517	

For additional information on reserves for insurance contracts, see note 8 of the Consolidated financial statements.

Tables 21.a and 21.b provide an analysis of the maturity of liabilities for investment contracts based on expected cash flows as of December 31, 2012 and 2011. The undiscounted contractual cash flows for liabilities for investment contracts are USD 58.3 billion and USD 51.3 billion as of December 31, 2012 and December 31, 2011, respectively. Liabilities for unit-linked investment contracts amount to USD 50.9 billion and USD 44.2 billion as at December 31, 2012 and 2011, respectively. The policyholders of unit-linked investment contracts can generally surrender their contracts at any time at which point the underlying unit-linked assets would be liquidated. Risks from the liquidation of unit-linked assets are borne by the policyholders of unit-linked investment contracts. Certain non-unit-linked contracts also allow for surrender of the contract by the policyholder at any time. Liabilities for such contracts amounted to USD 958 million and USD 950 million as of December 31, 2012 and 2011 respectively. Zurich Insurance Group actively manages the Global Life in-force business to improve persistency and retention.

Table 21.a					
Expected maturity profile for liabilities for investment contracts – current period	in USD millions, as of December 31, 2012				
	Liabilities related to unit-linked investment contracts	Liabilities related to investment contracts (amortized cost)	Liabilities related to investment contracts with discretionary participation features	Total	
< 1 year	4,441	172	295	4,908	
1 to 5 years	6,468	799	1,333	8,600	
5 to 10 years	6,966	173	1,068	8,207	
10 to 20 years	9,435	115	940	10,490	
> 20 years	23,612	46	2,267	25,925	
Total	50,923	1,305	5,903	58,131	

Risk review *continued*

Table 21.b

Expected maturity profile for liabilities for investment contracts – prior period	in USD millions, as of December 31, 2011				Total
	Liabilities related to unit-linked investment contracts	Liabilities related to investment contracts (amortized cost)	Liabilities related to investment contracts with discretionary participation features		
< 1 year	3,895	252	276		4,422
1 to 5 years	5,802	542	1,339		7,683
5 to 10 years	6,316	168	973		7,456
10 to 20 years	8,467	123	782		9,372
> 20 years	19,739	47	2,238		22,024
Total	44,220	1,131	5,607		50,958

See notes 15 and 21 of the Consolidated financial statements for information on the maturities of collateralized loans and total debt issued, respectively. For more information on Zurich Insurance Group's other financial liabilities, see note 19 of the Consolidated financial statements.

See note 6 of the Consolidated financial statements for information on the maturity of debt securities for total investments.

Zurich Insurance Group has committed to contribute to third parties that engage in investment in direct private equity and private equity funds. Commitments may be called by the counterparty over the term of the investment (generally three to five years) and must be funded by Zurich Insurance Group on a timely basis. See note 25 of the Consolidated financial statements.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems or from external events such as outsourcing, catastrophes, legislation, or external fraud.

Zurich Insurance Group has a comprehensive framework with a common approach to identify, assess, quantify, mitigate, monitor and report operational risk within Zurich Insurance Group.

Within this framework, Zurich Insurance Group:

- Uses a scenario-based approach to assess and quantify the capital required for operational risk for business units. This approach allows comparison of information across Zurich Insurance Group and highlights the main scenarios contributing to the Z-ECM capital required.
- Documents and evaluates loss events above a threshold determined by the Zurich Risk Policy, in a Zurich Insurance Group-wide database. Improvement actions are put in place to avoid recurrence of such operational loss events.
- Conducts operational risk assessments through which operational risks are identified for key business areas and are qualitatively assessed. Risks identified and assessed above a certain threshold must be mitigated, and escalated in specific reports at Zurich Insurance Group level. Plans for improvement actions are documented and tracked on an ongoing basis. Zurich Insurance Group uses a scoping exercise to determine which business units and Zurich Insurance Group-wide functional areas conduct operational risk assessments. In the assessments, Zurich Insurance Group uses such sources of information as Total Risk Profiling™, internal control assessments, and audit findings, as well as scenario modeling and loss event data.

Issues identified, including financial adjustments in the General Insurance business in Germany, have been communicated to the Board and either have been or are being addressed by the Zurich Insurance Group.

Zurich Insurance Group has specific processes and systems in place to focus on high priority operational matters such as information security, managing business continuity, and combating fraud.

In the area of information security Zurich Insurance Group continued to focus on its global improvement program with special emphasis on protecting customer information, improving security with its suppliers and monitoring that access to information is properly controlled. This helps Zurich Insurance Group to better protect information assets while ensuring compliance with regulation and policies.

A key task is maintaining and developing capability of Zurich Insurance Group's business continuity with an emphasis on recovery from events such as natural catastrophe and the possibility of a pandemic. Zurich Insurance Group continued to develop its existing business continuity capability by further implementing a more globally consistent approach to business continuity and crisis management.

Addressing the risk of claims and non-claims fraud continues to be of importance. In 2012, Zurich Insurance Group continued its global anti-fraud initiative to further improve the Zurich Insurance Group's ability to prevent, detect and respond to fraud. While claims fraud is calculated as part of insurance risk and non-claims fraud is calculated as part of operational risk for risk-based capital, both are part of the common framework for assessing and managing operational risks.

Generally, all business activities contain some aspect of operational risk. Therefore, ongoing initiatives such as The Zurich Way and operational transformation help Zurich Insurance Group manage operational risks through standardization of processes. Projects with an expected budget over a defined threshold undergo a risk assessment.

Zurich Insurance Group considers controls to be key instruments for monitoring and managing operational risk. Although primarily focused on important controls over financial reporting, internal control efforts also include related operational and compliance controls. Therefore, Zurich Insurance Group continues to strengthen the robustness, consistency, documentation and assessment of internal controls for significant entities and business processes. Operational effectiveness of key controls is assessed by self assessment and independent testing on relevant controls supporting the financial statements.

Risks to Zurich Insurance Group's reputation

Risks to Zurich Insurance Group's reputation include the risk that an act or omission by Zurich Insurance Group or any of its employees could result in damage to Zurich Insurance Group's reputation or loss of trust among its stakeholders. Every risk type has potential consequences for Zurich Insurance Group's reputation, and therefore, effectively managing each type of risk helps Zurich Insurance Group reduce threats to its reputation.

Additionally, Zurich Insurance Group endeavors to preserve its reputation by adhering to applicable laws and regulations, and by following the core values and principles of Zurich Basics, Zurich Insurance Group's code of conduct, which includes integrity and good business practice. Zurich Insurance Group centrally manages certain aspects of reputation risk, for example, communications, through functions with the appropriate expertise.

Risk review *continued*

Capital management and analysis of capital adequacy

Capital management

Zurich Insurance Group's capital management strategy is to maximize long term shareholder value by optimizing capital allocation while managing the balance sheet at "AA" level and in accordance with regulatory, solvency and rating agency requirements. In particular, Zurich Insurance Group endeavors to manage its capital such that Zurich Insurance Group and all of its regulated entities are adequately capitalized in compliance with the relevant regulatory capital adequacy requirements.

Further, Zurich Insurance Group strives to simplify its legal entity structure in order to reduce complexity and increase fungibility of capital. Zurich Insurance Group also wants to minimize constraints to capital fungibility by pooling risk, capital and liquidity centrally as much as possible.

Capital management framework

Zurich Insurance Group's capital management framework forms the basis for actively managing capital within Zurich Insurance Group. Major elements are economic, regulatory, and rating agency capital adequacy.

Zurich Insurance Group's policy is to manage its capital position by allocating capital to businesses earning the highest risk-adjusted returns and pooling risks and capital as much as possible to operationalize its global risk diversification, subject to local and Zurich Insurance Group regulatory solvency requirements and rating agency capital adequacy constraints.

Zurich Insurance Group manages capital and solvency through an integrated and comprehensive framework of principles and governance structures as well as methodology, monitoring and reporting processes. At a Zurich Insurance Group executive level, the Zurich Insurance Group's Group Balance Sheet Committee defines the capital management strategy and sets the principles, standards and policies for the execution of the strategy. Zurich Insurance Group's Group Treasury and Capital Management is responsible for the execution of the capital management strategy within the mandate set by the Zurich Insurance Group's Group Balance Sheet Committee.

Within these defined principles, Zurich Insurance Group manages its capital using a number of different capital models taking into account economic, regulatory, and rating agency constraints. Zurich Insurance Group's capital and solvency position is monitored and reported regularly. Based on the results of the capital models and defined standards and principles, Zurich Insurance Group's Group Treasury and Capital Management has a set of measures and tools available to manage capital within the defined constraints. This tool set is referred to as the capital management program.

Capital management program

Zurich Insurance Group's capital management program comprises various actions to optimize shareholders' total return and to meet capital needs, while enabling Zurich Insurance Group to take advantage of growth opportunities as they arise. Such actions are performed as and when required and include dividends, capital repayments, share buy-backs, issuances of shares, issuance of senior and hybrid debt, securitization and purchase of reinsurance.

Zurich Insurance Group seeks to maintain the balance between higher returns for shareholders on equity held, which may be possible with higher levels of borrowing, and the security provided by a sound capital position. The payment of dividends, share buy-backs, and issuances and redemption of debt have an important influence on capital levels.

Zurich Insurance Company Ltd 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 percent of annual retained earnings must be allocated to a general legal reserve until such reserve in the aggregate has reached 20 percent of the paid-in share capital; therefore the earnings allocated to those reserves are restricted. As of December 31, 2012, the amount of the general legal reserve exceeded 20 percent of the paid-in share capital of Zurich Insurance Company Ltd. Similarly, company laws in many countries in which ZIC Group's subsidiaries operate may restrict the amount of dividends payable by those subsidiaries to their parent companies.

Other than by operation of the restrictions mentioned above, the ability of ZIC Group's subsidiaries to pay dividends may be restricted or, while dividend payments as such 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 such as foreign exchange control restrictions existing in some countries.

In the U.S., restrictions on the payment of dividends that apply to insurance companies 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 12 month period to 10 percent 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 12 month period to 10 percent 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 in the insurer's state of domicile.

For details on dividend payments, and issuances and redemptions of debt, see notes 21 and 22 of the Consolidated financial statements.

Analysis of capital adequacy

Insurance Financial Strength Rating

Zurich Insurance Group maintains interactive relationships with three global rating agencies: Standard and Poor's, Moody's and A.M. Best. The Insurance Financial Strength Rating (IFSR) of Zurich Insurance Group's main operating entity is an important element of Zurich Insurance Group's competitive position. Moreover, the Zurich Insurance Group's credit ratings derived from the financial strength ratings affect the cost of capital.

Zurich Insurance Group maintained its strong rating level and its stable outlook in 2012. As of December 31, 2012 the IFSR of Zurich Insurance Company Ltd, the main operating entity of the Zurich Insurance Group, was rated "AA-/stable" by Standard and Poor's, "Aa3/stable" by Moody's and "A+ (superior)/stable" by A.M. Best.

Regulatory capital adequacy

Zurich Insurance Group endeavors to manage its capital such that all of its regulated entities meet local regulatory capital requirements at all times.

In each country in which Zurich Insurance Group operates, the local regulator specifies the minimum amount and type of capital that each of the regulated entities must hold in addition to their liabilities. Zurich Insurance Group targets to hold, in addition to the minimum capital required to comply with the solvency requirements, an adequate buffer to ensure that each of its regulated subsidiaries meets the local capital requirements. Zurich Insurance Group is subject to different capital requirements depending on the country in which it operates. The main areas are Switzerland and European Economic Area countries, and the U.S.

At a Zurich Insurance Group level, Zurich Insurance Group endeavors to pool risk and capital as much as possible and thereby create diversification benefits for Zurich Insurance Group. This also allows Zurich Insurance Group to take into account the benefits that arise from this pooling in those regions where these benefits are recognized under the capital adequacy regime, e.g. in the U.S., Ireland, and Switzerland.

Risk review *continued*

Regulatory requirements in Switzerland

In Switzerland, under the Swiss Solvency Test (SST), groups, conglomerates and reinsurers are required to use company-specific internal models to calculate risk-bearing and target capital. Internal models must be approved by the Swiss Financial Market Supervisory Authority (FINMA). In 2012, Zurich Insurance Group continued to further enhance and refine its internal model to meet evolving regulatory requirements. The model approval process continues with FINMA, which has approved on a provisional basis the use of Zurich Insurance Group's internal model for 2012, without prejudicing the final approval of the internal model. Zurich Insurance Group has filed an SST ratio with FINMA in excess of the regulatory requirements, both as of January 1, 2012 and as of July 1, 2012.

Regulatory requirements in the European Economic Area

In European countries, insurance entities are required to maintain minimum solvency margins according to the existing Solvency I legislation. Solvency I capital is calculated as a fixed percentage of premiums, claims, reserves and net amounts at risk. The required minimum solvency margin for general insurers is the greater of 16 percent of premiums written for the year or 23 percent of a three-year average of claims incurred, subject to the first tranche (EUR 61 million) of premiums at 18 percent and the first tranche (EUR 43 million) of claims at 26 percent. In these calculations, premiums and claims for certain liability lines are increased by 50 percent. A reduction is given for reinsurance based on reinsurance claims recoveries over three years as a percentage of gross claims in those years, limited to a maximum of 50 percent. Life insurance companies are required to maintain a minimum solvency margin generally of 4 percent of insurance reserves, but reduced to 1 percent of insurance reserves for life insurance where the credit and market risks are carried by policyholders, plus 0.3 percent of the amount at risk under insurance policies. The same minimum capital requirements are applicable for insurance entities operating in Switzerland. In certain European countries, both EU and non-EU, further requirements have been imposed by regulators.

On November 25, 2009 the directive on Solvency II was adopted. Solvency II aims to reflect the latest developments in prudential supervision, actuarial methods and risk management. It includes economic risk-based solvency requirements, which are more risk sensitive and more sophisticated than Solvency I. Solvency II capital requirements also consider all material risks and their interactions. As part of the risk management system, all EU/EEA insurance and reinsurance entities will be required to conduct their own risk and solvency assessment, including the assessment of the overall solvency needs reflecting their specific risk profiles. As part of the disclosure provisions, companies will have to publicly report their solvency and financial condition.

Zurich Insurance Group is fully engaged in an extensive program of work in order to meet Solvency II requirements when they enter into force. Zurich Insurance Group intends to use its internal model, which aligns the Solvency II approach with that used for the SST for Zurich Insurance plc (Ireland). Zurich Insurance Group has started the pre-application process in order to gain regulatory approval for the internal model from the Central Bank of Ireland, Zurich Insurance Group's EU lead regulator

Regulatory requirements in the U.S.

In the U.S., required capital is determined to be the "company action level risk-based capital" calculated with the risk-based capital model of the National Association of Insurance Commissioners. This method, which builds on regulatory accounts, measures the minimum amount of capital for an insurance company to support its overall business operations by taking into account its size and risk profile. The calculation is based on risk-sensitive factors that are applied to various asset, premium, claim, expense and reserve items.

Regulatory minimum capital requirements at Zurich Insurance Group level

As of December 31, 2012 and 2011 respectively, Zurich Insurance Group and its material, regulated subsidiaries complied with the applicable regulatory minimum capital requirements.

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Consolidated financial statements

Contents

Consolidated income statements	53
Consolidated statements of comprehensive income	54
Consolidated balance sheets	56
Consolidated statements of cash flows	58
Consolidated statements of changes in equity	60
1. Basis of presentation	62
2. New accounting standards and amendments to published accounting standards	66
3. Summary of significant accounting policies	67
4. Critical accounting judgments and estimates	78
5. Acquisitions and divestments	84
6. Investments	87
7. Derivative financial instruments and hedge accounting	94
8. Reserves for insurance contracts and reinsurers' share of reserves for insurance contracts	99
9. Liabilities for investment contracts	106
10. Equity component relating to contracts with DPF	106
11. Gross and ceded insurance revenues and expenses	107
12. Deferred policy acquisition costs and deferred origination costs	108
13. Administrative and other operating expense	109
14. Farmers management fees and other related revenues	110
15. Mortgage loans given as collateral and collateralized loans	110
16. Property and equipment	111
17. Goodwill and other intangible assets	112
18. Receivables and other assets	115
19. Other liabilities	115
20. Income taxes	117
21. Senior and subordinated debt	121
22. Shareholders' equity	125
23. Employee benefits	126
24. Share-based compensation and cash incentive plans	132
25. Contingent liabilities, contractual commitments and financial guarantees	135
26. Fair value of financial assets and financial liabilities	138
27. Related party transactions	145
28. Farmers Exchanges	147
29. Segment information	149
30. Significant subsidiaries	162
31. Events after the balance sheet date	165
Report of the statutory auditor	166

Consolidated income statements

in USD millions, for the years ended December 31

	Notes	2012	Restated 2011
Revenues			
Gross written premiums		51,285	47,748
Policy fees		2,692	2,452
Gross written premiums and policy fees		53,977	50,200
Less premiums ceded to reinsurers		(6,481)	(6,550)
Net written premiums and policy fees		47,496	43,650
Net change in reserves for unearned premiums	11	(741)	(751)
Net earned premiums and policy fees		46,755	42,899
Farmers management fees and other related revenues	14	2,846	2,767
Net investment result on Group investments	6	8,987	9,470
Net investment income on Group investments		6,674	7,142
Net capital gains/(losses) and impairments on Group investments		2,313	2,328
Net investment result on unit-linked investments	6	10,268	(3,544)
Net gain/(loss) on divestments of businesses		(34)	6
Other income		1,660	1,488
Total revenues		70,481	53,086
Benefits, losses and expenses			
Insurance benefits and losses, gross of reinsurance	11	37,271	38,132
Less ceded insurance benefits and losses	11	(3,519)	(5,052)
Insurance benefits and losses, net of reinsurance	11	33,752	33,080
Policyholder dividends and participation in profits, net of reinsurance	11	11,479	(2,685)
Underwriting and policy acquisition costs, net of reinsurance	11	10,014	8,516
Administrative and other operating expense	13	8,617	8,170
Interest expense on debt	21	571	616
Interest credited to policyholders and other interest		460	463
Total benefits, losses and expenses		64,894	48,160
Net income before income taxes		5,587	4,926
Income tax expense	20	(1,485)	(982)
attributable to policyholders	20	(194)	242
attributable to shareholders	20	(1,290)	(1,224)
Net income after taxes		4,102	3,944
attributable to non-controlling interests		139	72
attributable to shareholders		3,963	3,871

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

Consolidated financial statements *continued*

Consolidated statements of comprehensive income

in USD millions, for the years ended December 31

	Net income attributable to shareholders	Net unrealized gains/(losses) on available- for-sale investments	Cash flow hedges
2011			
Comprehensive income for the period, as restated	3,871	284	176
Details of movements during the period			
Change (before reclassification, tax and foreign currency translation effects and after allocation to policyholders)		799	207
Reclassification to income statement (before tax and foreign currency translation effects and after allocation to policyholders)		(643)	53
Deferred income tax (before foreign currency translation effects)		117	(71)
Foreign currency translation effects		11	(13)
2012			
Comprehensive income for the period	3,963	1,763	6
Details of movements during the period			
Change (before reclassification, tax and foreign currency translation effects and after allocation to policyholders)		3,915	32
Reclassification to income statement (before tax and foreign currency translation effects and after allocation to policyholders)		(1,721)	(35)
Deferred income tax (before foreign currency translation effects)		(512)	4
Foreign currency translation effects		82	6

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

	Cumulative foreign currency translation adjustment	Total other comprehensive income recycled through profit or loss	Revaluation reserve	Net actuarial gains/(losses) on pension plans	Total other comprehensive income not recycled through profit or loss	Total other comprehensive income attributable to shareholders	Total comprehensive income attributable to shareholders	Comprehensive income attributable to non-controlling interests	Total comprehensive income
	(691)	(230)	54	(929)	(875)	(1,106)	2,766	13	2,779
	(648)	358	73	(1,321)	(1,248)	(890)			
	(43)	(632)	–	–	–	(632)			
	–	46	(19)	348	330	376			
	–	(3)	–	44	44	41			
	396	2,166	–	(443)	(442)	1,723	5,686	186	5,872
	352	4,299	–	(464)	(464)	3,836			
	44	(1,712)	–	–	–	(1,712)			
	–	(509)	–	99	99	(410)			
	–	87	–	(78)	(78)	10			

Consolidated financial statements *continued*

Consolidated balance sheets

Assets	in USD millions, as of	Notes	Restated		
			12/31/12	12/31/11	01/01/11
Investments					
Total Group investments			208,460	197,443	196,846
Cash and cash equivalents			8,699	8,697	9,559
Equity securities			12,698	12,961	14,035
Debt securities			155,255	144,289	139,936
Real estate held for investment			8,561	8,472	8,274
Mortgage loans			9,394	9,649	10,032
Other loans			13,681	13,214	14,737
Investments in associates and joint ventures			172	161	188
Investments for unit-linked contracts			125,226	114,276	107,947
Total investments		6	333,687	311,719	304,794
Reinsurers' share of reserves for insurance contracts		8	19,753	19,592	18,816
Deposits made under assumed reinsurance contracts			2,588	2,711	2,837
Deferred policy acquisition costs		12	18,346	17,420	16,187
Deferred origination costs		12	770	824	866
Accrued investment income			2,426	2,600	2,758
Receivables and other assets		18	18,345	17,767	17,609
Mortgage loans given as collateral		15	–	223	743
Deferred tax assets		20	1,849	2,060	2,059
Assets held for sale ¹			102	54	–
Property and equipment		16	1,529	1,578	1,687
Goodwill		17	2,107	2,060	2,104
Other intangible assets		17	7,447	8,061	5,952
Total assets			408,948	386,668	376,413

¹ As of December 31, 2012 included land and buildings formerly classified as real estate held for investment and held for own use amounting to USD 89 million and USD 10 million, respectively. As of December 31, 2011 there are assets relating to the sale of a company in Bolivia (see note 5).

Liabilities
and equity

in USD millions, as of	Notes	12/31/12	Restated 12/31/11	Restated 01/01/11
Liabilities				
Reserve for premium refunds		706	611	518
Liabilities for investment contracts	9	58,131	50,958	50,667
Deposits received under ceded reinsurance contracts		1,558	1,560	1,362
Deferred front-end fees		6,073	5,720	5,626
Reserves for insurance contracts	8	265,233	253,207	242,885
Obligations to repurchase securities		1,539	1,794	3,330
Accrued liabilities		3,257	3,124	2,975
Other liabilities	19	17,440	18,334	16,650
Collateralized loans	15	–	223	743
Deferred tax liabilities	20	5,228	4,569	4,480
Liabilities held for sale ¹		–	55	–
Senior debt	21	7,366	7,065	7,110
Subordinated debt	21	5,861	5,476	6,824
Total liabilities		372,392	352,696	343,169
Equity				
Share capital	22	660	660	660
Additional paid-in capital	22	14,733	14,767	16,045
Net unrealized gains/(losses) on available-for-sale investments		4,386	2,622	2,338
Cash flow hedges		238	232	56
Cumulative foreign currency translation adjustment		(4,028)	(4,423)	(3,732)
Revaluation reserve		180	180	126
Retained earnings		17,715	17,191	16,183
Shareholders' equity		33,885	31,229	31,675
Non-controlling interests		2,672	2,743	1,568
Total equity		36,556	33,972	33,244
Total liabilities and equity		408,948	386,668	376,413

¹ As of December 31, 2011 included liabilities relating to the sale of a company in Bolivia (see note 5).

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

Consolidated financial statements *continued*

Consolidated statements of cash flows

in USD millions, for the year ended December 31	2012	Restated 2011
Cash flows from operating activities		
Net income attributable to shareholders	3,963	3,871
Adjustments for:		
Net (gain)/loss on divestments of businesses	34	(6)
(Income)/expense from equity method accounted investments	(18)	(12)
Depreciation, amortization and impairments of fixed and intangible assets	1,084	994
Other non-cash items	75	48
Underwriting activities:	10,358	(2,226)
<i>Reserves for insurance contracts, gross</i>	5,727	(1,162)
<i>Reinsurers' share of reserves for insurance contracts</i>	80	(730)
<i>Liabilities for investment contracts</i>	5,328	167
<i>Deferred policy acquisition costs</i>	(960)	(867)
<i>Deferred origination costs</i>	89	34
<i>Deposits made under assumed reinsurance contracts</i>	125	133
<i>Deposits received under ceded reinsurance contracts</i>	(31)	199
Investments:	(11,446)	2,510
<i>Net capital (gains)/losses on total investments and impairments</i>	(10,744)	2,973
<i>Net change in trading securities and derivatives</i>	(175)	(78)
<i>Net change in money market investments</i>	341	1,695
<i>Sales and maturities</i>		
<i>Debt securities</i>	108,519	106,991
<i>Equity securities</i>	64,133	52,243
<i>Other</i>	38,412	88,820
<i>Purchases</i>		
<i>Debt securities</i>	(110,197)	(106,363)
<i>Equity securities</i>	(62,935)	(54,555)
<i>Other</i>	(38,799)	(89,216)
Proceeds from sale and repurchase agreements	(332)	(1,572)
Movements in receivables and payables	(2,098)	570
Net changes in other operational assets and liabilities	583	290
Deferred income tax, net	441	(123)
Net cash provided by/(used in) operating activities	2,644	4,343

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

in USD millions, for the year ended December 31	2012	Restated 2011
Cash flows from investing activities		
Sales of property and equipment	95	49
Purchases of property and equipment	(226)	(199)
Disposal of equity method accounted investments, net	2	42
Acquisitions of companies, net of cash acquired	(97)	(977)
Divestments of companies, net of cash balances	(14)	20
Dividends from equity method accounted investments	6	3
Net cash provided by/(used in) investing activities	(234)	(1,061)
Cash flows from financing activities		
Dividends paid	(3,034)	(1,982)
Issuance of share capital	–	1
Redemption of preferred securities and transactions with non-controlling interests	–	(1,302)
Issuance of debt	1,755	2,645
Repayments of debt outstanding	(1,315)	(3,919)
Net cash provided by/(used in) financing activities	(2,594)	(4,557)
Foreign currency translation effects on cash and cash equivalents	168	150
Change in cash and cash equivalents	(16)	(1,126)
Cash and cash equivalents as of January 1	9,977	11,102
Cash and cash equivalents as of December 31	9,960	9,977
of which:		
– cash and cash equivalents – Group investments	8,699	8,697
– cash and cash equivalents – unit linked	1,261	1,280
Other supplementary cash flow disclosures		
Other interest income received	6,816	7,227
Dividend income received	1,843	1,779
Other interest expense paid	(1,129)	(1,119)
Income taxes paid	(1,238)	(1,122)

Cash and cash equivalents

in USD millions, as of December 31	2012	Restated 2011
Cash and cash equivalents comprise the following:		
Cash at bank and in hand	6,860	5,353
Cash equivalents	3,100	4,623
Total	9,960	9,977

As of December 31, 2012 and 2011, cash and cash equivalents held to meet local regulatory requirements were USD 1,345 million and USD 1,685 million, respectively.

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

Consolidated financial statements *continued*

Consolidated statements of changes in equity

in USD millions

	Share capital	Additional paid-in capital	
Balance as of December 31, 2010, as previously reported	660	16,045	
Total adjustments due to restatement	–	–	
Balance as of December 31, 2010, as restated	660	16,045	
Issuance of share capital	–	1	
Dividends to shareholders	–	–	
Redemption of preferred shares ¹	–	(1,284)	
Share-based payment transactions	–	22	
Transactions with non-controlling shareholders	–	(18)	
Total comprehensive income for the year, net of tax	–	–	
<i>Net income</i>	–	–	
<i>Net unrealized gains/(losses) on available-for-sale investments</i>	–	–	
<i>Cash flow hedges</i>	–	–	
<i>Cumulative foreign currency translation adjustment</i>	–	–	
<i>Revaluation reserve</i>	–	–	
<i>Net actuarial gains/(losses) on pension plans</i>	–	–	
Net changes in capitalization and non-controlling interests	–	–	
Balance as of December 31, 2011	660	14,767	
Balance as of December 31, 2011, as previously reported	660	14,767	
Total adjustments due to restatement	–	–	
Balance as of December 31, 2011, as restated	660	14,767	
Dividends to shareholders	–	–	
Share-based payment transactions	–	(34)	
Change in ownership interest with no loss of control	–	–	
Total comprehensive income for the year, net of tax	–	–	
<i>Net income</i>	–	–	
<i>Net unrealized gains/(losses) on available-for-sale investments</i>	–	–	
<i>Cash flow hedges</i>	–	–	
<i>Cumulative foreign currency translation adjustment</i>	–	–	
<i>Revaluation reserve</i>	–	–	
<i>Net actuarial gains/(losses) on pension plans</i>	–	–	
Net changes in capitalization and non-controlling interests	–	–	
Balance as of December 31, 2012	660	14,733	

¹ On April 17, 2011, Zurich Insurance Company Ltd repaid an amount of CHF 1.3 billion (USD 1.3 billion) to Zurich Insurance Group Ltd.

	Net unrealized gains/(losses) on available-for-sale investments	Cash flow hedges	Cumulative foreign currency translation adjustment	Revaluation reserve	Retained earnings	Shareholders' equity	Non-controlling interests	Total equity
	2,338	56	(3,732)	126	16,370	31,862	1,570	33,432
	-	-	-	-	(187)	(187)	(1)	(188)
	2,338	56	(3,732)	126	16,183	31,675	1,568	33,244
	-	-	-	-	-	1	-	1
	-	-	-	-	(1,934)	(1,934)	(49)	(1,983)
	-	-	-	-	-	(1,284)	-	(1,284)
	-	-	-	-	-	22	-	22
	-	-	-	-	-	(18)	-	(18)
	284	176	(691)	54	2,942	2,766	13	2,779
	-	-	-	-	3,871	3,871		
	284	-	-	-	-	284		
	-	176	-	-	-	176		
	-	-	(691)	-	-	(691)		
	-	-	-	54	-	54		
	-	-	-	-	(929)	(929)	-	-
	-	-	-	-	-	-	1,210	1,210
	2,622	232	(4,423)	180	17,191	31,229	2,743	33,972
	2,622	232	(4,474)	180	17,395	31,381	2,634	34,015
	-	-	51	-	(203)	(153)	109	(44)
	2,622	232	(4,423)	180	17,191	31,229	2,743	33,972
	-	-	-	-	(2,992)	(2,992)	(43)	(3,035)
	-	-	-	-	-	(34)	-	(34)
	-	-	-	-	(4)	(4)	-	(4)
	1,763	6	396	-	3,520	5,686	186	5,872
	-	-	-	-	3,963	3,963		
	1,763	-	-	-	-	1,763		
	-	6	-	-	-	6		
	-	-	396	-	-	396		
	-	-	-	-	-	-		
	-	-	-	-	(443)	(443)	-	-
	-	-	-	-	-	-	(214)	(214)
	4,386	238	(4,028)	180	17,715	33,885	2,672	36,556

Consolidated financial statements *continued*

Zurich Insurance Company Ltd (ZIC) and its subsidiaries (collectively the "Zurich Insurance Company Group" or "ZIC Group") is a provider of insurance-based products. The ZIC Group also distributes non-insurance products, such as mutual funds, mortgages and other financial services products, from selected third-party providers. The ZIC Group operates mainly in Europe, the USA, Latin America and Asia Pacific through subsidiaries, branch offices and representations.

The holding company Zurich Insurance Company Ltd, is incorporated in Zurich, Switzerland. The address of the registered office is Mythenquai 2, 8002 Zurich, Switzerland. Zurich Insurance Company Ltd is a wholly owned subsidiary of Zurich Insurance Group Ltd and together with its subsidiaries forms part of the Zurich Insurance Group.

On March 6, 2013, the Board of Directors of Zurich Insurance Company Ltd authorized 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 4, 2013.

1. Basis of presentation

General information

The Consolidated financial statements of the ZIC Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law. Where IFRS does not contain clear guidance governing the accounting treatment of certain transactions including those that are specific to insurance and reinsurance products, IFRS permits reference to another comprehensive body of accounting principles that uses a similar conceptual framework. The ZIC Group's accounting policies for insurance and reinsurance contracts are therefore based on those developed by the ZIC Group before the adoption of IFRS 4 in areas where IFRS 4 did not include specific requirements. Before the time of adoption, the ZIC Group typically applied U.S. GAAP pronouncements issued by the Financial Accounting Standards Board (FASB) on insurance and reinsurance contracts. Any subsequent changes to such pronouncements are not reflected in the ZIC Group's accounting policies. In case of business combinations, the ZIC Group may decide to maintain the local statutory treatment if this does not distort the fair presentation of the financial position of the ZIC Group. If significant, the impact of such cases is described elsewhere in the notes to these Consolidated financial statements.

The accounting policies applied by the reportable segments are the same as those applied by the ZIC Group. The ZIC Group accounts for inter-segment revenues and transfers as if the transactions were with third parties at current market prices, with the exception of dividends, realized capital gains and losses as well as gains and losses on transfer of net assets, which are eliminated against equity. In the Consolidated financial statements inter-segment revenues and transfers are eliminated.

Disclosures under IFRS 4 "Insurance Contracts" and IFRS 7 "Financial Instruments: Disclosures" relating to the nature and extent of risks, and capital disclosures under IAS 1 "Presentation of Financial Statements" have been included in the Risk Review on pages 15 to 50, and they form an integral part of the Consolidated financial statements.

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. Critical accounting judgments and estimates are discussed in note 4. Actual results may differ from the estimates and assumptions made.

The ZIC Group's consolidated balance sheets are not presented using a current/non-current classification. The following balances are generally considered to be current: cash and cash equivalents, deferred policy acquisition costs on general insurance contracts, accrued investment income, receivables, reserve for premium refunds, obligations to repurchase securities and accrued liabilities.

The following balances are generally considered to be non-current: equity securities, real estate held for investment, investments in associates and joint ventures, deferred policy acquisition costs on life insurance contracts, deferred tax assets, property and equipment, goodwill, other intangible assets and deferred tax liabilities.

The following balances are mixed in nature (including both current and non-current portions): debt securities, mortgage loans, other loans, reinsurers' share of reserves for insurance contracts, deposits made under assumed reinsurance contracts, deferred origination costs, other assets, mortgage loans given as collateral, reserves and investments for unit-linked contracts, liabilities for investment contracts, deposits received under ceded reinsurance

contracts, deferred front-end fees, reserves for losses and loss adjustment expenses, reserves for unearned premiums, future life policyholders' benefits, policyholders' contract deposits and other funds, other liabilities, collateralized loans, senior and subordinated debt, and assets and liabilities held for sale.

Maturity tables have been provided for the following balances: reserves for insurance contracts (tables 20a and 20b in the Risk review), liabilities for investment contracts (tables 21a and 21b in the Risk review), debt securities (table 6.4), derivative assets and derivative liabilities (tables 7.1 and 7.2), collateralized loans (table 15), other financial liabilities (table 19.2) and outstanding debt (table 21.4).

All amounts in the Consolidated financial statements, unless otherwise stated, are shown in USD, rounded to the nearest million with the consequence that the rounded amounts may not add to the rounded total in all cases. All ratios and variances are calculated using the underlying amounts rather than rounded amounts.

Table 1.1 summarizes the principal exchange rates used for translation purposes. Net gains/(losses) on foreign currency transactions included in the consolidated income statements were USD 77 million and USD 64 million for the years ended December 31, 2012 and 2011, respectively. Foreign currency exchange forward and swap gains/(losses) included in these amounts were USD 130 million and 111 million for the years ended December 31, 2012 and 2011, respectively.

Table 1.1

Principal exchange rates	USD per foreign currency unit	Consolidated			
		balance sheets		income statements and cash flows	
		12/31/2012	12/31/2011	12/31/2012	12/31/2011
Euro		1.3188	1.2969	1.2857	1.3927
Swiss franc		1.0928	1.0666	1.0668	1.1326
British pound		1.6272	1.5533	1.5847	1.6039

Restatements and reclassifications

In 2011, the ZIC Group completed the acquisition of the life insurance, pension and general insurance operations of Banco Santander S.A. (Santander) in Brazil, Argentina, Chile, Mexico and Uruguay (see note 5). In the ZIC Group's Consolidated financial statements 2011, total assets of USD 15.6 billion and total liabilities of USD 13.2 billion were initially included in receivables and other assets and other liabilities, respectively. The Consolidated financial statements as of December 31, 2012 include restated amounts as of December 31, 2011 to reallocate the preliminary numbers to individual balance sheet line items and for the subsequent reassessment of the initial purchase accounting. Table 1.3 shows the impact of the reclassifications as well as the updates to the initial purchase accounting on the consolidated balance sheet. Consolidated balance sheets, consolidated statements of changes in equity, consolidated statements of cash flows and notes 6, 8, 9, 12, 16, 17, 18, 19, 20, 26 and 29 have been restated accordingly.

In the course of the review related to the strengthening of reserves for losses and loss adjustment expenses in the General Insurance business in Germany, the ZIC Group determined that improper case reserving practices had resulted in errors which led to insufficient reserves for losses estimated in previous years. Additionally, the ZIC Group determined that deferred policy acquisition costs were overstated due to a system error in Germany. In aggregate, the errors identified were deemed material and have resulted in a restatement reducing total equity by USD 198 million and USD 188 million as of December 31, 2011 and January 1, 2011, respectively. For the year ended December 31, 2011 the impact on net income after taxes was a loss of USD 17 million and on business operating profit a loss of USD 18 million. The impact on various line items as of December 31, 2011 in the consolidated income statement and the consolidated balance sheet are set out in the restatement tables 1.2 and 1.3, respectively. Consolidated income statements, consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of changes in equity, consolidated statements of cash flows and notes 8, 11, 12, 20, 22 and 29 have been restated accordingly.

The ZIC Group erroneously classified certain life insurance products. The classification was corrected in 2012 as the impact on the ZIC Group's consolidated income statement was not material. The reclassifications in the consolidated balance sheet between liabilities for investment contracts and reserves for unit-linked contracts, and between deferred policy acquisition costs and deferred origination costs are set out in notes 8, 9 and 12.

Consolidated financial statements *continued*

The ZIC Group previously classified certain liabilities relating to non-life insurance annuities (mainly accident insurance) as policyholder contract deposits and other funds. The classification was prospectively changed in 2012 as the reclassification has no impact on the ZIC Group's consolidated balance sheet or income statement. The reclassifications from policyholder contract deposits and other funds to reserves for losses and loss adjustment expenses as well as future life policyholders' benefits are set out in note 8.

Table 1.2				
in USD millions, for the year ended December 31, 2011		As reported	Germany	As restated
Restatement of the consolidated income statement	Revenues			
	Gross written premiums	47,748	–	47,748
	Policy fees	2,452	–	2,452
	Gross written premiums and policy fees	50,200	–	50,200
	Less premiums ceded to reinsurers	(6,550)	–	(6,550)
	Net written premiums and policy fees	43,650	–	43,650
	Net change in reserves for unearned premiums	(751)	–	(751)
	Net earned premiums and policy fees	42,899	–	42,899
	Farmers management fees and other related revenues	2,767	–	2,767
	Net investment result on Group investments	9,470	–	9,470
	Net investment income on Group investments	7,142	–	7,142
	Net capital gains/(losses) and impairments on Group investments	2,328	–	2,328
	Net investment result on unit-linked investments	(3,544)	–	(3,544)
	Net gain/(loss) on divestments of businesses	6	–	6
	Other income	1,488	–	1,488
	Total revenues	53,086	–	53,086
	Benefits, losses and expenses			
	Insurance benefits and losses, gross of reinsurance	38,106	25	38,132
	Less ceded insurance benefits and losses	(5,052)	–	(5,052)
	Insurance benefits and losses, net of reinsurance	33,054	25	33,080
	Policyholder dividends and participation in profits, net of reinsurance	(2,685)	–	(2,685)
	Underwriting and policy acquisition costs, net of reinsurance	8,523	(7)	8,516
	Administrative and other operating expense	8,170	–	8,170
	Interest expense on debt	616	–	616
	Interest credited to policyholders and other interest	463	–	463
	Total benefits, losses and expenses	48,141	19	48,160
	Net income before income taxes	4,945	(19)	4,926
	Income tax expense	(984)	2	(982)
	attributable to policyholders	242	–	242
	attributable to shareholders	(1,226)	2	(1,224)
	Net income after taxes	3,961	(17)	3,944
	attributable to non-controlling interests	73	–	72
attributable to shareholders	3,888	(16)	3,871	

Restatement and reclassifications of the consolidated balance sheet

Table 1.3

in USD millions, as of December 31, 2011	As reported	Santander	Germany	As revised
Investments				
Total Group investments	194,151	3,293	–	197,443
Cash and cash equivalents	8,583	114	–	8,697
Equity securities	11,537	1,424	–	12,961
Debt securities	142,639	1,649	–	144,289
Real estate held for investment	8,468	4	–	8,472
Mortgage loans	9,649	–	–	9,649
Other loans	13,113	101	–	13,214
Investments in associates and joint ventures	161	–	–	161
Investments for unit-linked contracts	104,603	9,673	–	114,276
Total investments	298,754	12,965	–	311,719
Reinsurers' share of reserves for insurance contracts	19,361	231	–	19,592
Deposits made under assumed reinsurance contracts	2,711	–	–	2,711
Deferred policy acquisition costs	16,864	641	(85)	17,420
Deferred origination costs	824	–	–	824
Accrued investment income	2,600	–	–	2,600
Receivables and other assets	32,705	(14,938)	–	17,767
Mortgage loans given as collateral	223	–	–	223
Deferred tax assets	2,060	–	–	2,060
Assets held for sale	54	–	–	54
Property and equipment	1,578	1	–	1,578
Goodwill	2,060	–	–	2,060
Other intangible assets	5,773	2,288	–	8,061
Total assets	385,566	1,187	(85)	386,668
Liabilities				
Reserve for premium refunds	554	58	–	611
Liabilities for investment contracts	50,661	297	–	50,958
Deposits received under ceded reinsurance contracts	1,543	17	–	1,560
Deferred front-end fees	5,720	–	–	5,720
Reserves for insurance contracts	240,811	12,211	185	253,207
Obligations to repurchase securities	1,794	–	–	1,794
Accrued liabilities	3,087	37	–	3,124
Other liabilities	30,513	(12,179)	–	18,334
Collateralized loans	223	–	–	223
Deferred tax liabilities	4,049	592	(72)	4,569
Liabilities held for sale	55	–	–	55
Senior debt	7,065	–	–	7,065
Subordinated debt	5,476	–	–	5,476
Total liabilities	351,550	1,033	113	352,696
Equity				
Share capital	660	–	–	660
Additional paid-in capital	14,767	–	–	14,767
Net unrealized gains/(losses) on available-for-sale investments	2,622	–	–	2,622
Cash flow hedges	232	–	–	232
Cumulative translation adjustment	(4,474)	43	7	(4,423)
Revaluation reserve	180	–	–	180
Retained earnings	17,395	–	(203)	17,191
Shareholders' equity	31,381	43	(196)	31,229
Non-controlling interests	2,634	111	(2)	2,743
Total equity	34,015	154	(198)	33,972
Total liabilities and equity	385,566	1,187	(85)	386,668

Consolidated financial statements *continued*

2. New accounting standards and amendments to published accounting standards

Standards, amendments and interpretations effective or early adopted as of January 1, 2012 and relevant for the ZIC Group's operations

The following amendments to accounting standards and interpretations of standards relevant to the ZIC Group have been implemented for the financial year beginning January 1, 2012. The impact of adoption on the ZIC Group's Consolidated financial statements is disclosed in table 2.1.

Table 2.1

Standard/ Interpretation		Effective date
	Amended Standards	
	IFRS 7	Disclosures – Transfer of Financial Assets ¹
	IAS 12	Deferred Tax – Recovery of Underlying Assets ¹

¹ Adoption has no significant impact on the Consolidated financial statements

Standards, amendments and interpretations issued that are not yet effective nor yet adopted by the ZIC Group

The following standards, amendments and interpretations of existing published standards are not yet effective but are relevant to the ZIC Group's operations. The expected impact of these standards, amendments, and interpretations on the ZIC Group's Consolidated financial statements are disclosed in table 2.2. In addition to the standards and amendments listed in table 2.2 the ZIC Group will also have to incorporate amendments resulting from the IASB annual improvements project, which relate primarily to disclosure enhancements.

Table 2.2

Standard/ Interpretation		Effective date	Planned adoption date Fiscal Year
	New Standards		
	IFRS 10	Consolidated Financial Statements ²	2013
	IFRS 11	Joint Arrangements ¹	2013
	IFRS 12	Disclosure of Interests in Other Entities ¹	2013
	IFRS 13	Fair Value Measurement ³	2013
	IFRS 9	Financial Instruments ⁵	2015
	Amended Standards		
	IAS 1	Presentations of Components of Other Comprehensive Income (OCI) ¹	2013
	IAS 19	Employee Benefits ⁴	2013
	IAS 27	Separate Financial Statements ¹	2013
	IAS 28	Investments in Associates and Joint Ventures ¹	2013
	IFRS 7	Disclosures – Offsetting Financial Assets and Financial Liabilities ¹	2013
	IAS 32	Offsetting Financial Assets and Financial Liabilities ¹	2014

¹ Not expected to have a significant impact on the Consolidated financial statements.

² Expected to result in an immaterial net deconsolidation impact resulting from the additional consolidation of certain structured entities that are currently accounted for as associates and the deconsolidation of silo-structures and funds.

³ Expected to result in a change in the fair value hierarchy disclosures.

⁴ Projected expenses applying a high quality corporate bond rate rather than an expected return on assets rate would have been approximately USD 50 million lower. Additionally, impact from past service cost is immaterial.

⁵ The impact on the Consolidated financial statements will be assessed in conjunction with the revised standard IFRS 4 "Insurance Contracts". Changes to the IFRS timetable may impact this approach.

3. Summary of significant accounting policies

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

a) Consolidation principles

The ZIC Group's Consolidated financial statements include the assets, liabilities, equity, revenues, expenses and cash flows of Zurich Insurance Company Ltd and its subsidiaries. A subsidiary is an entity in which Zurich Insurance Company Ltd owns, directly or indirectly, more than 50 percent 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 divested during the year are included up to the date control ceased. All significant intercompany balances, profits and transactions are eliminated in full.

Acquisition transactions with non-controlling interests are accounted for as transactions with parties external to the ZIC Group. The effect of transactions with non-controlling interests is recorded in equity if there is no change in control.

Investments in associates and partnerships where the ZIC Group has the ability to exercise significant influence but not control, 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 ZIC Group owns, directly or indirectly, between 20 percent and 50 percent of the voting rights. Under the equity method of accounting, these investments are initially recognized at cost, including attributable goodwill, and adjusted thereafter for post-acquisition changes in the ZIC Group's share of the net assets of the investment.

The Consolidated financial statements are prepared as of December 31 based on individual company financial statements at the same date. In some cases information is included with a time lag of up to three months. The effect on the ZIC Group's Consolidated financial statements is not material.

b) Foreign currency translation and transactions

Foreign currency translation

Due to the ZIC Group's economic exposure to the U.S. dollar (USD), the presentation currency of the ZIC Group's consolidated financial statements is USD. Many ZIC Group companies use a different functional currency, being the currency of the respective primary economic environment in which these companies operate. Assets and liabilities are translated into the presentation currency at end-of-period exchange rates, while income statements and statements of cash flows are translated at average exchange rates for the period. The resulting translation differences are recorded directly in other comprehensive income (OCI) as cumulative translation adjustments.

Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency using the spot exchange rate at the date of the transaction or, for practical reasons, a weighted average rate, if exchange rates do not fluctuate significantly. Foreign currency monetary items and foreign currency non-monetary items, which are carried at fair value, are translated at end-of-period exchange rates. Foreign currency non-monetary items which are carried at historical cost are translated at historical exchange rates. The resulting foreign currency differences are recorded in income, except for the following:

- when gains or losses on non-monetary items measured at fair value, such as available-for-sale equity securities, are recognized directly in OCI, any foreign currency component included in the gains or losses is also recognized directly in OCI;
- when changes in the fair value of monetary items denominated in foreign currency, such as debt securities, that are classified as available-for-sale, are analyzed between foreign currency translation differences resulting from changes in the amortized cost of the security and other fair value changes in the security. Foreign currency translation differences related to changes in amortized cost are recognized in income, and those related to other changes in fair value are recognized in OCI; and
- foreign currency translation differences arising on monetary items that form part of net investments in foreign operations are included directly in OCI as cumulative foreign currency translation adjustment.

Consolidated financial statements *continued*

c) Common control business combination

A business combination of entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. Business combinations between entities under common control are accounted for by applying the pooling of interest method. The acquirer (entity that receives the net assets or the equity interest) initially recognizes the assets and liabilities transferred at their previous carrying amounts in the accounts of the transferor at the date of transfer. Any difference between the consideration paid and the carrying value of the net assets received is recorded in shareholders' equity. Such business combinations are recorded as if they had taken place at the beginning of the earliest period presented (or the date that the entities were first under common control, if later), for the purpose of including the result of the transferee in the retained earnings of the acquirer.

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

Classification

Contracts issued under which the ZIC Group accepts significant insurance risk and obligations arising from investment contracts with DPF are accounted for as insurance contracts.

The ZIC Group also issues products containing embedded options that entitle the policyholder to switch all or part of the current and future invested funds into another product issued by the ZIC Group. Where this results in the reclassification of an investment product to a product that meets the definition of an insurance contract, the previously held reserve and the related deferred origination costs are also reclassified and are accounted for in accordance with the accounting policy to be applied to the new product on a prospective basis. As a consequence, no gain or loss is recognized as a result of the reclassification of a contract from investment to insurance.

Once a contract has been classified as an insurance contract, no reclassification can be made subsequently.

Premiums

General insurance

Premiums from the sale of short-duration general insurance products are recorded when written and normally are accreted to earnings in relation to the insurance coverage provided. The unearned premium reserve represents the portion of the premiums written relating to the unexpired coverage period.

Life insurance

Premiums from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognized as revenue when due from the policyholder. For single premium and limited pay contracts, premiums are recognized in 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 insurance 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 deferred and recognized over the estimated life of the contracts.

Cash flows from certain universal life-type contracts in the ZIC Group's Spanish operations are recognized as gross written premiums and insurance benefits and losses and not as deposits.

Reserves for losses and loss adjustment expenses

Losses and loss adjustment expenses are charged to income as incurred. Reserves for losses and loss adjustment expenses represent estimates of future payments of reported and unreported claims for losses and related expenses with respect to insured events that have occurred. The ZIC Group does not discount its loss reserves, other than for settled claims with fixed payment terms. Any changes in estimates are reflected in the results of operations in the period in which estimates are changed.

Reserves for life benefits

Future life policyholders' benefits represent the estimated future benefit liability for traditional life insurance policies and include the value of accumulated declared bonuses or dividends that have vested to policyholders.

The reserves for life benefits for participating traditional life insurance policies are calculated using a net level premium valuation method based on actuarial assumptions taking into account guaranteed mortality and interest rates.

The reserves for life benefits for other traditional life insurance policies are calculated using a net level premium valuation method based on actuarial assumptions including mortality, persistency, expenses and investment return including a margin for adverse deviations. These assumptions are locked-in at inception and are regularly assessed as part of the liability adequacy testing over the period of the contract.

Policyholders' contract deposits represent the estimated policy benefits for investment type insurance contracts invested in non unit-linked funds. This liability comprises the accumulation of premiums received less charges plus declared policyholder dividends.

Where unrealized gains or losses on the revaluation of available-for-sale assets arise they are recorded directly in OCI in accordance with the ZIC Group's accounting policy for such assets, with the corresponding adjustments to the reserves for life benefits and related assets also recognized directly in OCI.

Reserves for unit-linked contracts are based on the fair value of the financial instruments backing those contracts less any fees and assessments charged to the policyholders.

For products containing guarantees in respect of minimum death benefits (GMDB), retirement income benefits (GRIB) and/or annuitization options (GAO), additional liabilities are recorded in proportion to the receipt of the contracted revenues coupled with a loss adequacy test taking into account policyholder behavior and current market conditions.

For products managed on a dynamic basis, an option in IFRS 4 is used to measure the insurance liabilities using current financial and non-financial assumptions, to better reflect the way that these products are managed. Financial assets relating to these liabilities are designated as "fair value through profit or loss".

Deferred acquisition costs (DAC)

Costs that vary with and are directly related to the acquisition of new and renewal business, including for example commissions and certain underwriting and policy issue expenses, are deferred and subsequently amortized over a defined period. Certain direct response marketing costs for efforts which solicit a direct response that is specific and quantifiable are also deferred, when it can be demonstrated that such marketing results in future economic benefits.

General insurance

DAC for general insurance contracts is amortized over the period in which the related premiums written are earned.

Life insurance

DAC for traditional participating life insurance contracts is amortized over the life of the contracts based on estimated gross margins expected to be realized over the life of the contract. Estimated gross margins are updated for actual and anticipated future experience using the latest revised interest rate for the remaining benefit period. Resultant deviations are reflected in income.

DAC for other traditional life insurance and annuity contracts is amortized over the life of the contracts based on expected premiums. Expected premiums are estimated at the date of policy issue for application throughout the life of the contract, unless a premium deficiency subsequently occurs.

DAC for investment type insurance contracts such as universal life, unit-linked and unitized with-profits contracts is amortized over the life of the contracts based on estimated gross profits expected to be realized over the life of the contract. Estimated gross profits are updated for actual and anticipated future experience using either the interest rate in effect at the inception of the contracts or the latest revised interest rate for the remaining benefit period, depending on whether crediting is based on the policyholder's or on the reporting entity's investment performance. Resultant deviations are reflected in income.

Unamortized DAC for life insurance contracts accrues interest at a rate consistent with the related assumptions for reserves.

For traditional participating and investment type life insurance contracts DAC is adjusted for the impact of unrealized gains/(losses) on allocated investments that are recorded in OCI.

Liability adequacy tests

Liability adequacy testing is performed annually for groupings of contracts determined in accordance with the ZIC Group's manner of acquiring, servicing and measuring the profitability of its insurance contracts.

Consolidated financial statements *continued*

General insurance

For general insurance contracts, unearned premiums are tested to determine whether they are sufficient to cover related expected losses, loss adjustment expenses, policyholder dividends, unamortized DAC and maintenance expenses using current assumptions and considering anticipated investment returns. If a premium deficiency is identified, the DAC asset for the respective grouping of contracts is written down by the amount of the deficiency. If, after writing down the DAC asset to nil, a premium deficiency still exists for the respective grouping of contracts, then a premium deficiency reserve is established for the amount of the remaining deficiency.

Life insurance

For life insurance contracts, the carrying amount of the existing reserve for life benefits, including any deferred front-end fees, reduced by the unamortized balance of DAC or present value of future profits of acquired insurance contracts (PVFP), is compared with the reserve for life benefits, calculated using revised assumptions for actual and anticipated experience as of the valuation date. If a deficiency is identified, the DAC or PVFP for the respective grouping of contracts is written down by the amount of the deficiency. If, after writing down the DAC or PVFP to nil, a deficiency still exists for the respective grouping of contracts, the reserve for life benefits is increased by the amount of the remaining deficiency.

Reinsurance

The ZIC 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 ZIC Group insurance companies assume reinsurance business incidental to their normal business.

Reinsurance contracts that do not transfer significant insurance risk are accounted for using the deposit method. A deposit asset or liability is recognized based on the premium paid or received less any explicitly identified premiums or fees to be retained by the ceding company. Interest on deposits is 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. Reinsurance deposit assets or liabilities also include funds deposited or held by the ZIC Group, under assumed or ceded reinsurance contracts, respectively, when funds are retained by the reinsured under the terms of the contract.

Reinsurance is recorded gross in the consolidated balance sheet. Reinsurance assets include balances expected to be recovered from reinsurance companies for ceded 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 liability associated with the reinsured policy.

Reinsurance assets are assessed for impairment on a regular basis for any events that may trigger impairment. If a reinsurance asset is impaired, the carrying amount of the asset is reduced to its recoverable amount, through the use of an allowance account, and the amount of the impairment loss is recognized in income. If a decrease in the impairment loss can be related objectively to an event occurring after the impairment loss was initially recognized, the impairment loss is reversed through income.

Premiums paid under retroactive contracts are included in reinsurance recoverables in the balance sheet. If the amount of gross liabilities reinsured is higher than the premium paid, reinsurance recoverables are increased by the difference and the resulting gain is deferred and amortized over the expected settlement period. If the amount of gross liabilities reinsured is lower than the premium paid, reinsurance recoverables are reduced by the difference and the resulting loss is recognized in income immediately.

e) Liabilities for investment contracts (without DPF)

Investment contracts are those contracts that transfer no significant insurance risk. The ZIC Group issues investment contracts without fixed terms (unit-linked) and investment contracts with fixed and guaranteed terms (fixed interest rate).

Unit-linked investment contracts

These represent portfolios maintained to meet the specific investment objectives of policyholders who bear the credit, market and liquidity risks related to the investments. The liabilities are carried at fair value, with fair value being determined by reference to the underlying financial assets and changes in fair value are recorded in income. The related assets for unit-linked investment contracts are classified as designated at fair value through profit or loss in order to reduce measurement inconsistencies.

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.

Investment contracts at amortized cost

Liabilities for investment contracts with fixed and guaranteed terms are measured at amortized cost, using the effective interest rate method. Transaction costs are included in the calculation of the effective yield. As of each reporting date, the ZIC Group re-estimates the expected future cash flows and re-calculates the carrying amount of the financial liability by computing the present value of estimated future cash flows using the original effective interest rate for the financial liability. Any adjustment is immediately recognized as income or expense.

Deferred origination costs (DOC)

The costs of acquiring new investment contracts with investment management services, such as commissions and other incremental expenses directly related to the issuance of each new contract, are capitalized and amortized in line with the revenue generated by providing investment management services. DOC is tested for recoverability annually.

f) Investments excluding derivative financial instruments

Investments include financial assets (excluding derivative financial instruments), cash and cash equivalents and real estate held for investment.

Categories and measurement of investments (excluding derivative financial instruments)

Financial assets are classified as available for sale, financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables.

The ZIC Group recognizes regular purchases and sales of financial assets on the trade date, which is the date on which the ZIC Group commits to purchase or sell the asset.

Available-for-sale financial assets

Available-for-sale financial assets are financial assets that are either designated as such or are not classified in any of the other categories.

Available-for-sale financial assets are carried at fair value, with changes in fair value recognized directly in OCI, until the securities are either sold or impaired.

The cumulative unrealized gains or losses recorded in OCI are net of cumulative deferred income taxes, certain related life policyholder liabilities and deferred acquisition costs. When available-for-sale financial assets are sold, impaired or otherwise disposed of, the cumulative gains or losses are recycled from OCI and recognized in income.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and those irrevocably designated at fair value through profit or loss at inception.

Financial assets irrevocably designated at inception at fair value through profit or loss are mainly financial assets backing unit-linked insurance contracts, unit-linked investment contracts and certain life insurance contracts with participation features. The designation of these assets at fair value through profit or loss eliminates or significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or from recognizing the resultant gains and losses on them on a different basis to the liabilities.

Financial assets at fair value through profit or loss are carried at fair value. Realized and unrealized gains and losses arising from changes in the fair value are recognized in income within net capital gains/(losses) on investments and impairments, in the period in which they arise.

Held-to-maturity investments

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturities other than those that meet the definition of loans and receivables, and for which the ZIC Group has the positive intention and ability to hold to maturity.

Held-to-maturity investments are carried at amortized cost using the effective interest rate method, less any charges for impairment.

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are not classified in any of the other categories.

Consolidated financial statements *continued*

Loans and receivables are carried at amortized cost using the effective interest rate method, less any charges for impairment.

Other items

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid investments that are readily convertible into cash and are subject to an insignificant risk of change in fair value, for example, short-term investments with maturities of three months or less from the date of acquisition. Cash and cash equivalents also includes cash received as collateral for securities lending. Cash and cash equivalents are stated at face value.

Real estate held for investment is initially recorded at cost (including transaction costs) and is subsequently measured at fair value with changes in fair value recognized in income. The gain or loss on disposal of real estate held for investment is the difference between the net proceeds received and the carrying amount of the investment and is recognized in the consolidated income statement when the disposal is completed.

Impairment of financial assets (excluding derivative financial instruments)

General

The ZIC Group assesses at each reporting date whether there is objective evidence that loss events occurred which negatively affect the estimate future cash flows of a financial asset or group of financial assets.

Available-for-sale financial assets

When there is objective evidence that an available-for-sale debt security is impaired, the cumulative loss that had been recognized directly in OCI is recognized in income as an impairment loss. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognized in income, the impairment loss is reversed through income, up to the amount of the previously recognized impairment loss, as adjusted for any amortization already recognized in income. Any further gains are recognized directly in OCI. Any subsequent losses, to the extent that they do not represent further impairment losses, are also recognized in OCI.

Objective evidence of impairment exists for an available-for-sale equity security when its fair value is below the weighted-average cost by a significant amount. Impairment thresholds are determined quarterly on the basis of the underlying price volatility of securities within the various equity markets in which the ZIC Group invests (such as North America, UK, Switzerland, other European countries and Asia Pacific). Additionally, the ZIC Group considers an equity security to be impaired when its fair value has been below the weighted-average cost for a prolonged period of 24 consecutive months or longer.

When there is objective evidence that an available-for-sale equity security is impaired, the cumulative loss that had been recognized directly in OCI, including any portion attributable to foreign currency changes, is recognized in income as an impairment loss. The impairment loss is the difference between the weighted-average acquisition cost (less any impairment loss on that security previously recognized in income) and the current fair value. Impairment losses on equity securities are not reversed through income, instead, when the fair value of a previously impaired equity security increases, the resulting unrealized gains are recognized through OCI. Any further decrease in fair value recorded subsequent to recognition of an impairment loss is also reclassified from OCI to income as impairment losses, together with any portion attributable to foreign currency changes, until the equity security is derecognized.

Held-to-maturity investments and loans and receivables

Generally, significant held-to-maturity financial assets are individually assessed to determine whether or not objective evidence of impairment exists. If no objective evidence of impairment exists the asset is included in a group of financial assets with similar credit risk characteristics that are collectively assessed for impairment.

Objective evidence of impairment exists if it is probable that the ZIC Group will not be able to collect principal and/or interest due according to the contractual terms of the instrument. When impairment is determined to have occurred, the carrying amount of held-to-maturity investments, loans or receivables is reduced through the use of an allowance account, and the movement in the impairment allowance is recognized as an impairment loss in income. The impairment allowance of financial assets carried at amortized cost is measured as the difference between the amortized cost of the assets and the present value of estimated future cash flows, calculated using the original effective interest rate, for fixed rate financial assets, or current effective interest rate, for variable rate financial assets. If the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss

was recognized, the impairment loss is reversed through income. The amount of reversal is limited so that it does not result in a carrying amount exceeding the amortized cost that would have been calculated at the date of reversal had the impairment not been previously recognized.

g) Derivative financial instruments and hedge accounting

Derivative financial instruments, except those designated under a qualifying hedge relationship are classified as held for trading assets or liabilities and carried at fair value on the balance sheet with changes in fair value recognized in income. Derivative financial instruments include embedded derivative features which are assessed at inception of the contract and, depending on their characteristics, are measured and presented as separate derivative financial instruments.

Derivative financial instruments that qualify for hedge accounting

Derivative financial instruments are used by the ZIC Group to economically hedge risks. In limited circumstances derivative financial instruments are designated as hedging instruments for accounting purposes:

- fair value hedges which hedge the exposure to changes in the fair value of a recognized asset or liability;
- cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction; or
- hedges of the net investment in a foreign operation.

All hedge relationships are formally documented, including the risk management objectives and strategy for undertaking hedge transactions. At inception of a hedge and on an ongoing basis, the hedge relationship is formally assessed in order to determine whether the hedging instruments are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risk. 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 in accordance with the respective accounting policy as if there was no hedging designation. Where hedge accounting conditions are met, the accounting treatments are as follows:

Fair value hedges

Gains or losses from re-measuring the derivative financial instruments that are designated and qualify as fair value hedges are recognized immediately in the same line item of the consolidated income statement as the offsetting change in fair value of the hedged item attributable to the risk being hedged.

Cash flow hedges

The effective portion of the gain or loss on the re-measurement of the cash flow hedging instrument is recognized directly in OCI. The ineffective portion is recognized immediately in income. The accumulated gains and losses on the hedged instrument in OCI are reclassified to income in the same period in which gains or losses on the item hedged are recognized in income.

Net investment hedges

Measurement of hedge effectiveness is based on changes in forward rates. Gains and losses on the designated hedging derivative relating to the effective portion of the hedge are directly recognized in OCI whereas the ineffective portion is immediately recognized in income. The accumulated gains and losses on the hedging instrument in OCI are reclassified to income on disposal of the foreign operation.

h) Borrowings

Borrowings (debt issued) are recognized initially at fair value of the consideration received, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in income over the period of the borrowing using the effective interest rate method.

When fair value hedge accounting is applied to borrowings, the carrying values of the borrowings are adjusted for changes in fair values related to the hedged exposure.

i) Derecognition of financial assets and liabilities

Financial assets are derecognized when the right to receive cash flows from the assets has expired, or when the ZIC Group has transferred its contractual right to receive the cash flows from the financial asset, and either

Consolidated financial statements *continued*

- substantially all the risks and rewards of ownership have been transferred; or
- substantially all the risks and rewards have not been retained or transferred, but control has been transferred.

Financial liabilities are derecognized when they are extinguished, which is when the obligation is discharged, cancelled or has expired.

Securities lending

Certain entities within the ZIC 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 ZIC Group retains substantially all the risks and rewards of ownership of these loaned securities, and also retains contractual rights to the cash flows therefrom. These securities are therefore not derecognized from the ZIC Group's balance sheet. Cash received as collateral for loaned securities is recorded as an asset and a corresponding liability is established.

Repurchase and reverse repurchase transactions

Securities sold under agreements to repurchase at a specified later date (repurchase agreements) and securities purchased under agreements to resell (reverse repurchase agreements) are accounted for as collateralized financing transactions.

The securities delivered under a repurchase agreement are not derecognized from the balance sheet when all or substantially all of the risk and rewards are retained. The proceeds received are reported as a liability under obligation to repurchase securities. Interest expense is charged to income using the effective interest rate method over the life of the agreement.

Under a reverse repurchase agreement, the securities received are not recognized on the balance sheet, as long as the risk and rewards of ownership have not been transferred to the ZIC Group. The cash delivered is derecognized and a corresponding receivable is recorded and reported within "Receivables and other assets". Interest income is recognized in income using the effective interest rate method over the life of the agreement.

In cases such as events of default by a third party, it may be determined that the risks and rewards of ownership over the collateral have been obtained by the ZIC Group. At such point in time, the securities held under the reverse repurchase agreement would be recognized on the balance sheet at fair value and the original receivable as collateral would be derecognized. Any shortfall is recorded as a loss in income.

j) Property and equipment

Buildings held for own use and equipment are carried at cost less accumulated depreciation and any accumulated impairment loss. These assets are depreciated usually on a straight-line basis to income over the following estimated useful lives:

- buildings 25 to 50 years;
- furniture and fixtures five to ten years; and
- computer equipment three to six years.

Land held for own use is carried at cost less any accumulated impairment loss.

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. Assets are grouped on a cash generating unit (CGU) level if the recoverable amount cannot be separately determined.

k) Intangible assets

Intangible assets include goodwill, present value of future profits from acquired insurance contracts, attorney-in-fact relationships, distribution agreements and other intangible assets, such as computer software licenses and capitalized software development costs.

Intangible assets with definite lives are carried at cost less accumulated amortization and impairments. They are amortized using the straight-line method over their useful lives and reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Intangible assets with indefinite lives are not subject to amortization but are tested for impairment annually and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Goodwill

Goodwill arises on the acquisition of subsidiaries, associates and jointly controlled entities and represents the excess of the cost of acquisition over the fair value of the ZIC Group's share of the net identifiable assets of the acquired entity at the acquisition date.

Goodwill on the acquisition of subsidiaries is capitalized as a separate line and reviewed for impairment annually, or more frequently if impairment indicators are observed. For the purpose of impairment testing, goodwill is allocated to cash generating units (CGU) based on the level at which management monitors operations and makes decisions relating to the continuation or disposal of assets and operations. On this basis, as of January 1, 2011, the ZIC Group aggregates CGUs on a General Insurance segment level. Within the segments Global Life and Farmers, CGUs are identified at either business unit level or individual reporting entity level.

Goodwill on the acquisition of associates and jointly controlled entities is included in the value of equity method accounted investments and is tested for impairment as part of the overall measurement of the carrying amount of those investments.

If goodwill has been allocated to a CGU and an operation within that unit is disposed of, the carrying amount of the operation includes attributable goodwill when determining the gain or loss on disposal.

Present value of future profits from acquired insurance contracts (PVFP)

An intangible asset representing the PVFP arises from the acquisition of life insurance businesses. Such an asset has a definite life and is amortized over the expected life of the acquired contracts, following the same rules outlined for deferred acquisition costs. The carrying value of the PVFP asset is tested periodically for impairment as part of the liability adequacy test for insurance contracts.

Attorney-in-fact relationships (AIF)

The AIF reflects the ability of the ZIC Group to generate future revenues based on the ZIC Group's relationship with the Farmers Exchanges, which are managed but not owned by Farmers Group Inc. (FGI), a wholly owned subsidiary of the Zurich Insurance Group. In determining that these relationships have an indefinite useful life, the ZIC 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 non-claims management services, and the historical AIF between FGI and the Farmers Exchanges. The AIF is reviewed for impairment at least annually.

Distribution agreements

Distribution agreements may have useful lives extending up to 30 years which are estimated based on the period of time over which they are expected to provide economic benefits, but no longer than the contractual term, after taking into account all economic and legal factors such as stability of the industry, competitive position and the period of control over the assets.

Software

Costs associated with research and maintenance of internally developed computer software are expensed as incurred. Costs incurred during the development phase are capitalized. Software under development is tested for impairment annually.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software.

The useful lives of computer software licenses and capitalized internal software development costs generally do not exceed five years. In some circumstances, capitalized software development costs may be amortized over a period of up to ten years, taking into account the effects of obsolescence, technology, competition and other economic and legal factors.

I) Provisions, contingent liabilities, commitments and financial guarantees

Provisions, contingent liabilities, commitments and financial guarantees are recognized when the ZIC Group has a present obligation (legal or constructive) as a result of a past event, it is more likely than not 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 such an obligation. Provisions are discounted when the effect of the time value of money is considered material.

Consolidated financial statements *continued*

Restructuring provisions comprise employee termination costs and costs related to onerous contracts. Restructuring provisions are recognized when the ZIC Group has a present obligation as a result of a detailed formal plan, which has been announced to those affected and the amount can be reasonably estimated.

m) Other revenue recognition

Farmers management fees

FGI provides non-claims related management services to the Farmers Exchanges, including risk selection, preparation and mailing of policy forms and invoices, premium collection, management of the investment portfolios and certain other administrative and managerial functions. Fees for these management services are primarily determined as a percentage of gross premiums earned by the Farmers Exchanges.

Other fees and commission income

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 ZIC Group recognizes these fees on a straight-line basis over the estimated life of the contract.

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

- Front-end fees charged to the customer at inception are 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 are billed in advance and recognized on a straight-line basis over the period in which the service is rendered. Fees charged at the end of the period are accrued as a receivable and are offset against the financial liability when charged to the customer.

n) Net investment income

Net investment income includes investment income earned and investment expenses incurred.

Investment income

Investment income primarily consists of interest income on debt securities, loans and receivables, dividend income on equity securities, rental income from real estate held for investment and income earned on equity method accounted investments.

For Group investments, interest income is recognized using the effective interest method. Interest income on impaired financial assets is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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

Rental income from real estate held for investment is recognized on an accrual basis.

Investment expenses

Investment expenses consist of costs relating to investment management services and operating expenses for real estate held for investment. These expenses are recognized on an accrual basis.

o) Employee benefits

Share-based compensation and cash incentive plans

Share based compensation plans include plans under which shares and options to purchase shares of Zurich Insurance Group Ltd (the ultimate parent of the ZIC Group), based on the performance of the businesses, are awarded by Zurich Insurance Group Ltd directly to employees of entities within the ZIC Group. With effect from 2011, share option grants were discontinued.

Under the ZIC Group's equity-settled share-based compensation plans, the fair value of the employee services received in exchange for the grant is determined by reference to the fair value of the shares and/ or options previously granted and is recognized as an expense in income over the vesting period, with a corresponding amount recorded in additional paid-in capital.

Non-market vesting conditions (for example, profitability and revenue growth targets) are included in assumptions to determine the number of shares and/or previously options that are expected to be issued or become exercisable. At each balance sheet date, the ZIC 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 to original estimates, if any, in income with a corresponding adjustment to additional paid-in capital. However, no subsequent adjustment to total additional paid-in capital is made after the vesting date.

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

Retirement benefits

Contributions to defined contribution plans are recorded as an expense in the period in which the economic benefit from the employees' service was received.

Defined benefit plan obligations and contributions are determined annually by qualified actuaries using the projected unit credit method. The ZIC Group's expense relating 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 in full in the period in which they occur and are presented on a separate line in the consolidated statement of comprehensive income. To the extent that past service costs are vested, they are recognized immediately. Unrecognized past service costs represent past service costs not yet vested, and are recognized on a straight-line basis over the average vesting period.

Other post-employment benefits

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

p) Leases

Payments made under operating leases (net of any incentives received from the lessor) are normally charged to income on a straight-line basis over the period of the lease.

Finance leases, where the ZIC Group is the lessee, are capitalized at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized in income. Contingent rents are recognized as expenses in the period in which they are incurred.

q) Income taxes

The ZIC Group provides current tax expense according to the tax laws of each jurisdiction in which it operates. Deferred 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 they can be utilized against future taxable income in the respective jurisdictions.

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 expected distributions to the holding company of the profits of subsidiaries are not recognized as deferred income taxes unless a distribution of those profits is intended in the foreseeable future.

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

Consolidated financial statements *continued*

4. Critical accounting judgments and estimates

The application of certain accounting policies necessitates critical accounting estimates that involve discretionary judgments and the use of assumptions which are susceptible to change due to inherent uncertainties. Because of the uncertainties involved, actual results could differ significantly from the assumptions and estimates made by management. Such critical accounting estimates are of significance to insurance reserves and deferred acquisition costs, the determination of fair value for financial assets and liabilities, the determination of fair values of assets and liabilities attributable to business combinations, impairment charges, deferred taxes and employee benefits.

a) Reserves for insurance contracts and deferred acquisition costs

The ZIC Group is required to establish reserves for payment of losses and loss adjustment expenses that arise from the ZIC 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 ZIC Group establishes its reserves by product line, type and extent of coverage and year of occurrence. There are two categories of loss reserve: 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 ZIC 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 ZIC Group bases such estimates on the facts available at the time the reserves are established. These reserves are generally established on an undiscounted basis to recognize the estimated costs of bringing pending claims to final settlement. The reserve calculation takes 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 ZIC 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 ZIC Group's estimation of reserves. Between the reporting and final settlement of a claim circumstances may change, which may 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 ZIC 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 ZIC Group establishes IBNR reserves, 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 such claims to final settlement. As these losses have not yet been reported, the ZIC Group relies upon historical information and statistical models, based on product line, type and extent of coverage, to estimate its IBNR liability. The ZIC Group also uses reported claim trends, claim severities, exposure growth, and other factors in estimating its IBNR reserves. These reserves are revised 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 ZIC Group's reserves. Short-tail claims, such as those 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 claims.

Since the ZIC 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. This volatility may also be contingent upon political and legal developments after the occurrence of the event.

The ZIC 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 ZIC Group's actuaries. Additionally, the ZIC Group's Corporate Center actuaries perform periodic reserve reviews of the ZIC Group's businesses throughout the world. Management considers the results of these reviews and adjusts its reserves for losses and loss adjustment expenses, where necessary.

The reserves for future life policyholders' benefits and policyholders' contract deposits and other funds contain a number of assumptions regarding mortality or longevity, lapses, surrenders, expenses and investment returns. These assumptions can vary by country, year of issuance and product and 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 ZIC 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 ZIC Group is exposed to longevity risk.
- Under certain contracts, the ZIC 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 may 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 ZIC Group's qualified actuaries in setting such assumptions includes, but is not limited to, pricing assumptions, available experience studies and profitability analysis.

Deferred policy acquisition costs are deferred only to the extent that they are recoverable from future policy income. Recoverability is tested at contract inception and subsequently on a regular basis with reference to current expectations of future profits or margins.

See note 8 for further information on reserves for insurance contracts and note 12 for deferred policy acquisition costs. Also refer to the insurance risk section of the Risk Review.

b) Fair value measurement

All financial assets and liabilities are recorded initially at fair value. Subsequently, available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss and derivative financial instruments are carried at fair value as of the reporting date. All other financial instruments are carried at amortized cost, with their fair values disclosed in note 26.

In determining the fair values of available-for-sale financial assets and financial assets at fair value through profit or loss, the ZIC Group makes extensive use of third party pricing providers and only in rare cases places reliance on prices that are derived from internal models. One of the objectives of the ZIC Group's control environment and the process of selection of pricing providers is to ensure that fair values of investments are sourced only from independent, reliable and reputable third party pricing providers that have proper processes and controls in place to guarantee that the price quality meets the high standards that the ZIC Group expects.

In addition, the ZIC Group's policy is to ensure that independently sourced prices are developed by making maximum use of current observable market inputs derived from orderly transactions and by employing widely accepted valuation techniques and models. When third party pricing providers are unable to obtain adequate observable information for a particular financial instrument, the fair value is determined either requesting selective non-binding broker quotes or using internal valuation models.

Consolidated financial statements *continued*

Investment accounting, operations and process functions, are completely independent from those responsible for buying and selling the assets, and are responsible for receiving, challenging and verifying values provided by third party pricing providers to ensure that fair values are reliable and comply with applicable accounting and valuation policies. The quality control procedures used depend on the nature and complexity of the invested assets and include regular reviews of valuation techniques and inputs used by pricing providers (for example, default rates of collateral for asset backed securities), variance and stale price analysis and comparisons with fair values of similar instruments and with alternative values obtained from asset managers and brokers.

Fair values of debt instruments issued by government entities and corporate entities are obtained from third party pricing providers. The fair value received from these pricing providers may be based on quoted prices in an active market for identical assets, alternative pricing methods such as matrix pricing or alternatively, based on an income approach employing discounted cash flow models.

Fair values of equity securities are generally based on quoted prices in an active market (i.e., exchange or dealer market) for identical assets. If such quoted prices are not available, then fair values are estimated on the basis of information from external pricing providers or internal pricing models (for example, discounted cash flow models or other recognized valuation techniques).

The ZIC Group holds certain asset classes that are not actively traded, in particular hedge funds and private equity investments. Fair values of such instruments are obtained from net asset value information and audited financial statements provided by the issuing hedge funds and private equity funds. Performance of these investments and determination of their fair value are monitored closely by the ZIC Group's in-house investment professionals.

Discounted cash flow models are used for mortgage and other loans and long term receivables. The discount yields in these models use either current interest rates charged by the ZIC Group on these instruments or calculated rates that reflect the return a market participant would expect to receive on instruments with similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest rates.

Fair values of debt instruments issued by the ZIC Group are estimated using discounted cash flow models based on the ZIC Group's current incremental borrowing rates for similar types of borrowings, with maturities consistent with those remaining for the debt instruments being valued.

Fair values of derivative instruments are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which use various inputs including current market and contractual prices for underlying instruments, time to expiry, correlations, yield curves, prepayment rates and volatility of underlying instruments. Such inputs used in pricing models are generally market observable or derived from market observable data.

Fair values of liabilities related to unit-linked investment contracts are determined by reference to the fair value of the financial assets backing these liabilities. Fair values of liabilities related to other investment contracts are determined using discounted cash flow models, that incorporate a variety of factors, including credit risk, embedded derivatives (such as unit-linking features), volatility factors (including contract holder behavior), servicing costs and surrenders.

For certain financial instruments, the carrying amounts approximate their fair value because of their short term nature. Such instruments include short-term investments, receivables, obligations to repurchase securities and other short-term financial assets and liabilities.

Fair value of real estate held for investment is based on valuations performed annually by internal valuation specialists and generally on a rotation basis at least once every three years by an independent qualified appraiser. The valuation methods applied are income capitalization, discounted cash flow analysis, and market comparables taking into account the actual letting status and observable market data.

See notes 6, 7 and 26 for further information on the fair value of financial assets and liabilities.

c) Fair values of assets and liabilities attributable to business combinations

Acquired businesses are accounted for using the purchase method of accounting which requires that the assets acquired and liabilities assumed are recorded at the date of acquisition at their respective fair values. Fair values of financial assets and liabilities and insurance liabilities are determined as described in the respective sections above.

Fair values of identifiable intangible assets are based on market-participant assumptions and applicable valuation techniques, depending on the nature of the assets valued. For customer relationship and contract intangibles, including bank distribution agreements, the multi-period excess earnings or cash flow method is applied, using future cash flows expected to be generated from such assets discounted at applicable market rates. For information technology intangibles the replacement cost method is generally applied.

See note 5 for further information on the fair value of assets and liabilities attributable to business combinations.

d) Impairment of assets

Assets are subject to regular impairment reviews under the relevant IFRS standard.

Financial assets

A financial asset is considered impaired if there is objective evidence of impairment as a result of one or more occurred loss events that have an impact on the estimated future cash flows of the financial asset. The decision to record an impairment is based on a review of such evidence, for example, the issuer's current financial position and its future prospects and the national or economic conditions that correlate with defaults on the assets reviewed for impairment.

For held-to-maturity investments and loans and receivables, the recoverable amount is determined by reference to the present value of the estimated future cash flows. The carrying amount of mortgage loans and receivables is reduced through an impairment allowance determined using an analytical method based on knowledge of each loan group or receivable. The method is normally based on historical statistics, adjusted for known or anticipated trends in the group of financial assets or individual accounts. As judgment is inherent in such impairment reviews, actual outcomes could vary significantly from the forecast future cash flows.

Goodwill and Attorney-in-fact relationships (AiF)

Goodwill is allocated to the Cash Generating Units (CGU) which represent the lowest level at which goodwill is monitored for internal management purposes. For goodwill the recoverable amount is the higher of its fair value less costs to sell and its value-in-use. Fair value at a CGU level is determined, considering quoted market prices, current share values in the market place for similar publicly traded entities, and recent sale transactions of similar businesses. Value-in-use is determined using the present value of estimated future cash flows expected to be generated from or used by the CGU. Cash flow projections are based on financial budgets, which are approved by management, typically covering a three-year period or if appropriate, a longer period. Cash flows beyond this period are extrapolated using amongst others estimated perpetual growth rates. The discount rates applied reflect the respective risk free interest rate adjusted for the relevant risk factors to the extent they have not already been considered in the underlying cash flows.

CGUs are defined separately for the three main business segments, General Insurance, Global Life and Farmers. General Insurance and Farmers are considered as single worldwide CGUs. For Global Life CGUs are defined on a lower level in line with management's view of the business.

The discount rates used in the recoverable amount calculations for developed markets are based on the capital asset pricing model and consider government bond rates which are further adjusted for equity risk premium, appropriate beta and leverage ratio. In emerging markets, discount rates are based on the U.S. dollar discount rate taking into account inflation differential expectations and country risks. All input factors to the discount rates are based on observable market data.

The recoverable amount of the intangible assets with an indefinite life related to the Farmers segment (i.e. attorney-in-fact (AIF) relationships and goodwill) is determined on the basis of value-in-use calculations. These calculations use cash flow projections based on business plans which are approved by management and typically cover a three-year period.

Table 4.1 sets out the applied discount rates and the perpetual nominal growth rates (PGR) beyond the projection period which are dependent on country specific growth rate and inflation expectations for the major CGUs.

Consolidated financial statements *continued*

Table 4.1

Discount and perpetual growth rates for Goodwill by major CGUs	Segment	in USD millions	Discount rates in %	Discount rates in %	Perpetual nominal growth rate in %	Perpetual nominal growth rate in %
			2012	2011	2012	2011
Farmers	Farmers	819	8.5	8.3	–	–
General Insurance	GI	852	8.0	7.9	2.1	–
Global Life Germany	Life	275	6.7	7.1	2.0	2.0
Zurich Assurance Ltd and Openwork Holdings Ltd	Life	109	5.9	5.8	–	–

Sensitivity tests have been performed on goodwill and typically comprised of an analysis for a decrease in cash flows of up to 30 percent, a decrease in the perpetual growth rate of up to 1.0 percentage point or an increase in the discount rate of up to 3.5 percentage points in order to reflect current adverse market conditions. No impairments were identified on this basis.

Distribution agreements

The recoverable amount for General Insurance intangible assets reflecting distribution agreements is determined on the basis of value-in-use calculations. These calculations use cash flow projections in line with the terms and conditions of the underlying distribution agreements. For Global Life business distribution agreements, the recoverable amount is determined based on projected cash flows and discount rates consistent with the data used for actuarial valuations.

The discount rates used in the recoverable amount calculations for developed markets are based on the capital asset pricing model and consider government bond rates which are further adjusted for equity risk premium, appropriate beta and leverage ratio. In emerging markets, discount rates are based on the U.S. dollar discount rate taking into account inflation differential expectations and country risks. All input factors to the discount rates are based on observable market data.

Table 4.2 sets out the applied discount rates and the PGR beyond the projection period which are dependent on country specific growth rate and inflation expectations for the major distribution agreements.

Table 4.2

Discount and perpetual growth rates by major distribution agreements	in USD millions	Range of discount rates in %	Range of discount rates in %	Perpetual nominal growth rate in %	Perpetual nominal growth rate in %
		2012	2011	2012	2011
Banco Sabadell S.A. entities in Spain	1,763	9.0	4.8–8.3	2.5	2.5
Banco Santander S.A. entities in Latin America	1,852	7.8–20.1	n/a	n/a	n/a

For impairment testing purposes these distribution agreements are assessed as single assets by counterparty.

Sensitivity tests have been performed on distribution agreements and typically comprised of an analysis for a decrease in cash flows, a decrease in the perpetual growth rate or an increase in the discount rate, applying reasonably possible changes. No impairments were identified on this basis.

In light of the current economic conditions in Spain the ZIC Group, in particular, monitors whether the actual performance of the distribution agreements with Banco Sabadell S.A. are in line with the business plans.

See notes 3, 6, 15, 17 and 18 for further information on impairment of assets.

e) 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, is 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. The utilization of deferred tax assets arising from unused tax losses or tax credits depends on the generation of sufficient taxable profits before the unused tax losses or tax credits expire. As of each balance sheet date, management evaluates the recoverability of deferred tax assets and if it is considered probable, that all or a portion of the deferred tax asset will not be utilized, then a valuation allowance is recognized.

See note 20 for further information on deferred taxes.

f) Employee benefits

The ZIC Group provides defined benefit plans and other post-employment plans. In assessing the ZIC 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. Discount rates for significant plans are based on a yield curve approach. The ZIC Group sets the discount rate by creating a hypothetical portfolio of high quality corporate bonds for which the timing and amount of cash outflows approximate the estimated payouts of the defined benefit plan. 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.

See note 23 for further information on employee benefits.

Consolidated financial statements *continued*

5. Acquisitions and divestments

Transactions in 2012

Acquisitions

On May 25, 2012, the ZIC Group increased its shareholding in Zurich Insurance Company South Africa Limited, a partially owned subsidiary, to 84.05 percent by purchasing a 25.1 percent shareholding from Royal Bafokeng Finance (Pty) Limited (RBF) for a purchase price of approximately USD 75 million. With this purchase of 25.1 percent the ZIC Group's controlled interest for the Consolidated financial statements is now in line with its legal ownership. The put option right granted to RBF in 2010 to sell back its entire shareholding to the ZIC Group also ceased to exist.

Divestments and loss of control

The ZIC Group lost control over one of its subsidiaries and consequently derecognized the assets and liabilities at their carrying value and recognized its retained investment in this entity as an equity security classified as available-for-sale as of September 30, 2012. A USD 38 million pre-tax loss has been recorded within net gain/(loss) on divestments of businesses.

Transactions in 2011

Acquisitions

On October 5, 2011, the ZIC Group completed the acquisition of a 51.0 percent participation in a holding company, which owns the life insurance, pension and general insurance operations of Banco Santander S.A. (Santander) in Brazil and Argentina. Between November 2, 2011 and November 4, 2011, the holding company completed the acquisition of a 100 percent participation in the life insurance, pension and general insurance operations of Santander in Chile, Mexico and Uruguay with the resulting 51.0 percent ultimate ownership for the ZIC Group. The ZIC Group obtained control over the acquired entities through its majority voting right in the holding company's board of directors and as shareholder, which together allow the ZIC Group to direct the relevant activities of the insurance operations (Zurich Santander). As part of the transaction, the ZIC Group entered into long-term strategic distribution arrangements with Santander in Latin America. This transaction is in line with the ZIC Group's emerging market strategy in both Global Life and General Insurance, and significantly expands the ZIC Group's presence in Latin America.

The initial consideration paid by the ZIC Group amounted to approximately USD 1.2 billion, subject to an estimated purchase price adjustment of USD 23 million for the purchase accounting as reflected in the Consolidated financial statements as of acquisition dates. Subsequently such estimated purchase price adjustment has decreased immaterially. The ZIC Group is still in the process of finalizing the purchase price adjustment. The ZIC Group and Santander have also entered into long term loan agreements with one of the acquired companies, whereby total funds of USD 511 million were provided in line with the shareholdings of the ZIC Group and Santander. In addition to the initial consideration, both an earn-out component based on the future profitability under the distribution agreements and a protection mechanism for the ZIC Group's initial consideration, which is based on a similar future profitability criterion, were agreed. Under the earn-out arrangement, payments are scheduled to be made after every five year period starting January 1, 2011 until December 31, 2035 by the ZIC Group, subject to the achievement of the profitability criterion. The earn-out payments which are denominated in local currency, are scheduled to increase over the 25 year period up to a cumulative maximum total amount of USD 1.6 billion, based on acquisition foreign exchange rates. On a present value basis the cumulative maximum earn-out payments amount to USD 334 million. The fair value of the earn-out liability as of acquisition date was estimated to amount to USD 99 million and was derived by a probability weighting of different profitability scenarios and by applying a local currency based discount rate.

Since acquisition the ZIC Group had in particular reassessed the value of technical reserves in Brazil, Chile and Mexico, deferred acquisition costs in Mexico and Chile and present value of future profits in Brazil, Mexico and Chile based on better available data as of the acquisition date. Total assets, including identifiable intangible assets for Global Life and General Insurance as of the acquisition dates, have been revised to USD 16.8 billion and total liabilities have been revised to USD 13.9 billion. These amounts have been allocated to individual balance sheet line items and exclude amounts reported in Other Operating Businesses. The initially recorded assets and liabilities in the ZIC Group's Consolidated financial statements 2011 have been restated as set out in note 1. The identifiable intangible assets, gross of deferred tax, comprise the value of the distribution agreements in Brazil, Argentina, Mexico and Chile amounting to USD 2.0 billion and the present value of future profits (PVFP) of acquired insurance contracts for the life insurance businesses in Brazil, Mexico and Chile of USD 309 million. Based on these numbers, the residual goodwill amounts to nil. The value of the distribution agreements and PVFP were determined on the basis of country specific in-force data, transaction projections and assumptions. The non-controlling interests are valued proportionately to the purchase price paid by the ZIC Group.

Acquisition related costs of USD 24 million were included in other administrative expenses for the year ended December 31, 2011, and were excluded from business operating profit.

Table 5.1 shows the main balance sheet line items as of the acquisition dates, representing the fair value of the Zurich Santander companies acquired.

Table 5.1				
Business combinations	in USD millions, as of acquisition dates			
	Global Life	General Insurance	Other Operating Businesses	Total
Total Group Investments	2,959	380	3	3,342
Cash and cash equivalents	127	6	3	136
Equity securities	1,290	139	–	1,429
Debt securities	1,461	209	–	1,670
Real estate held for investment	4	–	–	4
Other loans	77	26	–	103
Investments for unit-linked contracts	9,616	–	–	9,616
Total investments	12,575	380	3	12,958
Reinsurers' share of reserves for insurance contracts	11	227	–	238
Deferred policy acquisition costs	573	67	–	640
Receivables and other assets	393	290	–	683
Distribution agreement, gross of deferred tax	1,670	337	–	2,007
Present value of future profits, gross of deferred tax	309	–	–	309
Assets acquired	15,532	1,301	3	16,835
Liabilities for investment contracts	(309)	–	–	(309)
Reserves for insurance contracts	(11,775)	(391)	–	(12,166)
Other liabilities	(540)	(297)	–	(837)
Deferred tax liabilities	(491)	(108)	–	(599)
Senior and subordinated debt	–	–	(511)	(511)
Liabilities acquired	(13,114)	(796)	(511)	(14,422)
Net assets acquired	2,417	504	(508)	2,413
Non-controlling interests				(1,183)
Total acquisition costs				1,231
Cash consideration				1,156
Fair value of contingent consideration				99
Preliminary purchase price adjustment				(23)

The financial result for the period from the acquisition dates to December 31, 2012 is included in the ZIC Group's consolidated income statement for the year ended December 31, 2012. The main income statement information for Zurich Santander is shown in table 5.2.

Consolidated financial statements *continued*

Table 5.2

Income statement information

in USD millions

	Global Life	General Insurance	Core business total	Other Operating Businesses	Total
Information from acquisition to December 31, 2012					
Life insurance deposits	2,461	–	2,461	–	2,461
Gross written premiums and policy fees	2,050	720	2,770	–	2,770
Total BOP revenues	3,214	456	3,669	(18)	3,651
Business operating profit before non-controlling interests	246	120	367	(43)	323
Business operating profit after non-controlling interests	126	61	187	(22)	165
Net income after taxes before non-controlling interests					220
Net income after taxes after non-controlling interests					112
Pro forma 2011 information ¹					
Gross written premium for 12 months	2,326	677	3,003	n/a	3,003
Net income after taxes for 12 months					372

¹ Based on local GAAP information, as full year IFRS information is not available. The information is deemed to be a reasonable approximation but excludes the amortization of identifiable intangible assets and PVFP.

On September 30, 2011, the ZIC Group completed the acquisition of 100 percent of Malaysian Assurance Alliance Berhad, now known as Zurich Insurance Malaysia Berhad (ZIMB), a composite insurer based in Malaysia, together with 100 percent of four related services companies. The acquisition of ZIMB is aligned with the ZIC Group's emerging-market strategy of expanding the ZIC Group's presence in the Asia-Pacific region. The total preliminary purchase price of USD 138 million (initially USD 135 million) included an initial consideration of USD 108 million and an anticipated purchase price adjustment amounting to USD 30 million (initially USD 27 million). As of December 31, 2012, out of the initial consideration of USD 108 million, USD 63 million (initially USD 56 million) had been paid in cash, USD 45 million (initially USD 30 million) was placed in escrow and initially an amount of USD 22 million had been retained by the ZIC Group. The ZIC Group is still in the process of finalizing the purchase price adjustment. The amount in escrow is to be held for a period of two years. Based on the final purchase accounting the fair value of net tangible assets acquired amounted to USD 102 million (initially USD 113 million) and identifiable intangible assets, net of deferred tax, amounted to USD 19 million which mainly consisted of the PVFP of the acquired insurance contracts. Residual goodwill amounted to USD 17 million (initially USD 3 million), partly reflecting the future growth opportunities. In addition, the ZIC Group has injected approximately USD 135 million of capital into ZIMB immediately following the completion of the acquisition to meet regulatory capital requirements.

On July 12, 2011, as part of its preparations for local regulatory changes, the ZIC Group completed the acquisition of 75.0 percent of 2Plan Group Limited, an independent financial advice firm based in the UK. The total purchase price for the acquisition amounted to zero. The remaining 25.0 percent shareholding continues to be held by members of the founder management team who have options to sell their shareholdings to the ZIC Group at a price contingent upon the achievement of future profit targets by 2Plan Group Limited. Based on the final purchase accounting the tangible net assets acquired amounted to negative USD 5 million and identifiable intangible assets, net of deferred tax, amounted to USD 2 million consisting of software and capitalized recruitment director fees. Goodwill amounted to USD 3 million (initially USD 4 million) and reflects the future value from the ZIC Group's improved independent financial advisor proposition and technology offering in the UK.

Divestments

On January 12, 2012, the ZIC Group sold all of its shares in La Boliviana Ciacruz de Seguros y Reaseguros S.A. and Zurich Boliviana de Seguros Personales S.A. based in Bolivia, general and life insurance companies. As of December 31, 2011 these companies were classified as held for sale and the resulting loss on divestment of businesses amounted to USD 13 million.

On June 30, 2011, the ZIC Group sold all of its shares in Lonsec Limited, including three wholly owned subsidiaries, a research and broking company based in Australia, in an effort to focus on its core business lines, recording a pre-tax gain on disposal in aggregate of USD 10 million. On July 1, 2011, the ZIC Group entered into business outsourcing agreements for which a pre-tax gain of USD 9 million was realized. Total cash and net assets divested in 2011 were USD 8 million and USD 8 million, respectively. The total consideration received in 2011, net of immaterial transaction costs, amounted to USD 28 million.

6. Investments

Total investments includes Group investments and investments for unit-linked products. Group investments are those for which the ZIC Group bears part or all of the investment risk. They also include investments related to investment contracts with discretionary participation features. Investments for unit-linked products include such investments where the policyholder bears the investment risk, and are held for liabilities related to unit-linked investment contracts and reserves for unit-linked insurance contracts. They are managed in accordance with the investment objectives of each unit-linked fund.

Table 6.1a

Investment result for total investments

in USD millions, for the years ended December 31

	Net investment income		Net capital gains/ (losses) on investments and impairments		Investment result	
	2012	2011	2012	2011	2012	2011
	Cash and cash equivalents	61	68	(4)	10	57
Equity securities	1,796	1,820	8,981	(5,184)	10,778	(3,365)
Debt securities	5,394	5,696	2,552	1,158	7,946	6,854
Real estate held for investment	816	859	(331)	(33)	485	825
Mortgage loans	350	392	(8)	(8)	342	384
Other loans	837	917	17	202	854	1,119
Investments in associates and joint ventures	18	12	1	(45)	18	(33)
Derivative financial instruments ¹	–	–	(465)	927	(465)	927
Investment result, gross	9,272	9,763	10,744	(2,973)	20,016	6,790
Investment expenses	(761)	(864)	–	–	(761)	(864)
Investment result, net	8,511	8,899	10,744	(2,973)	19,255	5,926

¹ Net capital losses on derivative financial instruments attributable to cash flow hedge ineffectiveness amounted to USD 7 million and USD 13 million for the years ended December 31, 2012 and 2011, respectively.

Rental operating expenses for real estate held for investment included in investment expenses for total investments amounted to USD 194 million and USD 203 million for the years ended December 31, 2012 and 2011, respectively.

Consolidated financial statements *continued*

Table 6.1b

Investment result for Group investments	in USD millions, for the years ended December 31					
	Net investment income		Net capital gains/(losses) on investments and impairments		Investment result	
	2012	2011	2012	2011	2012	2011
Cash and cash equivalents	45	65	1	1	45	66
Equity securities	331	330	570	320	900	651
Debt securities	5,095	5,386	1,968	923	7,062	6,309
Real estate held for investment	506	531	12	46	517	576
Mortgage loans	350	392	(8)	(8)	342	384
Other loans	584	680	79	202	663	881
Investments in associates and joint ventures	18	12	1	(45)	18	(33)
Derivative financial instruments ¹	–	–	(308)	889	(308)	889
Investment result, gross, for Group investments	6,928	7,396	2,313	2,328	9,241	9,724
Investment expenses for Group investments	(253)	(253)	–	–	(253)	(253)
Investment result, net, for Group investments	6,674	7,142	2,313	2,328	8,987	9,470

¹ Net capital losses on derivative financial instruments attributable to cash flow hedge ineffectiveness amounted to USD 7 million and USD 13 million for the years ended December 31, 2012 and 2011, respectively.

Impairment charges on Group investments included in net capital gains/losses on investments and impairments amounted to USD 116 million and USD 330 million, including impairment charges on mortgage loans and other loans of USD 21 million and USD 5 million, for the years ended December 31, 2012 and 2011, respectively.

Table 6.1c

Investment result for unit-linked contracts	in USD millions, for the years ended December 31					
	Net investment income		Net capital gains/(losses) on investments		Investment result	
	2012	2011	2012	2011	2012	2011
Cash and cash equivalents	16	3	(4)	9	12	12
Equity securities	1,466	1,490	8,412	(5,505)	9,878	(4,015)
Debt securities	299	309	584	236	884	545
Real estate held for investment	310	328	(342)	(79)	(32)	249
Other loans	253	237	(62)	–	191	237
Derivative financial instruments	–	–	(157)	38	(157)	38
Investment result, gross, for unit-linked contracts	2,344	2,367	8,431	(5,302)	10,775	(2,934)
Investment expenses for unit-linked contracts	(508)	(610)	–	–	(508)	(610)
Investment result, net, for unit-linked contracts	1,836	1,757	8,431	(5,302)	10,268	(3,544)

Table 6.2

Net capital gains, losses and impairments on equity and debt securities for total investments	in USD millions, for the years ended December 31					
	Equity securities		Debt securities		Total	
	2012	2011	2012	2011	2012	2011
Securities at fair value through profit or loss:	8,654	(5,480)	924	777	9,578	(4,703)
Net capital gains/(losses) on Group investments	242	25	339	541	581	566
of which:						
Trading securities	10	5	5	5	15	10
Securities designated at fair value through profit or loss	232	20	334	537	567	557
Net capital gains/(losses) for unit-linked contracts	8,412	(5,505)	584	236	8,996	(5,269)
Available-for-sale securities:	327	295	1,628	382	1,956	677
Realized capital gains on Group investments	575	723	2,120	1,278	2,696	2,001
Realized capital losses on Group investments	(166)	(158)	(480)	(841)	(645)	(999)
Impairments on Group investments	(82)	(270)	(12)	(55)	(95)	(325)
Total net capital gains/(losses) and impairments	8,981	(5,184)	2,552	1,158	11,533	(4,026)

Details of total investments by category

	Total investments			
	2012		2011	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	9,960	3.0	9,977	3.2
Equity securities:				
Fair value through profit or loss	103,689	31.1	93,978	30.1
<i>of which:</i>				
<i>Trading securities</i>	410	0.1	438	0.1
<i>Securities designated at fair value through profit or loss</i>	103,279	31.0	93,540	30.0
Available-for-sale	9,153	2.7	8,518	2.7
Total equity securities	112,842	33.8	102,496	32.9
Debt securities:				
Fair value through profit or loss	21,047	6.3	20,605	6.6
<i>of which:</i>				
<i>Trading securities</i>	48	0.0	42	0.0
<i>Securities designated at fair value through profit or loss</i>	20,999	6.3	20,563	6.6
Available-for-sale	141,258	42.3	129,974	41.7
Held-to-maturity	5,012	1.5	5,535	1.8
Total debt securities	167,317	50.1	156,114	50.1
Real estate held for investment	12,041	3.6	12,370	4.0
Mortgage loans	9,394	2.8	9,649	3.1
Other loans	21,959	6.6	20,954	6.7
Investments in associates and joint ventures	172	0.1	161	0.1
Total investments	333,687	100.0	311,719	100.0

Details of Group investments by category

	Group investments			
	2012		2011	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	8,699	4.2	8,697	4.4
Equity securities:				
Fair value through profit or loss	3,545	1.7	4,443	2.3
<i>of which:</i>				
<i>Trading securities</i>	410	0.2	438	0.2
<i>Securities designated at fair value through profit or loss</i>	3,135	1.5	4,006	2.0
Available-for-sale	9,153	4.4	8,518	4.3
Total equity securities	12,698	6.1	12,961	6.6
Debt securities:				
Fair value through profit or loss	8,985	4.3	8,780	4.4
<i>of which:</i>				
<i>Trading securities</i>	48	0.0	42	0.0
<i>Securities designated at fair value through profit or loss</i>	8,937	4.3	8,738	4.4
Available-for-sale	141,258	67.8	129,974	65.8
Held-to-maturity	5,012	2.4	5,535	2.8
Total debt securities	155,255	74.5	144,289	73.1
Real estate held for investment	8,561	4.1	8,472	4.3
Mortgage loans	9,394	4.5	9,649	4.9
Other loans	13,681	6.6	13,214	6.7
Investments in associates and joint ventures	172	0.1	161	0.1
Total Group investments	208,460	100.0	197,443	100.0

Consolidated financial statements *continued*

Cash and investments with a carrying value of USD 6,340 million and USD 6,227 million were deposited on behalf of regulatory authorities as of December 31, 2012 and 2011, respectively.

Securities under security lending and short-term sale and repurchase agreements

As of December 31, 2012 and 2011, respectively, investments included USD 7,751 million and USD 6,298 million of loaned securities. These loaned securities were mainly debt securities. Liabilities for cash collateral received for securities lending comprised USD 330 million and USD 159 million as of December 31, 2012 and 2011, respectively. Non-cash collateral received for loaned securities comprised mainly equity and debt securities and amounted to USD 8,085 million and USD 6,474 million as of December 31, 2012 and 2011, respectively. The ZIC Group can sell or repledge the collateral only in the event of a default by a counterparty.

As of December 31, 2012 and 2011, respectively, debt securities with a carrying value of USD 1,550 million and USD 1,807 million have been sold to financial institutions under short-term sale and repurchase agreements. These securities continue to be recognized as investments in the ZIC Group's consolidated balance sheets. Obligations to repurchase these securities amounted to USD 1,539 million and USD 1,794 million as of December 31, 2012 and 2011, respectively.

The ZIC Group retains the rights to the risks and benefits of ownership of loaned securities and securities under short-term sale and repurchase agreements. These risks and benefits include changes in market values and income earned.

Table 6.3c

Details of investments held for unit-linked contracts

as of December 31	Investments for unit-linked contracts			
	2012		2011	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	1,261	1.0	1,280	1.1
Equity securities	100,144	80.0	89,535	78.3
Debt securities	12,062	9.6	11,825	10.3
Real estate	3,481	2.8	3,898	3.4
Other loans	8,279	6.6	7,739	6.8
Total investments for unit-linked contracts	125,226	100.0	114,276	100.0

Investments held under unit-linked investments contracts are classified as securities designated at fair value through profit or loss.

Accrued interest on unit-linked investments included in accrued investment income amounted to USD 210 million and USD 303 million as of December 31, 2012 and December 31, 2011, respectively.

Table 6.4

Debt securities maturity schedule (total investments)

in USD millions, as of December 31	Held-to-maturity		Available-for-sale		Fair value through profit or loss	
	2012	2011	2012	2011	2012	2011
Debt securities:						
< 1 year	493	680	9,733	11,003	4,004	4,486
1 to 5 years	2,188	2,225	46,027	41,316	5,441	5,050
5 to 10 years	527	613	33,784	30,306	3,867	3,803
> 10 years	1,805	2,017	32,233	26,939	6,747	6,195
Subtotal	5,012	5,535	121,777	109,564	20,058	19,533
Mortgage and asset-backed securities:						
< 1 year	–	–	540	866	26	41
1 to 5 years	–	–	5,358	6,417	406	365
5 to 10 years	–	–	2,175	3,361	114	252
> 10 years	–	–	11,407	9,765	443	414
Subtotal	–	–	19,481	20,410	988	1,072
Total	5,012	5,535	141,258	129,974	21,047	20,605

The analysis in table 6.4 is provided by contractual maturity. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

Available-for-sale securities	Table 6.5 in USD millions, as of December 31							
	Cost or amortized cost ¹		Gross unrealized gains		Gross unrealized losses		Fair value	
	2012	2011	2012	2011	2012	2011	2012	2011
Equity securities								
Common stock	4,992	4,452	1,841	1,490	(450)	(579)	6,383	5,363
Unit trusts	2,434	2,997	398	309	(247)	(309)	2,584	2,997
Non-redeemable preferred stock	167	159	21	8	(3)	(8)	186	158
Total equity securities	7,594	7,608	2,259	1,806	(700)	(896)	9,153	8,518
Debt securities								
Swiss federal and cantonal governments	3,925	3,104	466	511	(3)	–	4,388	3,615
United Kingdom government	7,227	7,035	496	736	(8)	(3)	7,715	7,768
United States government	10,560	8,498	340	549	(55)	(42)	10,845	9,005
Other governments and supra-nationals	36,226	34,744	2,795	1,553	(350)	(1,302)	38,672	34,995
Corporate securities	55,793	52,902	5,738	3,720	(1,386)	(2,460)	60,145	54,162
Mortgage and asset-backed securities	18,838	19,713	730	939	(87)	(242)	19,481	20,410
Redeemable preferred stocks	10	37	2	1	–	(19)	12	19
Total debt securities	132,579	126,033	10,567	8,008	(1,888)	(4,068)	141,258	129,974

¹ Net of impairments (see table 6.2).

Consolidated financial statements *continued*

Table 6.6

Fair value through profit or loss securities	as of December 31							
	Group investments				Investments for unit-linked products		Total investments	
	2012		2011		2012	2011	2012	2011
	USD millions	% of total	USD millions	% of total	USD millions	USD millions	USD millions	USD millions
Equity securities:								
Common stock	2,204	17.6	2,539	19.2	39,800	38,176	42,003	40,715
<i>of which: common stock portfolios backing participating with profit policyholder contracts</i>	534	4.3	498	3.8	–	–	534	498
Unit trusts	1,341	10.7	1,901	14.4	60,297	51,248	61,638	53,149
Non-redeemable preferred stock	–	0.0	3	0.0	47	111	47	114
Total equity securities	3,545	28.3	4,443	33.6	100,144	89,535	103,689	93,978
Debt securities:								
Debt securities	8,221	65.6	7,923	59.9	11,837	11,610	20,058	19,533
Mortgage and asset-backed securities	763	6.1	857	6.5	225	214	988	1,072
Total debt securities	8,985	71.7	8,780	66.4	12,062	11,825	21,047	20,605
Total	12,530	100.0	13,224	100.0	112,206	101,359	124,736	114,583

Table 6.7

Held-to-maturity debt securities	as of December 31			
	2012	2011	2012	2011
	USD millions	% of total	USD millions	% of total
Swiss federal and cantonal governments	1,847	36.9	1,804	32.6
United States government	1,627	32.5	1,839	33.2
Other governments and supra-nationals	1,168	23.3	1,148	20.7
Corporate securities	370	7.4	743	13.4
Total held-to-maturity debt securities	5,012	100.0	5,535	100.0

Table 6.8

Real estate held for investment (total investments)	in USD millions	
	2012	2011
As of January 1	12,370	12,355
Additions and improvements	316	267
Acquisitions	–	120
Disposals	(702)	(396)
Market value revaluation	(206)	40
Transfer from assets held for own use	–	116
Transfer to assets held for sale	(89)	–
Foreign currency translation effects	353	(133)
As of December 31	12,041	12,370

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

Investments in associates and joint ventures	in USD millions, as of December 31	Carrying value		Share in profit		Ownership interest	
		2012	2011	2012	2011	2012	2011
		Associates:					
Seven Investment Management Limited	21	19	1	2	49.00%	49.00%	
Other	18	16	4	2	–	–	
Joint ventures:							
MCIS Zurich Insurance Berhad	43	41	5	4	40.00%	40.00%	
Other	3	3	1	1	–	–	
SPEs:¹							
Euclid Office, L.P.	32	29	2	2	99.00%	99.00%	
Dallas Tower, L.P.	14	13	1	1	99.00%	99.00%	
Other	42	39	4	–	–	–	
Total	172	161	18	12	–	–	

¹ The ZIC Group has several special purpose entities (SPEs) in the U.S. which are consolidated using the equity method as a reasonable approximation, as the equity interest is usually 99% and the investment balance approximates the value of the SPE's assets. These entities were specifically designed to facilitate U.S. commercial property sale and leaseback transactions.

Net unrealized gains/(losses) on Group investments included in other comprehensive income	in USD millions, as of December 31	Total	
		2012	2011
Equity securities: available-for-sale		1,560	910
Debt securities: available-for-sale		8,679	3,941
Other		300	295
Less: amount of net unrealized gains/(losses) on investments attributable to:			
Life policyholder dividends and other policyholder liabilities		(3,918)	(1,349)
Present value of future profits		(523)	(199)
Life deferred acquisition costs and present value of future profits		(48)	103
Deferred income taxes		(1,385)	(834)
Non-controlling interests		(41)	(12)
Total¹		4,624	2,854

¹ Net unrealized gains/(losses) include net gains arising on cash flow hedges of USD 238 million and USD 232 million as of December 31, 2012 and 2011, respectively. In 2012 and 2011 the ZIC Group applied the cash flow hedge methodology to hedge foreign currency risk exposure and deferred the attributable basis spreads in shareholders' equity, whereas the fair value hedge methodology was used to hedge interest rate exposure with changes in the fair value being recorded through the income statement.

Consolidated financial statements *continued*

7. Derivative financial instruments and hedge accounting

The ZIC Group uses derivative financial instruments mainly for economic hedging purposes in order to mitigate risks. Such risks result from changes in interest rates, equity prices and exchange rates.

Table 7.1 shows the fair value and notional amounts for instruments which do not qualify for hedge accounting as of December 31, 2012 and 2011, respectively. Whilst these notional amounts express the extent of the ZIC Group's involvement in derivative transactions, they are not, however, representative of amounts at risk. Fair values for derivative financial instruments are included in the consolidated balance sheets in receivables and other assets, and other liabilities.

In certain circumstances derivative financial instruments may meet the requirements of an effective hedge for accounting purposes. Where this is the case, hedge accounting may be applied. Financial information for these instruments is set out in table 7.2.

Maturity profile of notional amounts and fair values of derivative financial instruments

Table 7.1

in USD millions, as of December 31

	Maturity by notional amount			2012			2011		
				Notional amounts	Positive fair values	Negative fair values	Notional amounts	Positive fair values	Negative fair values
	< 1 year	1 to 5 years	> 5 years						
Interest rate contracts:									
OTC									
Swaps	260	1,416	3,610	5,286	348	(45)	4,207	304	(12)
Swaptions	363	4,682	4,364	9,408	242	(104)	8,012	560	(43)
Exchange traded									
Futures	8	–	–	8	–	–	197	–	–
Total interest rate contracts	631	6,097	7,974	14,702	590	(148)	12,416	864	(56)
Equity contracts:									
OTC									
Swaps	42	–	–	42	–	(2)	36	–	(1)
Puts	7,093	940	1,821	9,854	220	(119)	4,019	253	(264)
Calls	1,261	865	–	2,126	–	(20)	1,087	–	(34)
Exchange traded									
Puts	49	–	–	49	1	–	44	4	–
Calls	–	–	–	–	–	–	22	–	(1)
Futures	503	–	–	503	1	(3)	511	–	(8)
Total equity contracts	8,949	1,805	1,821	12,575	223	(144)	5,718	257	(306)
Foreign exchange contracts:									
OTC									
Cross currency swaps	444	–	–	444	–	(45)	423	–	(28)
Options	–	–	–	–	–	–	789	–	(11)
Forwards	13,791	–	–	13,791	48	(84)	15,134	127	(114)
Total foreign exchange contracts	14,234	–	–	14,234	48	(129)	16,346	127	(154)
Credit contracts:									
OTC									
Credit default swaps	–	–	–	–	–	–	160	–	(1)
Total credit contracts	–	–	–	–	–	–	160	–	(1)
Other contracts:									
OTC									
Puts	–	–	93	93	–	–	523	–	(52)
Swaps	–	–	66	66	–	(11)	69	–	(9)
Total other contracts	–	–	159	159	–	(11)	591	–	(61)
Total Group derivative financial instruments	23,814	7,902	9,955	41,671	861	(433)	35,232	1,249	(578)
Total unit-linked derivative financial instruments	1,180	879	54	2,113	62	(5)	1,886	65	(37)
Total	24,994	8,781	10,008	43,784	923	(438)	37,118	1,315	(615)

Consolidated financial statements *continued*

Interest rate contracts

Interest rate contracts are used to hedge risks from changes in interest rates and to manage asset liability mismatches. Whenever possible the ZIC Group enters into exchange traded contracts, which are standardized and regulated. Furthermore, because of the structure of the exchanges, exchange traded contracts are not considered to carry counterparty risk. Over the counter (OTC) contracts are otherwise applied and comprise swaps and swaptions.

In terms of notional amounts, the major changes compared with December 31, 2011 were an increase of interest rate swaps related to a closed book of variable annuities products within the U.S. life business and an increase of swaptions, mainly long receiver, in order to protect the German and the Irish life insurance books against falling interest rates.

Equity contracts

Equity contracts are entered into, either on a portfolio and/or a macro level to protect equity investments against a decline in equity market prices or to manage the risk return profile of equity exposures. Most equity contracts are purchased put options.

The increase in the notional amount of put options between December 31, 2012 and December 31, 2011 was mainly driven by two new hedges to reduce the equity risk and to protect the ZIC Group against the tail risk related to the euro debt crisis. Total return swaps and exchange traded options relating to the dynamic hedging strategy that has been put in place to reduce the volatility associated with a closed book of variable annuities products within its U.S. life business.

Almost all positions are for hedging purposes. With respect to the short positions, call options are used in collar structures to mitigate the hedging costs for some life portfolios and the written put positions are part of the dynamic hedge or are fully backed by long put positions and relate only to legacy positions.

Foreign exchange contracts

Foreign exchange contracts are cross currency swaps and forward contracts which are used to hedge the ZIC Group's foreign currency exposures and to manage balance sheet mismatches. As of December 31, 2012 there was no open forward option position.

The decrease in notional amounts of foreign exchange forwards between December 31, 2011 and December 31, 2012, was mostly volume driven.

Credit contracts

As of December 31, 2012, there were no open positions for this product class, mainly as a result of matured positions.

Other contracts

Other contracts predominantly include stable value products (SVPs), which are designed to amortize on a quarterly basis investment gains and losses of the investment portfolios underlying certain life insurance policies, which are owned by banks (Bank Owned Life Insurance or BOLI) and other companies (Company Owned Life Insurance or COLI). Premiums received from policyholders under these policies are invested in separate account portfolios. Throughout the life of the policies, policyholders are entitled, in addition to mortality cover, to the tax-exempt investment returns of such separate account portfolios. The policies are long duration contracts providing charges and benefits over a policy life that can be greater than 45 years. When SVPs form part of these investment portfolios, they reduce the volatility of the policyholders' investment returns. In the event that a policy is surrendered which has a positive SVP value, the policyholder would be entitled to recover such SVP value as well as the market value of the underlying investments. Certain policy features as well as the applicable tax regulations provide disincentives for surrender. The ZIC Group monitors the risk of surrender on an ongoing basis and considers the likelihood of surrender as an input factor to the model to determine the fair value of the SVPs. During 2012, there were no surrenders compared with two policy surrenders in 2011. The fair value of the derivative liability recognized in respect of the SVPs, was nil and USD 52 million as of December 31, 2012 and 2011, respectively. The notional SVP derived value was USD 93 million and USD 523 million as of December 31, 2012 and 2011, respectively, representing the total loss before surrender charges in the unlikely event that all policies would have been surrendered on those dates.

Table 7.2 sets out details of fair value, cash flow and net investment hedges:

Maturity profile of notional amounts and fair values of derivative financial instruments	Table 7.2									
	in USD millions, as of December 31									
	Maturity by notional amount			Notional principal amounts	Positive fair values	Negative fair values	2012		2011	
	< 1 year	1 to 5 years	> 5 years				Notional principal amounts	Positive fair values	Negative fair values	Notional principal amounts
Fair value hedges:										
Cross currency interest rate swaps	672	858	–	1,530	252	–	1,518	269	–	
Currency swaps	–	8	61	69	–	(40)	69	–	(38)	
Interest rate swaps	–	–	1,097	1,097	37	–	–	–	–	
Total fair value hedges	672	865	1,158	2,695	288	(40)	1,588	269	(38)	
Cash flow hedges:										
Options on interest rate swaps	–	923	2,284	3,207	438	–	3,130	414	–	
Currency swaps	–	1,768	–	1,768	90	–	1,768	75	(9)	
Interest rate swaps	33	88	39	159	14	–	203	11	–	
Total cash flow hedges	33	2,779	2,323	5,135	542	–	5,102	501	(9)	
Net investment hedges:										
Forwards	273	–	–	273	–	(2)	–	–	–	
Total net investment hedges	273	–	–	273	–	(2)	–	–	–	

Fair value hedges

Designated fair value hedges consist of cross currency interest rate swaps used to protect the ZIC Group against changes in foreign currency exposure and interest rate exposure of euro and U.S. dollar – denominated debt issued by the ZIC Group.

A fair value hedge relationship on the EUR 500 million 4.5 percent subordinated note due June 2025 issued by Zurich Finance (USA), Inc. (see note 21), was entered into at the issuance of the debt instrument in 2005 and will end on June 15, 2015.

A fair value hedge relationship on 20 percent of the EUR 1.0 billion 4.5 percent senior note due for repayment in 2014 issued by Zurich Finance (USA), Inc. (see note 21), was entered into on January 1, 2007 and will end on the maturity of the underlying debt instrument in 2014.

A fair value hedge relationship on the USD 750 million 3.25 percent senior note due for repayment in September 2013 issued by Zurich Finance (Luxembourg), S.A. (see note 21), was entered into on April 8, 2010 and will end on the maturity of the underlying debt instrument in 2013.

A fair value hedge relationship on the CHF 400 million 1.5 percent senior note due for repayment in June 2019 issued by Zurich Insurance Company Ltd (see note 21), was entered into on June 25, 2012 and will end on the maturity of the underlying debt instrument in 2019.

A fair value hedge relationship on the EUR 500 million 3.375 percent senior note due for repayment in June 2022 issued by Zurich Insurance Company Ltd (see note 21), was entered into on June 27, 2012 and will end on the maturity of the underlying debt instrument in 2022.

The ZIC Group also has fair value hedge relationships consisting of currency swaps to protect certain non euro-denominated fixed income securities from foreign currency fluctuation.

Changes in the fair value of the derivative financial instruments designated as fair value hedges and changes in the fair value of the hedged item in relation to the risk being hedged are both recognized in income.

Consolidated financial statements *continued*

Table 7.3 sets out gains and losses arising from fair value hedges:

Table 7.3			
Gains/(losses) arising from fair value hedges	in USD millions, as of December 31	2012	2011
	Gains/(losses)		
	<i>on hedging instruments¹</i>	20	(6)
	<i>on hedged items attributable to the hedged risk</i>	(30)	–

¹ Excluding current interest income, which is recognized as an offset on the same line as the interest expense of the hedged debt.

Cash flow hedges

Designated cash flow hedges, such as options on interest rate swaps are used to protect the ZIC Group against variability of future cash flows due to changes in interest rates associated with expected future purchases of debt securities (during the years 2016, 2021 and 2026) required for certain life insurance policies. The effective portion of the gains and losses on these swaps are initially recognized in other comprehensive income. Subsequently the gains or losses will be recycled to income between the years ended December 31, 2012 and 2036. The gains and losses relating to the ineffective portion of these hedges are recognized immediately in income within net capital gains/losses on investments and impairments.

The ZIC Group also uses currency swaps for cash flow hedging to protect against exposures to variability of cash flows. The change in the fair value of the hedging instrument is recognized directly in other comprehensive income. The ineffective portion of the change in fair value is recognized directly in income within administrative and other operating expense. The effective portion, related to spot rate changes in the fair value of the hedging instrument, is reclassified to income within administrative and other operating expense as an offset to foreign currency revaluation on the underlying hedged debt.

As of December 31, 2012 the following cash flow hedge relationships were in place (see note 21):

- 80 percent of the EUR 1.0 billion 4.5 percent senior note due 2014 issued by Zurich Finance (USA), Inc. entered on January 1, 2007 ending September 17, 2014.
- 100 percent of EUR 600 million 6.5 percent senior note due October 2015 issued by Zurich Finance (USA), Inc. entered on April 14, 2009 ending October 15, 2015.

The net gains deferred in other comprehensive income on derivative financial instruments designated as cash flow hedges were USD 4 million and USD 245 million before tax for the years ended December 31, 2012 and 2011, respectively.

The portion recognized in income was a gain of USD 35 million and a loss of USD 53 million before tax for the years ended December 31, 2012 and 2011, respectively, as an offset to the foreign currency revaluation on the underlying hedged debt.

A loss of USD 7 million and USD 13 million for the years ended December 31, 2012 and 2011, respectively, was recognized in net capital gains/(losses) and impairments due to hedge ineffectiveness.

Net investment hedges

In December 2012, the ZIC Group started to apply net investment hedge accounting in order to hedge against the effects of changes in exchange rates in its net investments in foreign operations. A net hedge relationship through a foreign exchange forward with a notional amount of GBP 168 million was in place for the year ended December 31, 2012.

Net losses deferred in shareholders' equity on net investment hedges were USD 2 million before tax for the year ended December 31, 2012.

8. Reserves for insurance contracts and reinsurers' share of reserves for insurance contracts

Table 8.1

Reserves for insurance contracts	in USD millions, as of December 31					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
Reserves for losses and loss adjustment expenses	69,986	67,762	(12,601)	(12,421)	57,385	55,341
Reserves for unearned premiums	17,300	17,661	(2,666)	(2,532)	14,634	15,129
Future life policyholders' benefits	83,807	80,584	(2,507)	(2,583)	81,300	78,001
Policyholders' contract deposits and other funds	20,024	18,356	(2,106)	(2,181)	17,917	16,175
Reserves for unit-linked contracts	74,117	68,844	–	–	74,117	68,844
Total reserves for insurance contracts¹	265,233	253,207	(19,880)	(19,717)	245,353	233,490

¹ The total reserves for insurance contracts ceded are gross of allowance for uncollected amounts of USD 127 million and USD 125 million as of December 31, 2012 and December 31, 2011, respectively.

Table 8.2

Development of reserves for losses and loss adjustment expenses	in USD millions					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
As of January 1	67,762	68,274	(12,421)	(12,093)	55,341	56,180
Losses and loss adjustment expenses incurred:						
Current year	27,612	28,522	(3,273)	(4,755)	24,340	23,767
Prior years	(676)	(1,650)	105	347	(571)	(1,302)
Total incurred	26,936	26,873	(3,168)	(4,408)	23,769	22,465
Losses and loss adjustment expenses paid:						
Current year	(10,548)	(10,777)	694	959	(9,853)	(9,817)
Prior years	(16,230)	(16,133)	2,706	3,041	(13,525)	(13,092)
Total paid	(26,778)	(26,910)	3,400	4,000	(23,378)	(22,909)
Acquisitions/(divestments) and transfers ¹	1,217	207	(257)	(26)	960	181
Foreign currency translation effects	849	(682)	(156)	106	693	(576)
As of December 31	69,986	67,762	(12,601)	(12,421)	57,385	55,341

¹ The 2012 net movement includes a transfer of USD 1,224 million from policyholders' contract deposits and other funds, partially offset by USD (235) million relating to a reinsurance agreement which transfers the benefits and risks of some of the ZIC Group's general insurance portfolio to RiverStone Insurance (UK) Limited, and by USD (33) million transferred to future life policyholders' benefits (see note 1). The 2011 net movement relates mainly to acquisitions/divestments (see note 5).

The ZIC 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 or judgments are reflected in the results of operations in the period in which estimates and judgments are changed.

Significant delays may occur in the notification and settlement 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.

Table 8.2 shows the development of reserves for losses and loss adjustment expenses during the years 2012 and 2011.

The increase of USD 2,044 million during the year ended December 31, 2012 in net reserves for losses and loss adjustment expenses is mostly driven by the reclassification of USD 1,224 million transferred from policyholders' contract deposits and other funds to reserves for losses and loss adjustment expenses (see note 1), and the foreign currency impact of USD 693 million. Additionally, USD 571 million of favorable reserve development emerged from reserves established in prior years. Gross of reinsurance, the favorable development was USD 676 million. This favorable development was primarily attributable to the General Insurance business segment and mainly relates to the following movements by market-facing business, country and line of business:

Consolidated financial statements *continued*

- In Global Corporate, favorable development of USD 199 million was driven by Europe essentially originating from Switzerland, the UK and Ireland. The development occurred mostly in the property and engineering lines of business;
- In North America Commercial, favorable development of USD 203 million arose mostly from medical malpractice, general liability, errors and omissions and the Canadian operations;
- The personal and commercial business in Europe reported favorable prior year development of USD 90 million. The favorable development was driven by USD 435 million in Switzerland, mostly in motor, and USD 96 million in the UK and Ireland, coming from many lines of business. Partially offsetting this, Germany reported an adverse development of USD 476 million arising mainly from the medical and professional liability lines of business.

The Non-Core Businesses segment additionally added to the adverse development.

The decrease of USD 839 million during the year ended December 31, 2011 in net reserves for losses and loss adjustment expenses included USD 1,302 million of favorable reserve development emerging from reserves established in prior years. Gross of reinsurance, the favorable development was USD 1,650 million. This favorable development was primarily attributable to the General Insurance business and mainly related to the following movements by market-facing business, country and line of business:

- In Global Corporate, favorable development of USD 402 million was primarily driven by Europe and North America. In Europe, general liability and property contributed the most while in North America, the change in prior year estimates came from many lines of business with the exception of workers compensation;
- In North America Commercial, favorable development of USD 458 million arose mostly from medical malpractice, general liability, directors and officers, errors and omissions, direct markets and surety business;
- Favorable development in Europe of USD 186 million resulted primarily from favorable experience in Switzerland of USD 365 million, mostly in motor, while most other countries reported small favorable amounts. This was offset by Germany with USD 242 million of adverse development, driven by the medical and professional liability lines of business;

The remaining favorable development emerged from Group Reinsurance, International Markets, and the assumed business from the Farmers Exchanges.

Development of
insurance losses,
net

Table 8.3

in USD millions, as of December 31	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Gross reserves for losses and loss adjustment expenses	51,068	57,765	60,425	64,535	67,890	65,218	68,126	68,274	67,762	69,986
Reinsurance recoverable	(14,055)	(14,279)	(14,231)	(13,722)	(13,179)	(12,232)	(12,182)	(12,093)	(12,421)	(12,601)
Initial net reserves for losses and loss adjustment expenses	37,013	43,486	46,194	50,814	54,712	52,986	55,944	56,180	55,341	57,385
Cumulative paid as of December 31:										
<i>One year later</i>	(9,930)	(9,464)	(11,423)	(11,237)	(12,551)	(13,047)	(12,716)	(13,092)	(13,525)	
<i>Two years later</i>	(15,550)	(16,273)	(18,044)	(18,362)	(19,660)	(19,909)	(19,821)	(21,073)		
<i>Three years later</i>	(20,407)	(21,234)	(23,077)	(23,421)	(24,428)	(24,693)	(25,623)			
<i>Four years later</i>	(23,941)	(24,945)	(26,850)	(26,839)	(27,735)	(28,808)				
<i>Five years later</i>	(26,616)	(27,798)	(29,425)	(29,224)	(30,690)					
<i>Six years later</i>	(28,668)	(29,810)	(31,189)	(31,483)						
<i>Seven years later</i>	(30,245)	(31,148)	(33,030)							
<i>Eight years later</i>	(31,274)	(32,655)								
<i>Nine years later</i>	(32,423)									
Cumulative incurred as of December 31:										
<i>One year later</i>	1,964	141	(218)	(1,219)	(1,271)	(1,059)	(1,378)	(1,302)	(571)	
<i>Two years later</i>	3,400	1,520	(367)	(2,171)	(2,152)	(2,350)	(2,565)	(1,819)		
<i>Three years later</i>	4,991	1,839	(897)	(2,686)	(2,844)	(3,048)	(2,700)			
<i>Four years later</i>	5,241	1,808	(945)	(3,003)	(3,533)	(3,176)				
<i>Five years later</i>	5,457	2,118	(1,044)	(3,438)	(3,580)					
<i>Six years later</i>	6,004	2,194	(1,184)	(3,279)						
<i>Seven years later</i>	6,094	2,254	(841)							
<i>Eight years later</i>	6,223	2,686								
<i>Nine years later</i>	6,662									
Net reserves re-estimated as of December 31:										
<i>One year later</i>	38,977	43,627	45,976	49,594	53,441	51,927	54,565	54,878	54,770	
<i>Two years later</i>	40,413	45,006	45,827	48,642	52,559	50,637	53,379	54,361		
<i>Three years later</i>	42,004	45,325	45,297	48,127	51,868	49,939	53,243			
<i>Four years later</i>	42,254	45,294	45,249	47,811	51,179	49,810				
<i>Five years later</i>	42,470	45,604	45,150	47,376	51,131					
<i>Six years later</i>	43,017	45,680	45,010	47,535						
<i>Seven years later</i>	43,107	45,740	45,353							
<i>Eight years later</i>	43,236	46,172								
<i>Nine years later</i>	43,675									
Cumulative (deficiency)/redundancy of net reserves	(6,662)	(2,686)	841	3,279	3,580	3,176	2,700	1,819	571	
Cumulative (deficiency)/redundancy as a percentage of initial net reserves	(18.0%)	(6.2%)	1.8%	6.5%	6.5%	6.0%	4.8%	3.2%	1.0%	
Gross reserves re-estimated as of December 31, 2012	60,188	61,592	60,182	60,669	63,258	60,993	64,138	65,876	67,086	
Cumulative (deficiency)/redundancy of gross reserves	(9,120)	(3,827)	243	3,866	4,633	4,225	3,988	2,398	676	
Cumulative (deficiency)/redundancy as a percentage of initial gross reserves	(17.9%)	(6.6%)	0.4%	6.0%	6.8%	6.5%	5.9%	3.5%	1.0%	

Consolidated financial statements *continued*

Table 8.3 presents changes in the historical non-life reserves, net of reinsurance, that the ZIC Group established in 2003 and subsequent years. Reserves are presented by financial year, not by accident year. The reserves (and the development thereon) are for all accident years in that financial year. The top line of the table shows the estimated gross reserves for unpaid losses and loss adjustment expenses as of each balance sheet date, which represents the estimated amount of future payments for losses incurred in that year and in prior years. The cumulative paid portion of the table presents the cumulative amounts paid through each subsequent year in respect of the reserves established at each year end. Similarly, the cumulative incurred losses section details the sum of the cumulative paid amounts shown in the triangle above and the changes in loss reserves since the end of each financial year. The net reserves re-estimated portion of the table shows the re-estimation of the initially recorded reserve as of each succeeding year end. Reserve development is shown in each column. Changes to estimates are made as more information becomes known about the actual losses for which the initial reserves were established. The cumulative deficiency or redundancy is equal to the initial net reserves less the liability re-estimated as of December 31, 2012. It is the difference between the initial net reserve estimate and the last entry of the diagonal. Conditions and trends that have affected the development of reserves for losses and loss adjustment expenses in the past may or may not necessarily occur in the future, and accordingly, conclusions about future results cannot be derived from the information presented in table 8.3.

Table 8.4

Development of reserves for losses and loss adjustment expenses for asbestos and environmental claims

in USD millions		2012		2011	
		Gross	Net	Gross	Net
Asbestos					
As of January 1		3,283	2,867	3,408	2,863
Losses and loss adjustment expenses incurred		51	37	42	80
Losses and loss adjustment expenses paid		(134)	(110)	(159)	(68)
Acquisitions/(divestments) and transfers ¹		–	(127)	–	–
Foreign currency translation effects		132	112	(8)	(8)
As of December 31		3,332	2,779	3,283	2,867
Environmental					
As of January 1		286	198	290	223
Losses and loss adjustment expenses incurred		67	79	36	–
Losses and loss adjustment expenses paid		(67)	(55)	(41)	(25)
Acquisitions/(divestments) and transfers ¹		–	(21)	–	–
Foreign currency translation effects		1	–	1	–
As of December 31		288	202	286	198

¹ The 2012 net movement relates to a reinsurance agreement which transfers the benefits and risks of some of the ZIC Group's general insurance portfolio to RiverStone Insurance (UK) Limited, prior to a portfolio sale until regulatory clearance is obtained.

The ZIC Group has considered asbestos and environmental, including latent injury, claims and claims expenses in establishing the reserves for losses and loss adjustment expenses. The ZIC Group continues to be advised of claims asserting injuries from toxic waste, hazardous materials and other environmental pollutants, 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, together with increased medical diagnostic capabilities and awareness have often caused actual loss development to exhibit more variation than in other lines. Such claims require specialized reserving techniques and the uncertainty of the ultimate cost of these types of claims has tended to be greater than the uncertainty relating to standard lines of business.

Reserves for asbestos claims increased by USD 49 million gross but decreased USD 89 million net during 2012. During 2011, the gross reserve decreased by USD 125 million but increased USD 4 million on a net basis. As a significant portion of the ZIC Group's reserves are held in British pounds, there was an increase in gross and net reserves reported for 2012 due to the strengthening of the currency compared with the U.S. dollar. Without this effect, the total gross reserve would also have decreased. In addition, in 2012, following an in-depth review of asbestos, pollution and health (APH) book of business in the U.S., gross and net reserves were strengthened. Despite these increases, the total net reserves have decreased due to a reinsurance agreement which transfers the benefits and risks of some of the ZIC Group's APH portfolio to RiverStone Insurance (UK) Limited, prior to a portfolio sale until regulatory clearance is obtained.

For 2011, there was a decrease in gross and net reserves driven by the re-estimation of the ultimate liability for asbestos as well as the normal payout of claims. In addition, the decrease in gross reserves was partially offset by the increase in UK reserves, which contributed also to the overall increase in net reserves. This increase in UK gross and net reserves followed a court ruling in Scotland and Northern Ireland related to the impact of pleural plaques losses.

Reserves for environmental claims increased by USD 2 million gross and USD 4 million net, but decreased by USD 4 million gross and by USD 25 million net during the years ended December 31, 2012 and 2011, respectively.

While the ZIC 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 ZIC Group's results of operations, cash flows and financial position. The net reserve amounts relating to such claims are not discounted for the time value of money.

Table 8.5

Development of future life policyholders' benefits	in USD millions					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
As of January 1	80,584	79,315	(2,583)	(2,423)	78,001	76,891
Premiums	8,867	8,736	(541)	(511)	8,326	8,225
Claims	(9,168)	(10,463)	414	426	(8,754)	(10,036)
Fee income and other expenses	(1,789)	(2,072)	182	87	(1,608)	(1,985)
Interest and bonuses credited to policyholders	2,649	3,257	(75)	(161)	2,575	3,096
Change in assumptions	(147)	423	155	(23)	8	400
Acquisitions/transfers ¹	1,065	2,815	(14)	(7)	1,051	2,808
(Decreases)/increases recorded in other comprehensive income	167	252	-	-	167	252
Foreign currency translation effects	1,579	(1,679)	(45)	29	1,534	(1,650)
As of December 31	83,807	80,584	(2,507)	(2,583)	81,300	78,001

¹ The 2012 net movement includes USD 937 million transferred from reserves for unearned premiums, USD 66 million transferred from policyholders' contract deposits and other funds, USD 33 million transferred from loss reserves (see note 1) and USD 15 million from the acquisition of ZIMB (see note 5). The 2011 net movement includes reserves acquired with Zurich Santander of USD 1,258 million, as well as USD 1,353 million acquired with ZIMB (see note 5). Additionally it includes reclassifications of USD 212 million transferred from other liabilities, partly offset by USD (27) million transferred to liabilities for investment contracts (see note 1 of the Consolidated financial statements 2011).

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 amount of policyholder dividends to be paid is determined annually by each life insurance subsidiary. 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.

Consolidated financial statements *continued*

The net impact of changes in assumptions on net future life policyholders' benefits was USD 8 million and USD 400 million for the years ended December 31, 2012 and 2011, respectively. The net changes are shown in table 8.6.

Table 8.6			
Effect of changes in assumptions for future life policyholders' benefits	in USD millions, for the year ended December 31	2012	2011
		Interest rates	223
Legislative Changes	88	–	
Morbidity	(1)	(38)	
Longevity	(4)	(1)	
Lapses	(7)	(29)	
Investment return	(51)	(63)	
Changes in modelling	(58)	(4)	
Expense	(75)	(12)	
Other	(108)	96	
Net impact of changes in assumptions		8	400

Table 8.7			
Policyholders' contract deposits and other funds gross	in USD millions, as of December 31	2012	2011
		Annuities ¹	–
Universal life and other contracts	12,219	11,681	
Policyholder dividends	7,804	5,355	
Total		20,024	18,356

¹ Annuities were reclassified to reserves for losses and loss adjustment expenses and future life policyholders' benefits (see note 1).

Table 8.8						
Development of policyholders' contract deposits and other funds	in USD millions	Gross		Ceded		Net
		2012	2011	2012	2011	2012
						2011
As of January 1	18,356	17,430	(2,181)	(2,246)	16,175	15,184
Premiums	1,157	1,395	(27)	(60)	1,131	1,335
Claims	(1,269)	(1,421)	211	195	(1,058)	(1,225)
Fee income and other expenses	(230)	(344)	(60)	7	(290)	(337)
Interest and bonuses credited to policyholders	708	628	(81)	(79)	627	549
Change in assumptions	–	91	–	–	–	91
Acquisitions/transfers ¹	(1,308)	373	32	–	(1,276)	373
(Decrease)/increase recorded in other comprehensive income	2,313	477	–	–	2,313	477
Foreign currency translation effects	296	(273)	(1)	2	296	(271)
As of December 31	20,024	18,356	(2,106)	(2,181)	17,917	16,175

¹ The 2012 net movement includes USD (1,224) million transferred to loss reserves and loss adjustment expenses and USD (66) million transferred to future life policyholders' benefits (see note 1). The 2011 net movement includes USD 266 million from the acquisition of ZIMB and USD 107 million from Zurich Santander (see note 5).

Development
of reserves for
unit-linked
contracts

Table 8.9

in USD millions

	2012	2011
As of January 1	68,844	61,786
Premiums	11,064	9,263
Claims	(11,434)	(8,384)
Fee income and other expenses	(1,586)	(1,689)
Interest and bonuses credited/(charged) to policyholders	6,270	(1,274)
Acquisitions/transfers ¹	154	9,714
Foreign currency translation effects	804	(571)
As of December 31	74,117	68,844

¹ The 2012 movement includes USD 151 million transferred from liabilities for investment contract liabilities (see note 1). The 2011 net movement includes USD 9,634 million from Zurich Santander and USD 221 million acquired with ZIMB (see note 5). Additionally it includes a reclassification of USD (140) million to liabilities for investment contracts (see note 1 of the Consolidated financial statements 2011).

Consolidated financial statements *continued*

9. Liabilities for investment contracts

Table 9.1

in USD millions, as of December 31		2012	2011
Liabilities for investment contracts	Liabilities related to unit-linked investment contracts	50,923	44,220
	Liabilities related to investment contracts (amortized cost)	1,305	1,131
	Liabilities related to investment contracts with DPF	5,903	5,607
	Total	58,131	50,958

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

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

Table 9.2

in USD millions		2012	2011
Development of liabilities for investment contracts	As of January 1	50,958	50,667
	Premiums	7,307	7,934
	Claims	(6,353)	(5,762)
	Fee income and other expenses	(609)	(573)
	Interest and bonuses charged/(credited) to policyholders	4,983	(1,431)
	Acquisitions/transfers ¹	(150)	852
	Increase/(decrease) recorded in other comprehensive income	4	(6)
	Foreign currency translation effects	1,991	(723)
	As of December 31	58,131	50,958

¹ The 2012 movement includes USD (151) million transferred to reserves for unit-linked contracts (see note 1). The 2011 movement includes USD 309 million from Zurich Santander (see note 5), USD 140 million transferred from reserves for unit-linked contracts, USD 246 million transferred from other liabilities, USD 135 million transferred from non-technical provisions and USD 27 million transferred from future life policyholders' benefits (see note 1 of the Consolidated financial statements 2011).

10. Equity component relating to contracts with DPF

Certain investment and insurance contracts sold by the ZIC Group contain benefit features for which the amount and timing of declaration and payment are at the discretion of the ZIC Group. Where that discretion has not been exercised, the total amount of undeclared funds surplus is included in other comprehensive income. Mandated allocations related to unrealized results and earnings are included in policyholder liabilities and, upon declaration, discretionary bonuses are allocated to policyholders. The changes in table 10 represent the increase or decrease in unallocated gains and retained earnings after charging discretionary bonuses to policyholder liabilities.

Table 10

in USD millions		2012	2011
Development of the equity component relating to contracts with DPF	As of January 1	1,488	2,168
	Net unrealized (losses)/gains on investments	557	(676)
	Current period profit	476	5
	Foreign currency translation effects	39	(9)
	As of December 31	2,560	1,488

11. Gross and ceded insurance revenues and expenses

Table 11.1

Insurance benefits and losses	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
Losses and loss adjustment expenses	26,936	26,873	(3,168)	(4,408)	23,769	22,465
Life insurance death and other benefits	10,334	11,259	(351)	(644)	9,983	10,615
Total insurance benefits and losses	37,271	38,132	(3,519)	(5,052)	33,752	33,080

Table 11.2

Policyholder dividends and participation in profits	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
Change in policyholders' contract deposits and other funds	1,210	644	(19)	(1)	1,190	643
Change in reserves for unit-linked products	6,153	(1,826)	–	–	6,153	(1,826)
Change in liabilities for investment contracts – unit-linked	4,166	(1,801)	–	–	4,166	(1,801)
Change in liabilities for investment contracts – other	233	224	–	–	233	224
Change in unit-linked liabilities related to UK capital gains tax	(264)	75	–	–	(264)	75
Total policyholder dividends and participation in profits	11,499	(2,684)	(19)	(1)	11,479	(2,685)

Table 11.3

Underwriting and policy acquisition costs	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
Amortization of deferred acquisition costs	6,484	5,365	(536)	(506)	5,948	4,860
Amortization of deferred origination costs	168	135	–	–	168	135
Commissions and other underwriting and acquisition expenses ¹	4,283	3,802	(384)	(280)	3,898	3,522
Total underwriting and policy acquisition costs	10,934	9,302	(920)	(786)	10,014	8,516

¹ Net of additions related to deferred acquisition and origination costs.

Table 11.4

Change in reserves for unearned premiums	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2012	2011	2012	2011	2012	2011
Change in reserves for unearned premiums	845	932	(103)	(181)	741	751

Consolidated financial statements *continued*

12. Deferred policy acquisition costs and deferred origination costs

Table 12.1

Development of deferred policy acquisition costs	General Insurance		Global Life		Other segments ¹		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
	in USD millions							
As of January 1	3,482	3,332	13,584	12,686	353	169	17,420	16,187
Acquisition costs deferred	3,355	3,107	2,656	1,909	898	714	6,908	5,730
Amortization	(3,240)	(2,977)	(1,744)	(1,339)	(914)	(530)	(5,898)	(4,846)
Impairments	(39)	(14)	(11)	–	–	–	(50)	(14)
Amortization charged/ (credited) to other comprehensive income	–	–	(314)	(21)	–	–	(314)	(21)
Acquisitions/divestments/ transfers ²	(3)	67	(5)	573	–	–	(8)	640
Foreign currency translation effects	(13)	(33)	301	(223)	–	–	288	(256)
As of December 31	3,543	3,482	14,466	13,584	337	353	18,346	17,420

¹ Net of eliminations from inter-segment transactions.

² The 2012 movement includes USD 5 million transferred to deferred origination costs in Global Life (see note 1) and USD 3 million in General Insurance mainly as a consequence of the loss of control over one of the ZIC Group's subsidiaries (see note 5). The 2011 movement includes the acquisition of Zurich Santander (see note 5).

Impairments in 2012 include USD 39 million, following a reassessment of the deferred policy acquisition costs in the General Insurance business in Germany.

As of December 31, 2012 and 2011, deferred policy acquisition costs related to non-controlling interests were USD 572 million and USD 499 million, respectively.

Table 12.2

Development of deferred origination costs	in USD millions	
	2012	2011
As of January 1	824	866
Origination costs deferred	79	101
Amortization	(168)	(135)
Transfers ¹	5	–
Foreign currency translation effects	29	(9)
As of December 31	770	824

¹ The 2012 movement consists of USD 5 million transferred from deferred policy acquisition costs (see note 1).

13. Administrative and other operating expense

Table 13		2012	2011
Administrative and other operating expense	in USD millions, for the years ended December 31		
	Wages and salaries	3,315	3,258
	Other employee benefits	703	561
	Amortization and impairments of intangible assets	873	804
	Depreciation and impairments of property and equipment	210	190
	Rent, leasing and maintenance	427	449
	Marketing costs	212	209
	Life recurring commission	365	386
	Asset and other non-income taxes	124	50
	IT costs	841	800
	Litigation and settlement costs	94	76
	Restructuring costs	208	222
	Foreign currency translation	(50)	(108)
	Other	1,295	1,275
	Total	8,617	8,170

Table 13 reflects the costs by nature after allocation of certain costs, in particular wages and salaries as well as other employee benefits, on a functional basis.

Consolidated financial statements *continued*

14. Farmers management fees and other related revenues

Table 14

in USD millions, for the years ended December 31

Farmers management fees and other related revenues

	2012	2011
Farmers management fees and other related revenues	2,846	2,767

Farmers Group, Inc. and its subsidiaries (FGI) through its attorney-in-fact (AIF) relationship with the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc., a wholly owned subsidiary of the Zurich Insurance Group, is contractually permitted to receive a management fee of 20 percent (25 percent in the case of the Fire Insurance Exchange) of the gross premiums earned by the Farmers Exchanges.

FGI has historically charged a lower management fee than the amount allowed by contract. The range of fees has varied by line of business over time and from year to year. The gross earned premiums of the Farmers Exchanges were USD 18,703 million and USD 18,149 million for the years ended December 31, 2012 and 2011, respectively.

15. Mortgage loans given as collateral and collateralized loans

As part of the Deutscher Herold transaction in 2002, the ZIC Group acquired various mortgage loans. In 2012 the remaining mortgage loans were redeemed in line with the original contract terms.

Deutscher Herold had previously sold these loans to credit institutions while retaining the related credit and interest risk. Therefore the loans had not been derecognized from the consolidated balance sheets and the transaction was reflected as a collateralized borrowing. Accordingly, the loans were recorded as mortgage loans given as collateral and the liability to credit institutions as collateralized loans.

Table 15 shows the maturity schedule of collateralized loans as of December 31, 2011.

Table 15

in USD millions, as of December 31

Maturity schedule – collateralized loans

	2011	
	Carrying value ¹	Undiscounted cash flow ²
< 1 year	113	113
2 to 3 years	42	42
3 to 4 years	12	12
4 to 5 years	2	2
> 5 years	54	54
Total	223	223

¹ Allocation to the time bands is based on the expected maturity date.

² Based on the earliest contractual maturity.

16. Property and equipment

Table 16.1

Property and equipment – current period

in USD millions	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other equipment	Total
Gross carrying value as of January 1, 2012	325	1,057	571	556	694	3,203
Less: accumulated depreciation/impairments	–	(348)	(419)	(461)	(395)	(1,624)
Net carrying value as of January 1, 2012	325	709	151	94	299	1,578
Additions and improvements	–	15	39	35	137	226
Disposals	(5)	(21)	(7)	(7)	(42)	(82)
Transfers	(7)	(3)	15	–	(15)	(9)
Depreciation and impairments	(7)	(33)	(43)	(43)	(84)	(210)
Foreign currency translation effects	7	15	1	–	3	26
Net carrying value as of December 31, 2012	313	682	158	78	299	1,529
Plus: accumulated depreciation/impairments	7	378	344	439	346	1,513
Gross carrying value as of December 31, 2012	320	1,060	502	517	645	3,043

Table 16.2

Property and equipment – prior period

in USD millions	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other equipment	Total
Gross carrying value January 1, 2011	352	1,201	467	578	828	3,427
Less: accumulated depreciation/impairments	(1)	(424)	(360)	(484)	(471)	(1,740)
Net carrying value January 1, 2011	352	777	106	95	357	1,687
Additions and improvements	–	7	51	48	93	199
Acquisitions ¹	18	63	4	–	1	86
Disposals	(5)	(10)	(1)	(1)	(28)	(44)
Transfers	(37)	(86)	33	(2)	(53)	(144)
Depreciation and impairments	(1)	(33)	(40)	(45)	(71)	(190)
Foreign currency translation effects	(3)	(8)	(2)	(1)	(1)	(15)
Net carrying value as of December 31, 2011	325	709	151	94	299	1,578
Plus: accumulated depreciation/impairments	–	348	419	461	395	1,624
Gross carrying value as of December 31, 2011	325	1,057	571	556	694	3,203

¹ Related to the acquisition of Zurich Santander and ZIMB (see note 5).

The fire insurance value of the ZIC Group's own-use property and equipment totaled USD 3,036 million and USD 2,917 million as of December 31, 2012 and 2011, respectively.

Consolidated financial statements *continued*

17. Goodwill and other intangible assets

Table 17.1

Intangible assets –
current period

in USD millions	Goodwill	PVFP	Distribution agreements	Attorney-in-fact relationships	Software	Other intangible assets	Total
Gross carrying value as of January 1, 2012	2,186	2,824	4,562	1,025	4,203	190	14,990
Less: accumulated amortization/impairments	(126)	(1,640)	(430)	–	(2,587)	(86)	(4,870)
Net carrying value as of January 1, 2012	2,060	1,184	4,132	1,025	1,615	104	10,120
Additions and transfers	22	–	36	–	482	–	539
Divestments and transfers	(1)	–	(137)	–	(4)	–	(143)
Amortization	–	(205)	(213)	–	(391)	(13)	(822)
Amortization charged to other comprehensive income	–	(149)	–	–	–	–	(149)
Impairments	–	–	–	–	(51)	(1)	(52)
Foreign currency translation effects	27	13	(3)	–	19	3	59
Net carrying value as of December 31, 2012	2,107	844	3,815	1,025	1,670	94	9,554
Plus: accumulated amortization/impairments	132	2,047	620	–	2,741	125	5,665
Gross carrying value as of December 31, 2012	2,239	2,890	4,435	1,025	4,410	219	15,219

As of December 31, 2012, intangible assets relating to non-controlling interests were USD 201 million for the present value of future profits (PVFP) of acquired insurance contracts, USD 1,789 million for distribution agreements and USD 11 million for software.

Additions to goodwill of USD 14 million relates to the acquisition of ZIMB in 2011, resulting from an increase in the anticipated purchase price adjustment and finalization of the purchase accounting (see note 5) and an increase of USD 8 million relating to the increase of an earn out liability in Brazil.

New distribution agreements in General Insurance operations in Brazil, to gain access to the mass consumer market, and in Global Life operations in the Middle East, resulted in additions of USD 36 million.

The loss of control over one of the ZIC Group's subsidiaries resulted in the derecognition of the related assets and liabilities, including a goodwill asset of USD 1 million and USD 137 million of distribution agreements (see note 5).

Table 17.2

Intangible assets
by segment –
current period

in USD millions, as of December 31, 2012	Goodwill	PVFP	Distribution agreements	Attorney-in-fact relationships	Software	Other intangible assets	Total
General Insurance	852	–	713	–	586	76	2,227
Global Life	435	844	3,102	–	403	17	4,801
Farmers	819	–	–	1,025	382	–	2,226
Other Operating Businesses	–	–	–	–	300	–	300
Net carrying value as of December 31, 2012	2,107	844	3,815	1,025	1,670	94	9,554

Intangible assets –
prior period

Table 17.3

in USD millions

	Goodwill	PVFP	Distribution agreements	Attorney-in-fact relationships	Software	Other intangible assets	Total
Gross carrying value as of January 1, 2011	2,241	2,528	2,607	1,025	3,959	195	12,556
Less: accumulated amortization/impairments	(136)	(1,622)	(326)	–	(2,339)	(76)	(4,500)
Net carrying value as of January 1, 2011	2,104	906	2,281	1,025	1,620	119	8,056
Additions and transfers	51	332	2,082	–	560	1	3,026
Divestments and transfers ¹	(12)	–	–	–	–	–	(12)
Amortization	–	(114)	(127)	–	(430)	(14)	(685)
Amortization charged to other comprehensive income	–	82	–	–	–	–	82
Impairments	–	–	–	–	(119)	–	(119)
Foreign currency translation effects	(84)	(23)	(103)	–	(15)	(2)	(228)
Net carrying value as of December 31, 2011	2,060	1,184	4,132	1,025	1,615	104	10,120
Plus: accumulated amortization/impairments	126	1,640	430	–	2,587	86	4,870
Gross carrying value as of December 31, 2011	2,186	2,824	4,562	1,025	4,203	190	14,990

¹ The reduction in Goodwill is mainly a result of a revised earn-out calculation within one of the ZIC Group's Spanish General Insurance operations and the classification as held for sale of the ZIC Group's operation in Bolivia.

As of December 31, 2011, intangible assets related to non-controlling interests were USD 277 million for the present value of future profits (PVFP) of acquired insurance contracts, USD 1,950 million for distribution agreements and USD 5 million for software.

Additions to goodwill of USD 33 million related to the acquisition of Compagnie Libanaise d'Assurances SAL. The acquisition of several smaller companies generated a further USD 12 million of goodwill and earn-out payments to Deutsche Bank Group for the acquisition of Zurich Life and Pensions S.p.A. Italy (formerly DWS Vita S.p.A.) increased goodwill by USD 6 million.

A long term strategic arrangement over a 25 year period with Banco Santander S.A. in Latin America significantly expanded the ZIC Group's presence in this emerging market and resulted in new distribution agreements totalling USD 2,007 million within both the Global Life and General Insurance operations in Mexico, Brazil, Chile and Argentina. This transaction also resulted in additions to PVFP amounting to USD 309 million in Mexico, Brazil and Chile. In addition, the acquisition of ZIMB resulted in an addition to PVFP amounting to USD 24 million (see note 5).

Extensions of existing distribution agreements also resulted in net additions of USD 28 million in the Global Life insurance operations in Italy, USD 14 million in the General Insurance operations in Turkey and USD 5 million in the Global Life insurance operations in Spain. New distribution agreements to gain access to the mass consumer market in Brazil added a further USD 28 million.

The decision to decentralize its direct insurance efforts in the ZIC Group's General Insurance operations in Switzerland and Spain was the main driver of software impairments, resulting in USD 85 million charge for software which will no longer be used.

Consolidated financial statements *continued*

Table 17.4

Intangible assets
by segment –
prior periodin USD millions, as of
December 31, 2011

	Goodwill	PVFP	Distribution agreements	Attorney- in-fact relationships	Software	Other intangible assets	Total
General Insurance	827	–	853	–	548	83	2,311
Global Life	413	1,184	3,279	–	372	21	5,269
Farmers	819	–	–	1,025	409	–	2,254
Other Operating Businesses	–	–	–	–	286	–	286
Net carrying value as of December 31, 2011	2,060	1,184	4,132	1,025	1,615	104	10,120

18. Receivables and other assets

Table 18			
in USD millions, as of December 31		2012	2011
Receivables and other assets	Financial assets		
	Derivative assets	1,754	2,085
	Receivables from policyholders	3,514	3,365
	Receivables from insurance companies, agents and intermediaries	5,884	5,539
	Receivables arising from ceded reinsurance	1,117	1,187
	Reverse repurchase agreements	988	814
	Amounts due from investment brokers	493	321
	Other receivables	1,976	2,032
	Allowance for impairments ¹	(327)	(320)
	Other assets	135	134
	Non-financial assets		
	Current tax receivables	1,186	817
	Accrued premiums	688	684
	Prepaid expenses	265	274
	Prepaid insurance benefits	333	432
	Other assets	340	404
	Total receivables and other assets	18,345	17,767

¹ Allowance for impairments includes USD 79 million and USD 81 million as of December 31, 2012 and 2011, respectively, for receivables arising from ceded reinsurance.

Receivables are carried at notional amounts, and are generally settled within one year. The notional and fair value amounts do not vary significantly.

19. Other liabilities

Table 19.1			
in USD millions, as of December 31		2012	2011
Other liabilities	Other financial liabilities		
	Derivative liabilities	480	662
	Amounts due to policyholders	761	645
	Amounts due to insurance companies, agents & intermediaries	1,360	1,388
	Amounts due to reinsurers	1,398	1,117
	Liabilities for cash collateral received for securities lending	330	159
	Amounts due to investment brokers	1,276	1,370
	Liabilities for defined benefit plans	3,417	2,905
	Other liabilities for employee benefit plans	109	109
	Other liabilities	5,385	6,722
	Other non-financial liabilities		
	Current tax payables	1,101	946
	Restructuring provisions	296	254
	Premium prepayments and other advances	916	891
	Other liabilities	613	1,166
	Total other liabilities	17,440	18,334

Consolidated financial statements *continued*

Table 19.2 shows the maturity schedule of other financial liabilities as of December 31, 2012 and 2011, respectively.

Maturity schedule – other financial liabilities ¹	in USD millions, as of December 31		2012		2011	
			Carrying value ²	Undiscounted cash flow ³	Carrying value ²	Undiscounted cash flow ³
< 1 year			9,958	9,944	10,937	10,929
1 to 2 years			47	20	157	168
2 to 3 years			27	8	40	42
3 to 4 years			18	16	83	96
4 to 5 years			69	89	3	4
> 5 years			979	1,442	951	1,158
Total			11,097	11,520	12,171	12,398

¹ Excluding liabilities for defined benefit plans.

² Allocation to the time bands is based on the expected maturity date.

³ Based on the earliest contractual maturity.

Restructuring provisions	in USD millions		2012	2011
	As of January 1		254	155
Provisions made during the period		173	179	
Increase of provisions set up in prior years		43	45	
Provisions used during the period		(170)	(112)	
Provisions reversed during the period		(6)	(2)	
Foreign currency translation effects		5	(11)	
As of December 31		296	254	

During the year ended December 31, 2012, restructuring programs primarily impacted several European countries within the General Insurance and Global Life operations with estimated costs of USD 173 million for restructuring programs announced in the current year and USD 43 million for increases of provisions for restructuring which had been initiated in prior years. In addition, software impairments amounting to USD 11 million were made as part of the restructuring decisions of Global Life operations.

During the year ended December 31, 2011, the ZIC Group initiated several restructuring programs, recording a total charge to income of USD 179 million. A further USD 45 million was recorded in respect of restructuring programs initiated in prior years. The main restructuring program impacted several European countries within the General Insurance operations with estimated costs of USD 112 million. In addition, the ZIC Group recorded USD 85 million of software impairments as outlined in note 17.

20. Income taxes

Table 20.1			
in USD millions, for the years ended December 31		2012	2011
Income tax expense – current/deferred split	Current	1,043	1,106
	Deferred	441	(124)
	Total income tax expense	1,485	982

Table 20.2			
in USD millions, for the years ended December 31		2012	2011
Income tax expense – policyholder/shareholder attribution	Total income tax expense/(benefit) attributable to policyholders	194	(242)
	Total income tax expense attributable to shareholders	1,290	1,224
	Total income tax expense	1,485	982

The ZIC 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 insurance benefits and losses.

Table 20.3					
in USD millions, for the years ended December 31		Rate	2012	Rate	2011
Expected and actual income tax expense	Net income before income taxes		5,587		4,926
	less: income tax (expense)/benefit attributable to policyholders		(194)		242
	Net income before income taxes attributable to shareholders		5,392		5,167
	Expected income tax expense attributable to shareholders computed at the Swiss statutory tax rate	22.0%	1,186	22.0%	1,137
	Increase/(reduction) in taxes resulting from:				
	<i>Tax rate differential in foreign jurisdictions</i>		228		224
	<i>Tax exempt and lower taxed income</i>		(132)		(82)
	<i>Non-deductible expenses</i>		85		75
	<i>Tax losses previously unrecognized or no longer recognized</i>		(14)		(4)
	<i>Prior year adjustments and other</i>		(62)		(125)
	Actual income tax expense attributable to shareholders	23.9%	1,290	23.7%	1,224
	plus: income tax expense/(benefit) attributable to policyholders		194		(242)
	Actual income tax expense	26.6%	1,485	19.9%	982

Table 20.3 sets out the factors that cause the actual income tax expense to differ from the expected expense computed by applying the Swiss statutory tax rate of 22.0 percent, which is the rate applicable in the jurisdiction where the ultimate parent company is resident.

Consolidated financial statements *continued*

Table 20.4			
in USD millions, as of December 31		2012	2011
Current tax receivables and payables	Current tax receivables	1,186	817
	Current tax payables	(1,101)	(946)
	Net current tax receivables/(payables)	85	(129)

Table 20.5			
in USD millions, as of December 31		2012	2011
Deferred tax assets and liabilities	Deferred tax assets	1,849	2,060
	Deferred tax liabilities	(5,228)	(4,569)
	Net deferred tax liabilities	(3,379)	(2,510)

Table 20.6			
in USD millions		2012	2011
Development of net deferred tax liabilities	As of January 1	(2,510)	(2,421)
	Net change recognized in the income statement	(441)	124
	Net change recognized in equity	(410)	376
	Net changes due to acquisitions/(divestments)	44	(618)
	Foreign currency translation effects	(62)	29
	As of December 31	(3,379)	(2,510)

As of December 31, 2012 and 2011, respectively, USD 13 million was debited and USD 397 million was credited as deferred tax to shareholders' equity, net of foreign currency translation effects.

The net deferred tax liabilities related to non-controlling interests amounted to USD 577 million and USD 614 million as of December 31, 2012 and 2011, respectively.

Table 20.7			
in USD millions, as of December 31		2012	2011
Deferred taxes – policyholder/ shareholder attribution	Net deferred tax liabilities attributable to policyholders	(321)	(154)
	Net deferred tax liabilities attributable to shareholders	(3,058)	(2,356)
	Net deferred tax liabilities	(3,379)	(2,510)

Deferred tax
assets/(liabilities)
analysis
by source

Table 20.8

in USD millions, as of December 31

	2012		2011	
	Assets	Liabilities	Assets	Liabilities
Gross deferred tax				
Deferred acquisition and origination costs	35	(677)	24	(655)
Depreciable and amortizable assets	45	(63)	30	(73)
Life policyholders' benefits and deposits ¹	13	(15)	96	(49)
Unrealized (gains)/losses on available-for-sale investments and cash flow hedges	251	(501)	409	(513)
Accruals and deferred income	158	(1)	177	(2)
Reserves for losses and loss adjustment expenses	434	(132)	457	(4)
Reserves for unearned premiums	765	(59)	729	(61)
Pensions and other employee benefits	544	–	541	–
Other assets/liabilities	775	(89)	748	(296)
Tax loss carryforwards	420	–	558	–
Gross deferred tax assets/(liabilities) before valuation allowance	3,440	(1,539)	3,771	(1,653)
Valuation allowance	(52)	–	(58)	–
Gross deferred tax assets/(liabilities) after valuation allowance	3,388	(1,539)	3,713	(1,653)
Deferred tax assets	1,849		2,060	
Deferred acquisition and origination costs	89	(2,662)	60	(2,565)
Depreciable and amortizable assets	247	(2,585)	287	(2,620)
Life policyholders' benefits and deposits ¹	1,162	(961)	956	(777)
Unrealized (gains)/losses on available-for-sale investments and cash flow hedges	209	(1,364)	303	(1,075)
Accruals and deferred income	116	(84)	109	(169)
Reserves for losses and loss adjustment expenses	149	(82)	142	(243)
Reserves for unearned premiums	50	(72)	47	(64)
Deferred front-end fees	616	–	634	–
Pensions and other employee benefits	482	(40)	457	(37)
Other assets/liabilities	744	(1,357)	923	(1,128)
Tax loss carryforwards	127	–	203	–
Gross deferred tax assets/(liabilities) before valuation allowance	3,992	(9,208)	4,121	(8,678)
Valuation allowance	(12)	–	(12)	–
Gross deferred tax assets/(liabilities) after valuation allowance	3,980	(9,208)	4,109	(8,678)
Deferred tax liabilities		(5,228)		(4,569)
Net deferred tax liabilities		(3,379)		(2,510)

¹ Includes reserves for unit-linked contracts.

The ZIC Group's deferred tax assets and liabilities are recorded by its tax paying entities throughout the world, which may include several legal entities within each tax jurisdiction. Legal entities are grouped as a single taxpayer only when permitted by local legislation and when deemed appropriate. The first part of table 20.8 includes single taxpayers with a net deferred tax asset position and the second part includes single taxpayers with a net deferred tax liability position.

As of December 31, 2012 and 2011, the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognized amount to approximately USD 6 billion and USD 3 billion, respectively. In the remote scenario in which these temporary differences were to reverse simultaneously, the resulting tax liabilities would be very limited due to participation exemption rules.

Consolidated financial statements *continued*

Table 20.9			
in USD millions, as of December 31			
		2012	2011
Tax losses carryforwards and tax credits	For which deferred tax assets have been recognized, expiring		
	< 5 years	104	170
	5 to 20 years	622	1,208
	> 20 years or with no time limitation	989	986
	Subtotal	1,715	2,364
	For which deferred tax assets have not been recognized, expiring		
	5 to 20 years	102	169
	> 20 years or with no time limitation	152	168
	Subtotal	254	337
	Total	1,969	2,701

The tax rates applicable to tax losses for which a deferred tax asset has not been recognized are 28.9 percent and 30.4 percent for the years 2012 and 2011, respectively.

The recoverability of the deferred tax asset for each taxpayer is based on the taxpayer's 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 its ability to offset the deferred tax asset against deferred tax liabilities.

Management assesses the recoverability of the deferred tax asset carrying values based on future years taxable income projections and believes that the carrying values of the deferred tax assets as of December 31, 2012, are recoverable.

21. Senior and subordinated debt

Table 21.1		2012	2011
Senior and subordinated debt	in USD millions, as of December 31		
	Senior debt		
	Zurich Insurance Company Ltd		
	3.75% CHF 500 million notes, due September 2013 ⁷	545	531
	2.25% CHF 500 million notes, due July 2017 ⁷	543	529
	2.875% CHF 250 million notes, due July 2021 ⁷	269	262
	2.375% CHF 525 million notes, due November 2018 ⁷	568	553
	1.50% CHF 400 million notes, due June 2019 ^{6,7,8}	440	–
	3.375% EUR 500 million notes, due June 2022 ^{6,7,8}	682	–
	Various debt instruments payable within 1 year with Zurich Insurance Group Ltd ⁴	706	524
	Zurich Finance (Luxembourg) S.A.		
	3.25% USD 750 million notes, due September 2013 ^{5,7,8}	757	764
	Zurich Finance (USA), Inc.		
	4.50% EUR 1 billion notes, due September 2014 ^{2,7,8}	1,333	1,312
	4.875% EUR 800 million notes, due April 2012 ^{1,7}	–	1,037
	6.50% EUR 600 million notes, due October 2015 ^{3,7,8}	790	776
	Euro Commercial Paper Notes	400	400
	Zurich Santander Insurance America S.L.		
	7.5% EUR 167 million loan, due December 2035	220	236
	Other		
	Various debt instruments payable in more than 1 year	113	141
	Senior debt	7,366	7,065
	Subordinated debt		
	Zurich Insurance Company Ltd		
	12.0% EUR 143 million perpetual capital notes ⁷	188	184
	7.5% EUR 425 million notes, due July 2039 ⁷	557	547
	4.25% CHF 700 million perpetual notes ⁷	756	735
	4.625% CHF 500 million perpetual notes ⁷	539	525
	8.25% USD 500 million perpetual capital notes ⁷	495	–
	Zurich Finance (UK) plc		
	6.625% GBP 450 million perpetual notes ^{5,7}	723	690
	Zurich Finance (USA), Inc.		
	5.75% EUR 500 million notes, due October 2023 ^{1,7}	652	641
	4.5% EUR 500 million notes, due June 2025 ^{5,7,8}	705	688
	ZFS Finance (USA) Trust II		
	Series II 6.45% USD 700 million Trust Preferred Securities (ECAPS), due December 2065	676	674
	ZFS Finance (USA) Trust IV		
	Series IV 5.875% USD 500 million Trust Preferred Securities, due May 2062	–	250
	ZFS Finance (USA) Trust V		
	Series V 6.5% USD 1 billion Trust Preferred Securities, due May 2067	498	497
	Other		
	Various debt instruments payable in more than 1 year	73	44
	Subordinated debt	5,861	5,476
	Total senior and subordinated debt	13,227	12,541

¹ The bond is economically hedged, but hedge accounting treatment has not been applied.

² The bond is part of a qualifying cash flow hedge (80 percent of the total) and fair value hedge (20 percent of the total).

³ The bond is part of a qualifying cash flow hedge (100 percent).

⁴ Loans with subsidiaries of Zurich Insurance Group which are not part of Zurich Insurance Company Group Ltd

⁵ The holders of these notes benefit from the Replacement Capital Covenant which states that if Series IV and V Fixed/Floating Trust Preferred Securities, issued by ZFS Finance (USA) Trusts IV and V, are called before 2042 and 2047 respectively, the ZIC Group will issue a replacement debt instrument with terms and provisions that are as or more equity-like than the replaced notes.

⁶ These bonds are part of qualifying fair value hedges (100 percent).

⁷ Issued under the Zurich Insurance Group's Euro Medium Term Note Programme (EMTN Programme).

⁸ The ZIC Group applied the cash flow hedge methodology to hedge the foreign currency exposure and deferred the attributable basis spreads in shareholders' equity, whereas the fair value hedge methodology was used to hedge the interest rate exposure with changes in the fair value being recorded through the income statement.

None of the debt instruments listed in table 21.1 were in default as of December 31, 2012 or 2011.

Consolidated financial statements *continued*

Senior and subordinated debt

To facilitate the issuance of debt, the Zurich Insurance Group has in place a Euro Medium Term Note Programme (EMTN Programme) allowing for the issuance of senior and subordinated notes up to a maximum of USD 18 billion. All issuances under this programme are either issued or guaranteed by Zurich Insurance Company Ltd. The ZIC Group has also issued debt instruments outside this programme.

i) Senior debt

Senior debt amounted to USD 7,366 million and USD 7,065 million as of December 31, 2012 and December 31, 2011, respectively.

The increase was primarily due to the issuance of two notes: in June 2012 under its EMTN Programme, Zurich Insurance Company Ltd issued a 1.5% CHF 400 million senior note and a 3.375% EUR 500 million senior note. There was also a USD 182 million call account increase with Zurich Insurance Group Ltd. This was partially offset by the redemption of a 4.875% EUR 800 million senior note issued in 2009 by Zurich Finance (USA) which matured in April 2012 and the translation effects of the U.S. dollar against the currencies in which the notes were issued.

ii) Subordinated debt

Subordinated debt securities are obligations of the ZIC Group which, in case of liquidation of the ZIC Group, rank junior to all present and future senior indebtedness and certain other obligations of the ZIC Group.

Subordinated debt amounted to USD 5,861 million and USD 5,476 million as of December 31, 2012 and December 31, 2011, respectively.

The increase is mainly the result of 8.25% USD 500 million perpetual capital notes issued in January 2012 by Zurich Insurance Company Ltd under its EMTN Programme and the translation effects of the U.S. dollar against the currencies in which the notes were issued. This was partially offset by the early redemption of the remaining USD 250 million of 5.875% USD 500 million Series IV Fixed/Floating Trust Preferred Securities issued by ZFS Finance (USA) Trust IV in 2007, which were called in June 2012.

Table 21.2

Description and features of significant subordinated debt	Description	Coupon conditions	Call/ redemption date	Redemption conditions
	12.00% EUR 143 million, perpetual capital notes	12.00% payable annually up to July 15, 2014 and then reset quarterly to 3-month EURIBOR plus 10.33%.	Quarterly on or after July 15, 2014	Redeemable in whole at par plus any accrued interest.
	7.5% EUR 425 million notes, due July 2039	7.5% payable annually up to July 24, 2019 and then reset quarterly to 3-month EURIBOR plus 5.85%.	Quarterly on or after July 24, 2019	Redeemable in whole or in part at par plus any accrued interest.
	4.25% CHF 700 million, perpetual notes	4.25% payable annually up to May 26, 2016 and then reset quarterly to 3-month CHF-Libor plus 3.046%.	Quarterly on or after May 26, 2016	Redeemable in whole or in part at par plus any accrued interest.
	4.625% CHF 500 million, perpetual notes	4.625% payable annually up to May 16, 2018 and then reset to the prevailing 7 year CHF mid swap rate plus 2.691%.	Annually on or after May 16, 2018	Redeemable in whole or in part at par plus any accrued interest.
	8.25% USD 500 million, perpetual capital notes	8.25% per annum payable quarterly until January 18, 2018. Resets to the 6-Year USD mid swap rate plus 6.84% until January 18, 2024. Resets thereafter every 6 years to the 6-Year USD mid swap rate plus 7.84%.	Quarterly on or after January 18, 2018	Redeemable in whole or in part at par plus any accrued interest.
	6.625% GBP 450 million, perpetual notes	6.625% payable annually up to October 2, 2022 and then reset every 5 years to the reset rate of interest plus 2.85%. ¹	Every five years on or after October 2, 2022	Redeemable in whole every five years at par plus any accrued interest.
	5.75% EUR 500 million notes, due October 2023	5.75% payable annually up to October 2, 2013 and then reset quarterly to 3-month EURIBOR plus 2.67%.	Quarterly on or after October 2, 2013	Redeemable in whole at par plus any accrued interest.
	4.5% EUR 500 million notes, due June 2025	4.5% payable annually up to June 15, 2015 and then reset quarterly to 3-month EURIBOR plus 2.20%.	Quarterly on or after June 15, 2015	Redeemable in whole at par plus any accrued interest.
	Series II 6.45% USD 700 million Fixed/Adjustable Trust Preferred Securities (ECAPS), due December 2065	6.45% payable semi-annually until June 15, 2016 and then reset quarterly to the adjustable rate plus 2.00%. ²	Quarterly on or after June 15, 2016	Redeemable in whole or in part at par plus any accrued interest.
	Series V 6.5% USD 1 billion Fixed/Floating Trust Preferred Securities, due May 2067	6.5% payable semi-annually until May 9, 2017 and then reset quarterly to 3-month LIBOR plus 2.285%.	Quarterly on or after May 9, 2017	Redeemable in whole or in part at par plus any accrued interest.

¹ Reset rate of interest is equal to the gross redemption yield on the benchmark five-year Gilt as determined by the Calculation Bank.

² 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% for Series II.

Consolidated financial statements *continued*

Table 21.3

Maturity schedule of outstanding debt

in USD millions, as of December 31

	2012		2011	
	Carrying value	Undiscounted cash flows	Carrying value	Undiscounted cash flows
< 1 year	2,409	3,006	1,961	2,557
1 to 2 years	1,356	1,907	1,305	1,823
2 to 3 years	902	1,371	1,324	1,811
3 to 4 years	–	429	917	1,319
4 to 5 years	543	934	–	376
5 to 10 years	2,705	4,340	1,345	2,838
> 10 years	5,313	7,418	5,689	7,625
Total	13,227	19,406	12,541	18,350

Debt maturities reflect original contractual dates without taking early redemption options into account. For call/redemption dates, see table 21.3. The total notional amount of debt due in each period is not materially different from the total carrying value disclosed in table 21.4. Undiscounted cash flows include interest and principal cash flows on debt outstanding as of December 31, 2012 and December 31, 2011. All debt is assumed to mature within 20 years of the balance sheet date without refinancing. Floating interest rates are assumed to remain constant as of December 31, 2012 and December 31, 2011. The aggregated cash flows are translated into U.S. dollars at end-of-period rates.

Table 21.4

Interest expense on debt

in USD millions, for the years ended December 31

	2012	2011
Senior debt	222	265
Subordinated debt	348	351
Total	571	616

Interest expense on debt amounted to USD 571 million and USD 616 as of December 31, 2012 and 2011, respectively. The lower interest expense on senior debt was mainly due to the maturity of the 4.875% EUR 800 million notes in April 2012 as well as the positive impact of refinancing the 3.875% CHF 1 billion notes in July 2011 and the 3.5% CHF 300 million notes in November 2011 at lower rates. This reduction was partially offset by the 7.5% EUR 167 million senior loan to support the ZIC Group's business in Latin America and the issuance of two new senior notes under the EMTN Programme in June 2012. By contrast interest expense on subordinated debt increased mainly as a result of the issuance of two new subordinated notes in March 2011 and January 2012, partially offset by the early redemption in June 2012 of the remaining USD 250 million of 5.875% USD 500 million Series IV Fixed/Floating Trust Preferred Securities.

Credit facilities

On December 4, 2012 the ZIC Group amended the revolving credit facility agreement dated October 31, 2011 and redenominated the total amount of EUR 2.5 billion maturing in 2018 at the latest into USD 3.2 billion. Farmers Group, Inc. and its subsidiaries ceased to be a borrower and a guarantor under the facility and Zurich Insurance Company Ltd assumed this additional borrowing capacity and became the exclusive guarantor of the total amount of USD 3.2 billion.

In addition, the ZIC Group has access to four other revolving credit facilities totaling USD 441 million, of which USD 336 million are expiring in 2014 and USD 75 million in 2015. No borrowings were outstanding under any of these facilities as of December 31, 2012 or December 31, 2011.

22. Shareholders' equity

Share capital and profit sharing certificates

Table 22

number of shares, as of December 31	2012	2011
Contingent and issued share capital, CHF 10 par value	86,000,000	86,000,000
Issued share capital, CHF 10 par value	82,500,000	82,500,000
Profit sharing certificates (Genussscheine) ¹	2	2

¹ These profit sharing certificates confer on their holder the right to receive a dividend if and to the extent the General Meeting decides. However, they do not confer on their holder any voting rights or rights associated thereto, any rights to subscribe for new shares, or any rights to liquidation proceeds.

a) Issued share capital

As of December 31, 2012 and 2011, Zurich Insurance Company Ltd had an issued share capital of CHF 825,000,000, consisting of 82,500,000 issued and fully paid registered shares of CHF 10 par value each.

b) Contingent share capital

At the General Meeting of Shareholders on June 11, 1997, a contingent capital of CHF 35,000,000, or 3,500,000 shares with a par value of CHF 10 each, was created, of which 2,500,000 shares can be issued in connection with the granting of conversion and/or option rights and 1,000,000 shares can be issued for the purpose of employees' share ownership plans. None of the contingent shares have been issued as of December 31, 2012 and December 31, 2011.

c) Profit sharing certificates

As of December 31, 2012 and 2011, Zurich Insurance Company Ltd had two profit sharing certificates with no par value issued.

d) Additional paid-in capital

On April 25, 2008, Zurich Insurance Company Ltd entered into a subordinated loan agreement for an amount of CHF 6.1 billion (USD 6.0 billion) with Zurich Group Holding in order to finance its purchase of Farmers Group Inc. Following the merger of Zurich Group Holding into Zurich Insurance Group Ltd in December 2009, the loan was assumed by Zurich Insurance Group Ltd.

The loan is undated and pays interest subject to solvency thresholds and the payment of interest is optional if Zurich Insurance Company Ltd does not declare or pay any dividends or other profit distributions to its shareholders. The loan is classified as an equity instrument under IFRS as it meets the classification criteria as such under IAS 32.

On April 7, 2011, Zurich Insurance Company Ltd repaid an amount of CHF 1.3 billion (USD 1.3 billion) to Zurich Insurance Group Ltd. The remaining loan amounted to CHF 4.8 billion (USD 5.2 billion) and CHF 4.8 billion (USD 5.1 billion) as of December 31, 2012 and 2011, respectively.

Consolidated financial statements *continued*

23. Employee benefits

Personnel and other related costs incurred for the year ended December 31, 2012 and 2011, were USD 6,095 million and USD 5,868 million, including wages and salaries of USD 4,846 million and USD 4,868 million, respectively.

The ZIC Group operates a number of retirement benefit arrangements for employees, 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 ZIC Group also operates post-employment plans, mainly in the U.S., which provide employees with certain defined post-employment benefits such as medical care and life insurance.

To ensure appropriate governance of the ZIC Group's pension and post-employment benefit plans, the Zurich Insurance Group Pension Committee provides oversight of the ZIC Group's benefits policy.

a) Defined benefit plans

Defined benefit pension plans

Employees of the ZIC Group's companies are covered by various pension plans, the largest of which are in the UK, U.S., Germany and Switzerland. Certain companies provide defined benefit plans, some of which provide benefits related to employees' service periods and pensionable earnings. Others provide cash balance plans where the participants receive the benefit of the accumulated employer and employee contributions together with additional cash credits in line with the rules of the plan. 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.

Most of the ZIC Group's defined benefit pension plans are funded through contributions by the ZIC Group, and in some cases the employee, to trusts or foundations independent of the ZIC 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 funded, a liability for the accrued pension obligations is recognized in the ZIC Group's consolidated balance sheets.

For the defined benefit pension plans, total contributions to funded pension plans and benefit payments by the ZIC Group are currently estimated at USD 488 million for 2013 compared with USD 479 million estimated in the previous year for 2012. The actual amounts may differ.

Other defined post-employment benefits

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

Tables 23.1, 23.2 and 23.3 show the funded status of the ZIC Group's plans, being the pension plans' assets at fair value less the pension plans' liabilities based on the present value of the obligations. Plans that are wholly unfunded are shown separately from plans that are wholly or partly funded.

Status of funded defined benefit plans	Defined benefit pension plans					Other defined post-employment benefits				
	2012	2011	2010	2009	2008	2012	2011	2010	2009	2008
Present value of funded obligations	(19,043)	(17,189)	(14,978)	(13,966)	(12,680)	(2)	(1)	–	(70)	(93)
Fair value of plan assets	16,268	14,902	13,791	12,622	10,879	–	–	–	–	–
Funded status	(2,775)	(2,287)	(1,186)	(1,344)	(1,801)	(2)	(1)	–	(70)	(92)
Unrecognized past service cost	–	(1)	(1)	–	(1)	–	–	–	–	–
Cumulative impact of asset ceiling	–	(3)	(3)	(15)	(7)	–	–	–	–	–
Liability – funded obligations	(2,775)	(2,291)	(1,190)	(1,359)	(1,808)	(2)	(1)	–	(70)	(92)

Pensions are long-term by nature. However, short-term variations between long-term actuarial assumptions and actual experience may be positive or negative, resulting in actuarial gains or losses, which are recognized in full in the period in which they occur, and are included in OCI.

Status of unfunded defined benefit plans	Defined benefit pension plans					Other defined post-employment benefits				
	2012	2011	2010	2009	2008	2012	2011	2010	2009	2008
Present value of unfunded obligations	(307)	(289)	(260)	(230)	(210)	(315)	(301)	(295)	(205)	(183)
Unrecognized past service cost	(4)	(5)	(10)	–	–	(14)	(18)	(23)	(28)	(1)
Liability – unfunded obligations	(311)	(293)	(270)	(229)	(209)	(329)	(319)	(318)	(234)	(184)

Status of funded and unfunded defined benefit plans	Defined benefit pension plans					Other defined post-employment benefits				
	2012	2011	2010	2009	2008	2012	2011	2010	2009	2008
Liability	(3,086)	(2,585)	(1,460)	(1,588)	(2,017)	(331)	(320)	(319)	(303)	(277)

Consolidated financial statements *continued*

in USD millions, as of December 31	Defined benefit pension plans		Other defined post-employment benefits	
	2012	2011	2012	2011
	Current service cost	(332)	(314)	(10)
Interest cost	(740)	(745)	(13)	(13)
Expected return on plan assets	608	756	–	–
Past service cost	(11)	(6)	5	5
Gains on curtailment or settlement	43	2	–	12
Net pension expense	(432)	(307)	(18)	(7)

Pension expense is recognized in other employee benefits, which are included in administrative and other operating expense.

in USD millions, as of December 31	Defined benefit pension plans	
	2012	2011
Mortgage loans	444	465
Cash and cash equivalents	182	193
Equity securities	3,696	3,233
Debt securities	11,002	10,151
Real estate	938	854
Other assets ¹	7	7
Total	16,268	14,902

¹ UK annuity policies.

As a matter of policy, pension plan investment guidelines do not permit investment in any assets in which the Zurich Insurance Group or its subsidiaries have an interest, including shares or other financial instruments issued and real estate held for own use.

in USD millions	Defined benefit pension plans		Other defined post-employment benefits	
	2012	2011	2012	2011
Benefit obligation as of January 1	(17,478)	(15,238)	(302)	(296)
Current service cost	(332)	(314)	(10)	(10)
Past service cost including plan amendments	(11)	(10)	–	–
Interest cost	(740)	(745)	(13)	(13)
Actuarial gain/(loss) included in other comprehensive income	(1,083)	(1,894)	(3)	(4)
Employee contributions	(51)	(52)	–	(6)
Employer contributions paid directly to meet benefits	30	–	21	–
Benefits paid	628	612	–	20
Effect of curtailments or settlements	254	2	–	12
Foreign currency translation effects	(566)	162	(9)	(5)
Benefit obligation as of December 31	(19,350)	(17,478)	(318)	(302)

Table 23.7					
Movement in fair value of plan assets – funded plans	in USD millions	Defined benefit pension plans		Other defined post-employment benefits	
		2012	2011	2012	2011
		Fair value of plan assets as of January 1	14,902	13,791	–
Expected return on plan assets	608	756	–	–	
Actuarial gain/(loss) included in other comprehensive income	611	560	–	–	
Employer contributions	452	459	–	14	
Employee contributions	51	52	–	6	
Benefits paid	(628)	(612)	–	(20)	
Effect of curtailments or settlements	(211)	–	–	–	
Foreign currency translation effects	483	(105)	–	–	
Fair value of plan assets as of December 31	16,268	14,902	–	–	

The actual returns on defined benefit pension plan assets for the years ended December 31, 2012 and 2011 were gains of USD 1,219 million and USD 1,316 million, respectively.

The summary of the balance sheet changes in relation to defined benefit plans and other defined post-employment benefits is shown in table 23.8.

Table 23.8					
Movement in liability for funded and unfunded plans	in USD millions	Defined benefit pension plans		Other defined post-employment benefits	
		2012	2011	2012	2011
		Liability as of January 1	(2,585)	(1,460)	(320)
Current year expense	(432)	(307)	(18)	(7)	
Contributions paid	452	459	–	14	
Contributions paid directly to meet benefits	30	–	21	–	
Change in liability due to asset ceiling	3	–	–	–	
Actuarial gain/(loss) included in other comprehensive income	(473)	(1,333)	(3)	(4)	
Foreign currency translation effects	(82)	58	(9)	(5)	
Liability as of December 31	(3,086)	(2,585)	(331)	(320)	

Consolidated financial statements *continued*

The movements in actuarial gains and losses due to differences between actual and expected experience on the ZIC Group's plan assets and defined benefit obligations, together with the impact of changes in actuarial assumptions to reflect economic conditions at the year end are summarized in table 23.9.

in USD millions		2012	2011	2010	2009	2008
Actuarial gain/(loss)	Actuarial gain/(loss) as of January 1	(4,200)	(2,914)	(2,672)	(2,907)	(1,308)
	Experience adjustments on plan liabilities	(212)	(190)	205	(37)	(147)
	Experience adjustments on plan assets	611	560	388	318	(1,485)
	Changes due to discount rate assumptions	(1,452)	(1,602)	(742)	(103)	223
	Changes due to other actuarial assumptions	577	(105)	(65)	144	(392)
	Asset ceiling recognition	3	–	11	(7)	51
	Foreign currency translation effects	(108)	51	(39)	(80)	152
	Total actuarial gain/(loss) as of December 31	(4,781)	(4,200)	(2,914)	(2,672)	(2,907)
	Total actuarial gain/(loss) net of policyholder participation and taxes as of December 31	(3,308)	(2,857)	(1,924)	(1,762)	(1,934)

The principal financial assumptions used to calculate the ZIC Group's major defined benefit pension and defined post-employment benefit obligations and the ZIC Group's pension expenses are in table 23.10.

Assumptions used in determining the actuarial liabilities for major defined benefit pension plans	as of December 31		2012				2011			
	Switzerland	United Kingdom	United States	Germany	Switzerland	United Kingdom	United States	Germany		
	Discount rate	1.7%	4.7%	3.9%	3.3%	2.1%	5.0%	4.5%	5.4%	
Inflation rate	1.5%	3.3%	2.9%	2.3%	1.6%	3.7%	2.2%	1.8%		
Expected long-term rate of return on assets	2.6%	4.6%	4.7%	4.3%	3.4%	6.2%	6.4%	4.5%		
Expected future salary increases	2.1%	3.8%	4.4%	3.6%	2.2%	4.2%	4.3%	3.1%		
Expected future pension increases	1.0%	3.3%	0.0%	2.3%	1.1%	3.7%	0.0%	1.8%		
Current average life expectancy for a 65 year old male	21.2	22.9	19.5	18.6	21.1	22.9	19.6	18.4		

The expected long-term rate of return on assets was derived separately for each of the ZIC Group's funded benefit plans. Each major asset class is assigned an expected long-term rate of return, net of investment expenses, appropriate for the environment in which that plan is invested. The overall expected long-term rate of return on assets for a plan is calculated as the weighted average of the expected return for each asset class, weighted by the plan's target allocation to each asset class.

The mortality assumptions in each country have been based on mortality tables in accordance with the general use in that market. Where appropriate these tables make allowance for projected future improvements in life expectancy.

Assumptions used in determining the actuarial liabilities for other defined post-employment benefit plans

Table 23.11

as of December 31	2012	2011
	U.S.	U.S.
Discount rate	3.7%	5.0%
Expected increase in long-term health cost – initial rate	7.9%	7.7%
Expected increase in long-term health cost – ultimate rate	4.9%	4.8%

The actuarial assumptions for healthcare cost trend rates have an impact on the amounts recognized. A one percentage point change in the health care cost trend rates would have the effect on amounts recognized as set out in table 23.12.

Effect of a change in health care cost trends on other defined post-employment benefits

Table 23.12

in USD millions, as of December 31	1% increase	1% decrease
Effect on total service cost and interest cost	– ¹	– ¹
Effect on benefit obligation	4	(3)

¹ Below USD 1 million.

b) Defined contribution pension plans

Certain of the ZIC Group's companies sponsor defined contribution pension plans. Eligibility for participation in such plans is either based on completion of a specified period of continuous service or the date of commencement of employment. The plans provide for voluntary contributions by employees and contributions by the employer which typically range from 2 percent to 10 percent of annual pensionable salary, depending on a number of factors. The ZIC Group's contributions under these plans amounted to USD 132 million and USD 127 million in 2012 and 2011, respectively.

Consolidated financial statements *continued*

24. Share-based compensation and cash incentive plans

The ZIC 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 Zurich Insurance 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 compensation plans are based on the provision of the Zurich Insurance Group Ltd shares, the ultimate parent which is not part of the ZIC Group.

a) Cash incentive plans

Various businesses throughout the ZIC Group operate short-term incentive programs for executives, management and, in some cases, for employees of that business. Awards are made in cash, based on the accomplishment of both organizational and individual performance objectives. The expense recognized for these cash incentive plans amounted to USD 488 million and USD 484 million for the years ended December 31, 2012 and 2011, respectively.

b) Share-based compensation plans for employees and executives

The ZIC Group encourages employees to own shares in Zurich Insurance Group Ltd 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 24.1

Expenses recognized in income	in USD millions, as of December 31	2012	2011
	Total option-based expenses	14	35
	Total share-based expenses	126	141
	Total expenses	140	176

The explanations below provide a more detailed overview of the main plans of the ZIC Group.

Employee share plans

Share Incentive Plan for employees in the UK

The ZIC Group established an Inland Revenue approved Share Incentive Plan and launched the partnership shares element of this plan in 2003, which enabled participating employees to make monthly purchases of Zurich Insurance Group Ltd shares at the prevailing market price out of their gross earnings. There were 181 and 252 participants in the plan as of December 31, 2012 and 2011, respectively. The ZIC Group also operates the profit-sharing element of the Share Incentive Plan (reward shares) which was launched in 2004 with annual share allocations being made in May each year subject to business performance. The awards are based on the business operating profit (BOP) after tax for the year, for the business unit of each participating employee. Individual awards are subject to a maximum of 5 percent of a participant's base salary (before any flexible benefit adjustments) with an overall maximum of GBP 3,000. The total number of participating employees in the reward share element of the plans as of December 31, 2012 and 2011 was 5,289 and 4,463 respectively.

Share Incentive Plan for employees in Switzerland

Under this plan, employees have the option to acquire sales-restricted shares at a 30 percent discount to the market value. The maximum permitted investment in shares is equivalent to CHF 3,500 per employee per annum. During 2012, 4,894 employees were eligible to participate in the share incentive plan for employees in Switzerland compared with 5,448 in 2011. For the years ended December 31, 2012 and 2011, 1,385 and 1,084 employees, respectively, purchased shares under the 2011 and 2010 share plan.

The ZIC Group Long-Term Incentive Plan

Participants in this plan are granted a target number of performance shares in shares of Zurich Insurance Group Ltd in April each year, such that the economic value is a defined percentage of the annual salary of each participant in the year of grant. Performance shares vest on an annual basis over the subsequent three year period, with the actual level of vesting being between 0 percent and 175 percent of the original shares granted, with an additional discretion to increase vesting to a maximum of 200 percent, depending on the performance of the Zurich Insurance Group over the previous three calendar years. Performance metrics used to determine the level of vesting are the Zurich Insurance Group's return on equity and the position of its total annual relative shareholder return measured against an international peer group of insurance companies. One half of the shares that actually vest are sales-restricted for a further three years. As of December 31, 2012 and 2011 there were 1,129 and 1,152 participants in the plan, respectively.

Prior to 2011, for selected senior executives, the target granted was allocated between performance shares and share options in shares of Zurich Insurance Group Ltd. Vesting of the share options is based on the same criteria as those for performance shares over the subsequent three year period, with the same potential multiple of the share options granted dependent on the achievement of the same performance metrics. Share options, once vested, may be exercised by the participant over the period up to seven years from the date of grant.

c) Further information on performance share and option plans

Table 24.2

Movements in options under the Zurich Insurance Group Long-Term Incentive Plan	Number of shares under option		Weighted average exercise price (in CHF)	
	2012	2011	2012	2011
	As of January 1	3,268,779	3,693,558	285
Options vesting	444,277	828,407	240	261
Options forfeited	(33,940)	(142,385)	258	248
Options exercised	(408,159)	(304,080)	202	206
Options expired during period	(766,373)	(806,721)	273	276
As of December 31	2,504,584	3,268,779	295	285
Exercisable options as of December 31	2,261,239	2,587,617	295	285

The average share price for Zurich Insurance Group Ltd shares in 2012 and 2011 was CHF 221.56 and CHF 212.72 respectively.

Table 24.3

Share options exercised during the period	Amount		Weighted average share price (in CHF)	
	2012	2011	2012	2011
	Exercise date			
January to April	296,042	255,232	235	260
May to August	33,289	26,388	222	229
September to December	78,828	22,460	238	208
Total	408,159	304,080	232	232

Consolidated financial statements *continued*

Table 24.4

Range of exercise prices for options outstanding

in CHF, as of December 31

	Number of options		Weighted average contractual life in years		Weighted average remaining expected life in years	
	2012	2011	2012	2011	2012	2011
Exercise price						
100 to 200	255,683	478,212	7.0	7.0	3.3	4.3
201 to 300	876,150	1,161,398	7.0	7.0	4.3	4.5
301 to 400	1,372,751	1,629,169	7.0	7.1	1.3	2.3
Total	2,504,584	3,268,779	7.0	7.0	2.6	3.4

Table 24.5

Options and shares during the period

for the years ended December 31

	Number		Weighted average fair value at grant date (in CHF)	
	2012	2011	2012	2011
Shares granted during the period	549,831	537,955	226	244
Options granted during the period ¹	–	–	–	–

¹ Number of options granted for closed plans.

The shares granted during the year are the target allocations made under the Zurich Insurance Group's Long-Term Incentive Plan. Whether these grants vest or not will depend on whether the performance metrics are achieved. If the performance metrics change from the initial assumptions, the expense is adjusted.

25. Contingent liabilities, contractual commitments and financial guarantees

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

Table 25.1		2012	2011
Quantifiable commitments and contingencies	in USD millions, as of December 31		
	Commitments under investment agreements	4,225	4,037
	Less funded commitments	(3,690)	(3,586)
	Remaining commitments under investment agreements	535	451
	Guarantees and letters of credit ¹	4,412	4,650
	Future operating lease commitments	1,074	1,155
	Undrawn loan commitments	16	35
	Other commitments and contingent liabilities	41	7

¹ Guarantee features embedded in life insurance products are not included.

Commitments under investment agreements

The ZIC Group has committed to contribute capital to subsidiaries and third parties that engage in making investments in direct private equity and private equity funds. Commitments may be called by the counterparty over the term of the investment (generally three to five years) and must be funded by the ZIC Group on a timely basis.

Guarantees and letters of credit

USD 4,412 million and USD 4,650 million for financial guarantees and letters of credit were outstanding as of December 31, 2012 and 2011, respectively. The ZIC Group knows of no event of default that would require it to satisfy financial guarantees. Irrevocable letters of credit have been issued to secure certain reinsurance contracts.

The ZIC Group is active in numerous countries where insurance guarantee funds exist. The design of such funds varies from jurisdiction to jurisdiction. In some, funding is based on premiums written, in others the ZIC Group may be called upon to contribute to such funds in case of a failure of another market participant. In addition, in some jurisdictions the amount of contribution may be limited, for example, to a percentage of the net underwriting reserve net of payments already made.

The ZIC Group carries certain contingencies in the ordinary course of business in connection with the sale of its companies and businesses. These are primarily in the form of indemnification obligations provided to the acquirer in a transaction in which a ZIC Group company is the seller. They vary in scope and duration by counterparty and generally are intended to shift the potential risk of certain unquantifiable and unknown loss contingencies from the acquirer to the seller.

Commitments under lease agreements

The ZIC Group has entered into various operating leases as lessee for office space and certain computer and other equipment. Lease expenses totaled USD 99 million and USD 137 million for the years ended December 31, 2012 and 2011, respectively.

Consolidated financial statements *continued*

Table 25.2

in USD millions, as of December 31		2012	2011
Future payments under non-cancelable operating leases with terms in excess of one year	< 1 year	205	189
	1 to 2 years	184	189
	2 to 3 years	170	165
	3 to 4 years	154	151
	4 to 5 years	108	141
	> 5 years	253	320
	Total	1,074	1,155

Indemnity agreements

The ZIC Group, through certain of its subsidiaries, has agreed to arrangements that cap Converium's (now Scor Holding (Switzerland) AG) and its successor companies' net exposure for losses arising out of the September 11, 2001 World Trade Center event in New York. As of December 31, 2012 the ZIC Group has recorded provisions of USD 44 million, for losses in excess of USD 289 million.

Other contingent liabilities

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

The ZIC Group has commitments to provide collateral on certain contracts in the event of a financial strength downgrading for Zurich Insurance Company Ltd from the current AA- by Standard & Poor's. Should the rating by Standard & Poor's fall to A+, then the additional collateral based on information available as of December 31, 2012 and 2011 is estimated to amount to approximately USD 71 million and USD 131 million, respectively.

In common with other groups writing life insurance business in the UK, the ZIC Group remains exposed to a number of Conduct of Business issues. While provisions are maintained which reflect management's best estimate at the balance sheet date of the probable costs and expenses of resolving these matters, significant uncertainty regarding the ultimate cost remains. The main area of uncertainty concerns complaints related to sales advice. The key assumptions used to derive the complaint provisions are the volume of complaints, both those already recorded and an assumption as to the level of future complaints, the percentage of complaints expected to be successful (the uphold rate), the average redress payable for each complaint and the expenses of reviewing each case or complaint. The assumptions used to set the provisions have been based on actual recent experience.

Pledged assets

The majority of assets pledged to secure the ZIC Group's liabilities relate to debt securities pledged under short-term sale and repurchase agreements. The total amount of pledged financial assets including the securities under short-term sale and repurchase agreements amounted to USD 9,445 million and USD 8,147 million as of December 31, 2012 and 2011, respectively.

Terms and conditions associated with the financial assets pledged to secure the ZIC Group's liabilities are usual and standard in the markets in which the underlying agreements were executed.

Legal proceedings and regulatory investigations

The ZIC Group and its subsidiaries are continuously involved in legal proceedings, claims and regulatory investigations arising, for the most part, in the ordinary course of their business operations. The ZIC Group's business is subject to extensive supervision, and companies in the ZIC Group are in regular contact with various regulatory authorities. In addition, certain companies within the ZIC Group are engaged in the following legal proceedings and regulatory investigations.

An action entitled Fuller-Austin Asbestos Settlement Trust, et al. v. Zurich American Insurance Company (ZAIC), et al., was filed in May 2004 in the Superior Court for San Francisco County, California. Three other similar actions were filed in 2004 and 2005 and have been coordinated with the Fuller-Austin action (collectively, the Fuller-Austin Case). In addition to ZAIC and four of its insurance company subsidiaries, Zurich Insurance Company Ltd and Orange Stone Reinsurance Dublin (Orange Stone) are named as defendants. The plaintiffs, who are historical policyholders of the Home Insurance Company (Home), plead claims for, inter alia, fraudulent transfer, tortious interference, unfair business practices, alter ego and agency liability relating to the recapitalization of Home, which occurred in 1995 following regulatory review and approval. The plaintiffs allege that pursuant to the recapitalization and subsequent transactions, various Zurich entities took assets of Home without giving adequate consideration in return, and contend that this forced Home into liquidation. The plaintiffs further allege that the defendants should be held responsible for Home's alleged obligations under their Home policies. The trial judge designated the plaintiffs' claims for constructive fraudulent transfer for adjudication before all other claims; he subsequently ordered an initial bench trial on certain threshold elements of those fraudulent transfer claims and on certain of defendants' affirmative defenses. The trial commenced on November 1, 2010. Closing arguments were heard on February 22 and 23, 2012, and a decision is pending. The ZIC Group maintains that the Fuller-Austin Case is without merit and intends to continue to defend itself vigorously.

While the ZIC Group believes that it is not a party to, nor are any of its subsidiaries the subject of, any unresolved current legal proceedings, claims, litigation and investigations that will have a material adverse effect on the ZIC Group's consolidated financial condition, proceedings are inherently unpredictable, and it is possible that the outcome of any proceeding could have a material impact on results of operations in the particular reporting period in which it is resolved.

Consolidated financial statements *continued*

26. Fair value of financial assets and financial liabilities

Tables 26.1a and 26.1b compare the fair value of financial assets and financial liabilities with their carrying value.

Fair value (FV) and carrying value of financial assets and financial liabilities – Group investments and other Non-unit-linked	Table 26.1a			
	in USD millions, as of December 31			
	Total fair value		Total carrying value	
	2012	2011	2012	2011
Cash and cash equivalents	8,699	8,697	8,699	8,697
Available-for-sale securities				
Debt securities	141,258	129,974	141,258	129,974
Equity securities	9,153	8,518	9,153	8,518
Total available-for-sale securities	150,411	138,492	150,411	138,492
Securities at FV through profit or loss				
Trading				
Debt securities	48	42	48	42
Equity securities	410	438	410	438
Designated at FV				
Debt securities	8,937	8,738	8,937	8,738
Equity securities	3,135	4,006	3,135	4,006
Total securities at FV through profit or loss	12,530	13,224	12,530	13,224
Derivative assets	1,692	2,019	1,692	2,019
Held-to-maturity debt securities	5,723	6,182	5,012	5,535
Investments in associates and joint ventures	172	161	172	161
Loans and receivables				
Mortgage loans	10,173	10,197	9,394	9,649
Other loans	16,153	14,995	13,681	13,214
Deposits made under assumed reinsurance contracts	2,583	2,703	2,588	2,711
Mortgage loans given as collateral	–	223	–	223
Receivables	13,614	12,905	13,645	12,939
Total loans and receivables	42,522	41,022	39,308	38,735
Total financial assets	221,750	209,797	217,825	206,863
Derivative liabilities	(475)	(625)	(475)	(625)
Financial liabilities held at amortized cost				
Liabilities related to investment contracts	(1,540)	(1,354)	(1,305)	(1,131)
Liabilities related to investment contracts with DPF	(5,663)	(5,337)	(5,903)	(5,607)
Senior debt	(7,887)	(7,313)	(7,366)	(7,065)
Subordinated debt	(6,379)	(5,153)	(5,861)	(5,476)
Deposits received under ceded reinsurance contracts	(1,482)	(1,477)	(1,558)	(1,560)
Collateralized loans	–	(223)	–	(223)
Other financial liabilities	(1,217)	(1,138)	(1,217)	(1,142)
Obligation to repurchase securities	(1,539)	(1,794)	(1,539)	(1,794)
Total financial liabilities	(26,182)	(24,414)	(25,225)	(24,623)

Fair value (FV) and carrying value of financial assets and financial liabilities – unit-linked

Table 26.1b

in USD millions, as of December 31

	Total fair value		Total carrying value	
	2012	2011	2012	2011
Cash and cash equivalents	1,261	1,280	1,261	1,280
Investments at FV through profit or loss				
Designated at FV				
Debt securities	12,062	11,825	12,062	11,825
Equity securities	100,144	89,535	100,144	89,535
Other loans	8,279	7,739	8,279	7,739
Total investments at FV through profit or loss	120,484	109,099	120,484	109,099
Derivative assets	62	65	62	65
Total	121,808	110,444	121,808	110,444
Financial liabilities at FV through profit or loss				
Designated at FV				
Liabilities related to unit-linked investment contracts	(50,923)	(44,220)	(50,923)	(44,220)
Derivative liabilities	(5)	(37)	(5)	(37)
Total	(50,928)	(44,256)	(50,928)	(44,256)

The methods and assumptions used by the ZIC Group in determining fair values of financial assets and liabilities are set out in note 4. Depending on the valuation techniques used and whether the underlying assumptions are based on observable market data, financial instruments carried at fair value are classified under the following three levels (the fair value hierarchy).

Level 1 – this category includes financial assets for which fair values are determined based on quoted prices (unadjusted) in active markets for identical instruments. A market is considered active only if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The ZIC Group has classified under level 1 the majority of common stocks, government bonds and certain corporate bonds and investments in unit trusts that are traded in very liquid markets.

Level 2 – this category includes financial assets and liabilities for which fair values are determined using valuation techniques with all significant inputs based on observable market data. Depending on the nature of the instruments and the market in which they are traded, examples of observable market data may include quoted prices, broker quotes, interest rates, yield curves etc. The ZIC Group has classified under level 2 the majority of corporate bonds, investments in unit trusts, agency-backed and senior tranches of asset-backed securities, and OTC derivative financial instruments. While markets for these instruments do not meet the strict requirements to be classified as active, they offer sufficient transaction volumes and, therefore, observable market data to enable the ZIC Group to determine their fair value. The ZIC Group has also classified under level 2 liabilities related to unit-linked investment contracts.

Level 3 – this category includes financial assets and liabilities for which fair values are determined using valuation techniques with at least one significant input not being based on observable market data. In circumstances when there is little, if any, market activity for a certain instrument, the ZIC Group is required to develop internal valuation inputs based on the best information available about the assumptions that market participants would use when pricing the asset or liability. This would normally apply in the case of investments in hedge funds, private equity funds, asset-backed securities for which currently very limited market activity is observed, and long-dated derivative financial instruments. The effect of changes in the internal valuation inputs to reasonably possible alternative values is disclosed in tables 26.4a and 26.4b.

Consolidated financial statements *continued*

Group investments and other non-unit linked financial instruments carried at fair value

Table 26.2a				
in USD millions, as of December 31, 2012				
	Level 1	Level 2	Level 3	Total
Fair value hierarchy – current period				
Available-for-sale securities				
Debt securities	44,458	94,064	2,736	141,258
Equity securities	3,883	4,331	939	9,153
Total available-for-sale securities	48,341	98,395	3,675	150,411
Securities at FV through profit or loss				
Trading				
Debt securities	43	5	–	48
Equity securities	–	43	367	410
Designated at FV				
Debt securities	2,737	6,110	90	8,937
Equity securities	383	1,493	1,260	3,135
Total securities at FV through profit or loss	3,163	7,650	1,716	12,530
Derivative assets	2	1,660	30	1,692
Total	51,506	107,706	5,421	164,632
Derivative liabilities	(3)	(472)	–	(475)
Total	(3)	(472)	–	(475)

Table 26.2b				
in USD millions, as of December 31, 2011				
	Level 1	Level 2	Level 3	Total
Fair value hierarchy – prior period				
Available-for-sale securities				
Debt securities	39,825	87,888	2,261	129,974
Equity securities	3,657	3,884	977	8,518
Total available-for-sale securities	43,481	91,772	3,239	138,492
Securities at FV through profit or loss				
Trading				
Debt securities	35	7	–	42
Equity securities	–	40	398	438
Designated at FV				
Debt securities	3,155	5,394	189	8,738
Equity securities	483	2,258	1,265	4,006
Total securities at FV through profit or loss	3,673	7,699	1,851	13,224
Derivative assets	4	1,982	33	2,019
Total	47,158	101,453	5,123	153,735
Derivative liabilities	(8)	(565)	(52)	(625)
Total	(8)	(565)	(52)	(625)

Development of financial instruments classified under level 3 – current period	Available-for-sale securities		Securities at FV through profit or loss			Derivative assets	Derivative liabilities
	Debt securities	Equity securities	Trading	Designated at FV			
			Equity securities	Debt securities	Equity securities		
As of January 1, 2012	2,261	977	398	189	1,265	33	(52)
Realized gains/(losses) recognized in income	37	31	8	8	10	–	–
Unrealized gains/(losses) recognized in income ¹	(11)	(4)	(7)	4	76	(5)	52
Unrealized gains/(losses) recognized in other comprehensive income	165	58	–	–	–	–	–
Purchases	680	86	29	14	155	–	–
Sales/redemptions/settlements	(1,084)	(212)	(67)	(100)	(245)	–	–
Transfers into Level 3	929	2	–	12	–	–	–
Transfers out of Level 3	(261)	(4)	–	(42)	–	–	–
Foreign currency translation effects	20	5	7	4	(1)	1	–
As of December 31, 2012	2,736	939	367	90	1,260	30	–

¹ Presented as impairments for available-for-sale securities, and net capital gains/(losses) and impairments for securities at fair value through profit and loss on Group investments in the consolidated income statements.

During the year ended December 31, 2012, the ZIC Group transferred USD 0.9 billion of debt securities from level 2 to level 3. The transfers were mainly the result of higher price volatility and credit rating downgrades of certain asset-backed securities, resulting in a deterioration of the market activity of the instruments.

Development of financial instruments classified under level 3 – prior period	Available-for-sale securities		Securities at FV through profit or loss			Derivative assets	Derivative liabilities
	Debt securities	Equity securities	Trading	Designated at FV			
			Equity securities	Debt securities	Equity securities		
As of January 1, 2011	3,394	2,836	377	191	1,545	46	(25)
Realized gains/(losses) recognized in income	26	500	6	1	23	–	–
Unrealized gains/(losses) recognized in income ¹	(12)	(61)	(1)	(10)	28	16	(27)
Unrealized gains/(losses) recognized in other comprehensive income	(14)	(277)	–	–	–	–	–
Purchases	354	630	95	16	34	–	–
Sales/redemptions/settlements	(1,539)	(1,187)	(79)	(16)	(369)	–	–
Transfers into Level 3	79	9	–	1	–	–	–
Transfers out of Level 3	(40)	(1,566)	–	–	–	(27)	–
Foreign currency translation effects	14	92	–	7	4	(1)	–
As of December 31, 2011	2,261	977	398	189	1,265	33	(52)

¹ Presented as impairments for available-for-sale securities, and net capital gains/(losses) and impairments for securities at fair value through profit and loss on Group investments in the consolidated income statements.

During the year ended December 31, 2011, the ZIC Group transferred USD 1.6 billion of equity securities from Level 3 to Level 1. The transfer arose because the investment in New China Life Insurance Company Ltd was listed on the Hong Kong Stock Exchange on December 15, 2011.

Consolidated financial statements *continued*

Sensitivity of fair values reported for level 3 instruments to changes in key assumptions

As of December 31, 2012 and 2011 under level 3, the ZIC Group classified asset-backed securities (ABSs) amounting to USD 2.8 billion and USD 2.5 billion, respectively. These ABSs include non-agency backed securities for which the limited market activity observable during the year required the ZIC Group's external pricing providers to make certain internal valuation assumptions. To determine the fair value of these investments, pricing providers use valuation models that are based on an expected present value technique.

The key assumptions driving the valuation of these investments include discount margins and rates for prepayment, recovery and default. The effect on reported fair values of using reasonably possible alternative values for each of these assumptions, while the other key assumptions remain unchanged, is disclosed in tables 26.4a and 26.4b. While these tables illustrate the overall effect of changing the values of the unobservable inputs by a set percentage, the significance of the impact and the range of reasonably possible alternative assumptions, may differ significantly between investments, given their different terms and circumstances.

The sensitivity analysis is intended to reflect the uncertainty inherent in the valuation of these investments, under the current market conditions, and its results cannot be extrapolated due to non-linear effects that changes in valuation assumptions may have on the fair value of these investments. Furthermore, the analysis does not indicate a probability of such changes occurring and it does not necessarily represent the ZIC Group's view of expected future changes in the fair value of these investments. Any management actions that may be taken to mitigate the inherent risks are not reflected in this analysis.

Table 26.4a

Sensitivity analysis of Level 3 ABSs to changes in key assumptions – current period

as of December 31, 2012	Less favorable values (relative change)	Decrease of reported fair value USD millions	More favorable values (relative change)	Increase of reported fair value USD millions
Key assumptions				
Discount margins	+20%	(95)	-20%	97
Prepayment rates	-20%	(7)	+20%	8
Recovery rates	-20%	(2)	+20%	2
Default rates	+20%	(10)	-20%	5

Table 26.4b

Sensitivity analysis of Level 3 ABSs to changes in key assumptions – prior period

as of December 31, 2011	Less favorable values (relative change)	Decrease of reported fair value USD millions	More favorable values (relative change)	Increase of reported fair value USD millions
Key assumptions				
Discount margins	+20%	(85)	-20%	90
Prepayment rates	-20%	(9)	+20%	10
Recovery rates	-20%	(1)	+20%	1
Default rates	+20%	(3)	-20%	3

As of December 31, 2012 and 2011, under level 3 the ZIC Group also classified investments in hedge funds and private equity funds amounting to USD 2.0 billion and USD 1.9 billion, respectively. These investments are valued based on regular reports from the issuing funds and fair values are reviewed by a team of in-house investment professionals and may be adjusted based on their understanding of the circumstances of individual investments. Investments in hedge funds and private equity funds have not been included in the sensitivity analysis due to the large number of valuation assumptions that while, in total, have a significant effect on the fair value of these investments, when considered individually, the impact of changing them to reasonably possible alternative values would not be significant.

Unit-linked financial instruments

Table 26.5a				
in USD millions, as of December 31, 2012				
	Level 1	Level 2	Level 3	Total
Investments at FV through profit or loss				
Designated at FV				
Debt securities	4,357	7,616	88	12,062
Equity securities	42,232	55,171	2,741	100,144
Other loans	–	8,279	–	8,279
Total investments at FV through profit or loss	46,589	71,066	2,829	120,484
Derivative assets	–	62	1	62
Total	46,589	71,127	2,830	120,547
Financial liabilities at FV through profit or loss				
Designated at FV				
Liabilities related to unit-linked investment contracts	–	(50,923)	–	(50,923)
Derivative liabilities	–	(4)	(1)	(5)
Total	–	(50,927)	(1)	(50,928)

Table 26.5b				
in USD millions, as of December 31, 2011				
	Level 1	Level 2	Level 3	Total
Investments at FV through profit or loss				
Designated at FV				
Debt securities	5,203	6,493	129	11,825
Equity securities	39,778	45,153	4,604	89,535
Other loans	–	7,739	–	7,739
Total investments at FV through profit or loss	44,981	59,385	4,733	109,099
Derivative assets	–	64	1	65
Total	44,981	59,449	4,734	109,164
Financial liabilities at FV through profit or loss				
Designated at FV				
Liabilities related to unit-linked investment contracts	–	(44,220)	–	(44,220)
Derivative liabilities	–	(33)	(3)	(37)
Total	–	(44,253)	(3)	(44,256)

Consolidated financial statements *continued*

Table 26.6a		Securities at FV through profit or loss	
in USD millions		Designated at FV	
		Debt securities	Equity securities
Development of financial assets classified under level 3 – current period	As of January 1, 2012	129	4,604
	Realized gains/(losses) recognized in income	1	402
	Unrealized gains/(losses) recognized in income	6	(93)
	Purchases	–	27
	Sales/redemptions	(14)	(2,194)
	Transfers into level 3	–	4
	Transfers out of level 3	(38)	(11)
	Foreign currency translation effects	5	2
	As of December 31, 2012	88	2,741

Table 26.6b		Securities at FV through profit or loss	
in USD millions		Designated at FV	
		Debt securities	Equity securities
Development of financial assets classified under level 3 – prior period	As of January 1, 2011	143	4,650
	Realized gains/(losses) recognized in income	2	46
	Unrealized gains/(losses) recognized in income	–	218
	Purchases	5	27
	Sales/redemptions	(21)	(329)
	Transfers into level 3	–	1
	Transfers out of level 3	–	(4)
	Foreign currency translation effects	–	(5)
	As of December 31, 2011	129	4,604

27. Related party transactions

In the normal course of business, the ZIC Group enters into various transactions with related companies, including various reinsurance and cost-sharing arrangements. These transactions are not considered material to the ZIC 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.

Table 27.1 sets out related party transactions with equity method accounted investments, reflected in the consolidated income statements and consolidated balance sheets.

Table 27.1			
in USD millions			
Related party transactions included in the Consolidated financial statements	for the years ended December 31,		
		2012	2011
	Net earned premiums and policy fees	13	28
	Net investment result on Group investments	62	75
	Other income	19	22
	Insurance benefits and losses, net of reinsurance	(9)	(4)
	Underwriting and policy acquisition costs, net of reinsurance	(1)	(2)
	Administrative and other operating expense	(17)	(30)
	Interest expense on debt	(1)	(30)
as of December 31,			
	2012	2011	
Cash and cash equivalents	–	253	
Other loans ¹	1,275	1,291	
Deposits made under assumed reinsurance contracts	4	5	
Accrued investment income	13	14	
Receivables and other assets	13	14	
Reserves for insurance contracts	(11)	(11)	
Accrued liabilities	2	2	
Other liabilities	(228)	(245)	
Senior debt ²	(706)	(524)	

¹ Includes loans of Zurich Insurance Group Ltd which amounted to USD 524 million as of both December 31, 2012 and 2011.

² Includes debt received from Zurich Insurance Group Ltd which amounted to USD 706 million and USD 524 million as of December 31, 2012 and 2011, respectively.

On April 25, 2008 a subordinated loan agreement was entered into between Zurich Insurance Company Ltd and Zurich Group Holding, which was assumed by Zurich Insurance Group Ltd as a consequence of its merger of Zurich Group Holding. The remaining loan amounted to CHF 4.8 billion (USD 5.2 billion) and CHF 4.8 billion (USD 5.1 billion) as of December 31, 2012 and 2011, respectively (see note 22).

Consolidated financial statements *continued*

Table 27.2 summarizes related party transactions with key personnel reflected in the Consolidated financial statements. Key personnel includes members of the Board of Directors of Zurich Insurance Group Ltd and Zurich Insurance Company Ltd and members of the Group Executive Committee of Zurich Insurance Group.

Table 27.2			
in USD millions, for the years ended December 31			
	2012	2011	
Related party transactions – key personnel	Remuneration of key personnel of the Zurich Insurance Group		
	Cash compensation, current benefits and fees	31	33
	Post-employment benefits	3	3
	Share-based compensation	14	19
	Total remuneration of key personnel	48	55

As of December 31, 2012 and 2011 there were no loans, advances or credits outstanding from members of the Group Executive Committee of Zurich Insurance Group. Outstanding loans and guarantees granted to members of the Board of Directors amounted to USD 3 million for both the years ended December 31, 2012 and December 31, 2011. The terms “members of the Board of Directors” and “members of the Group Executive Committee of Zurich Insurance Group” in this context include the individual as well as members of their respective households. The figures in table 27.2 include the fees paid to members of the Board of Directors of Zurich Insurance Group Ltd and Zurich Insurance Company Ltd, which were USD 5 million for both the years ended December 31, 2012 and December 31, 2011.

No provision for non-repayment has been required in 2012 and 2011 for the loans or guarantees made to members of the Group Executive Committee of Zurich Insurance Group.

The cash compensation, current benefits and fees are short term in nature.

28. Farmers Exchanges

Farmers Group, Inc. and its subsidiaries (FGI) provide certain non-claims related management services to the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc. a wholly owned subsidiary of the Zurich Insurance Group. The finances and operations of the Farmers Exchanges are governed by independent Boards of Governors. In addition, the ZIC Group has the following relationships with the Farmers Exchanges.

a) Certificates of contribution issued by the Farmers Exchanges

As of December 31, 2012 and 2011, FGI and other ZIC Group companies held the following 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.

Table 28		
Surplus Notes	in USD millions, as of December 31	
	2012	2011
6.15% certificate of contribution, due June 2021	707	707
6.15% certificate of contribution, due June 2021	140	140
6.15% certificate of contribution, due June 2021	60	60
4.65% certificate of contribution, due December 2013	150	150
Various other certificates of contribution	23	23
Total	1,080	1,080

Conditions governing payment of interest and repayment of principal are outlined in the certificates of contribution. 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 U.S. 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 U.S.

b) Quota share reinsurance treaties with the Farmers Exchanges

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

Auto Physical Damage Quota Share reinsurance agreement

The Auto Physical Damage (APD) Quota Share reinsurance agreement (APD agreement) with the Farmers Exchanges provides for annual ceded premiums of USD 1 billion with 20.0 percent assumed by Farmers Re Co (USD 200 million) and 80.0 percent assumed by ZIC (USD 800 million), a 25.8 percent ceding commission for acquisition expenses, and an 8.2 percent ceding commission for unallocated loss adjustment expenses. In addition, Farmers Re Co and ZIC assume a quota share percentage of ultimate net losses sustained by the Farmers Exchanges in their APD lines of business. The APD agreement also includes provisions for additional experience commissions that will depend on loss experience and recoveries below a specified ratio for each year. This experience commission arrangement limits Farmers Re Co and ZIC's potential underwriting gain on the assumed business to 2.0 percent of premiums assumed plus 20.0 percent of the underwriting gain resulting from a combined ratio under 98.0 percent. The APD agreement can be cancelled after 90 days notice by any of the parties.

Effective January 1, 2012, the APD agreement was replaced with a new APD treaty with substantially the same terms as the prior agreement but with the ceding commission for acquisition expenses ranging between 27.1 percent and 29.1 percent and the ceding commission for unallocated loss adjustment expenses ranging between 8 percent and 10 percent, both based on a previous 5 year average experience. In addition, the experience commission was eliminated.

Farmers Exchanges' share of ceded premiums amounted to USD 1 billion for both the years ended December 31, 2012 and 2011. Ceded incurred losses and loss adjustment expenses totaled USD 723 million and USD 709 million for the years ended December 31, 2012 and 2011, respectively. Farmers Exchanges' share of the total commission income was USD 290 million and USD 268 million for the years ended December 31, 2012 and 2011, respectively.

Consolidated financial statements *continued*

All Lines Quota Share reinsurance agreement

Certain of the Farmers Exchanges participate in an All Lines Quota Share reinsurance agreement (All Lines agreement) with Farmers Re Co and ZIC which has been amended over the years, with the participation ratio at 12 percent as of December 31, 2010. The All Lines agreement provided for a cession of a 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 agreement has been applied. The All Lines agreement, which can be terminated after 90 days notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 26.7 percent, 9.0 percent of premiums for unallocated loss adjustment expenses and 5.3 percent of premiums for other expenses. In addition, under the All Lines agreement, the Farmers Exchanges catastrophe losses are subject to a maximum of USD 1.2 billion.

Effective December 31, 2011, the All Lines agreement was amended subsequent to which Farmers Re Co and ZIC entered into a 20.0 percent All Lines agreement, under which each assumes a percentage of all lines of business written by the Farmers Exchanges, prospectively. Under the All Lines agreement, which amended the 12.0 percent All Lines agreement in effect since December 31, 2010, Farmers Re Co and ZIC assume a 4.0 percent and 16.0 percent 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 agreement has been applied. In addition, under the All Lines agreement, the Farmers Exchanges catastrophe losses are subject to a maximum of USD 1.2 billion. As a result, Farmers Re Co and ZIC are subject to a maximum annual catastrophe loss of USD 48.0 million and USD 192 million, respectively. Unearned premiums totaling USD 527 million were transferred from the Farmers Exchanges to Farmers Re Co and ZIC as a result of their increased participation in the All Lines agreement as from December 31, 2011. In addition, Farmers Re Co and ZIC remitted USD 141 million of reinsurance commissions to the Farmers Exchanges for acquisition expenses due to the increased participation in the All Lines agreement. Ceded premiums earned and commissions were USD 1,984 million and USD 635 million, respectively, and recoveries totaled USD 1,396 million, for the year ended December 31, 2011.

Effective December 31, 2012, the All Lines agreement was amended such that Farmers Re Co assume a 2.5 percent instead of 4 percent quota share and ZIC continues to assume a 16.0 percent 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 agreement has been applied. The remaining 1.5 percent quota share is assumed by a third party on the same terms as Farmers Re Co and ZIC. Unearned premiums totaling USD 102 million were transferred from Farmers Re Co to the Farmers Exchanges as a result of its decreased participation in the All Lines agreement effective December 31, 2012. In addition, the Farmers Exchanges remitted USD 27 million of reinsurance commissions to Farmers Re for acquisition expenses due to the decreased participation in the All Lines agreement.

Based on the results for 2012, ceded premiums earned and commissions were USD 3,418 million and USD 1,094 million, respectively, and recoveries totaled USD 2,475 million, for the year ended December 31, 2012.

29. Segment information

The ZIC Group pursues a customer-centric strategy and is managed on a matrix basis, reflecting both businesses and geography. The ZIC Group's operating segments have been identified on the basis of the businesses operated by the ZIC Group and how these are strategically managed to offer different products and services to specific customer groups. Segment information is presented accordingly. The ZIC Group's reportable segments are as follows:

General Insurance is the segment through which the ZIC Group provides a variety of motor, home and commercial products and services for individuals, as well as small and large businesses.

Global Life pursues a strategy of providing market-leading unit-linked, protection and corporate propositions through global distribution and proposition pillars to develop leadership positions in its chosen segments.

Farmers provides, through Farmers Group, Inc. and its subsidiaries (FGI), non-claims related management services to the Farmers Exchanges. FGI receives fee income for the provision of services to the Farmers Exchanges, which are managed but not owned by Farmers Group, Inc. a wholly owned subsidiary of the Zurich Insurance Group. This segment also includes all reinsurance assumed from the Farmers Exchanges by the ZIC Group. Farmers Exchanges are prominent writers of personal and small commercial lines of business in the U.S.

For the purpose of discussing financial performance the ZIC Group considers General Insurance, Global Life and Farmers to be its core business segments.

Other Operating Businesses predominantly consist of the ZIC Group's Headquarter and Holding and Financing activities. Certain alternative investment positions not allocated to business operating segments are included within Holding and Financing.

Non-Core Businesses include insurance and reinsurance businesses that the ZIC Group does not consider core to its operations and that are therefore mostly managed to achieve a beneficial run-off. Non-core businesses are mainly situated in the U.S., Bermuda, the United Kingdom and Ireland.

The ZIC Group also manages two of the three core segments on a secondary level.

The General Insurance segment is managed based on market-facing businesses, including:

- Global Corporate
- North America Commercial
- Europe
- Latin America
- Asia-Pacific
- Middle East and Africa

The Global Life segment is managed on a regional-based structure within a global framework, including:

- North America
- Latin America
- Europe
- Asia-Pacific and Middle East

Consolidated financial statements *continued*

The segment information includes the ZIC Group's internal performance measure, business operating profit (BOP). This measure is the basis on which business units are managed. It indicates the underlying performance of the business units by eliminating the impact of financial market volatility and other non-operational variables. BOP reflects adjustments for shareholders' taxes, net capital gains on investments and impairments (except for investments in hedge funds, certain securities held for specific economic hedging purposes and policyholders' share of investment results for the life businesses), non-operational foreign exchange movements, and significant items arising from special circumstances, including restructuring charges, charges for litigation outside the ordinary course of business and gains and losses on divestments of businesses.

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Consolidated financial statements *continued*

Table 29.1

in USD millions, for the years ended December 31

Business operating
profit by business
segment

	General Insurance		Global Life	
	2012	2011	2012	2011
Revenues				
Direct written premiums ¹	33,393	32,379	11,043	9,335
Assumed written premiums	2,217	2,193	102	97
Gross Written Premiums	35,610	34,572	11,145	9,432
Policy fees	–	–	2,445	2,152
Gross written premiums and policy fees	35,610	34,572	13,590	11,583
Less premiums ceded to reinsurers	(5,874)	(5,325)	(710)	(682)
Net written premiums and policy fees	29,736	29,247	12,880	10,901
Net change in reserves for unearned premiums	(540)	(171)	(259)	(36)
Net earned premiums and policy fees	29,195	29,076	12,621	10,865
Farmers management fees and other related revenues	–	–	–	–
Net investment result on Group investments	2,587	2,807	4,833	4,575
Net investment income on Group investments	2,516	2,799	3,991	4,146
Net capital gains/(losses) and impairments on Group investments	71	8	842	429
Net investment result on unit-linked investments	–	–	9,703	(3,548)
Other income	992	922	1,047	1,012
Total BOP revenues	32,774	32,805	28,203	12,904
<i>of which: inter-segment revenues</i>	<i>(508)</i>	<i>(573)</i>	<i>(367)</i>	<i>(341)</i>
Benefits, losses and expenses				
Insurance benefits and losses, net ¹	20,527	20,939	9,592	9,503
Losses and loss adjustment expenses, net	20,547	20,919	–	59
Life insurance death and other benefits, net ¹	(20)	20	9,592	9,444
Policyholder dividends and participation in profits, net	4	9	10,781	(2,826)
Income tax expense/(benefit) attributable to policyholders	–	–	194	(242)
Underwriting and policy acquisition costs, net	5,833	5,581	2,804	2,029
Administrative and other operating expense (excl. depreciation/amortization)	3,894	3,674	2,536	2,394
Interest credited to policyholders and other interest	18	24	403	395
Restructuring provisions and other items not included in BOP	(113)	(238)	(113)	(130)
Total BOP benefits, losses and expenses (before interest, depreciation and amortization)	30,163	29,988	26,196	11,123
Business operating profit (before interest, depreciation and amortization)	2,611	2,817	2,007	1,781
Depreciation and impairments of property and equipment	110	85	32	30
Amortization and impairments of intangible assets	211	278	483	315
Interest expense on debt	141	209	22	56
Business operating profit before non-controlling interests	2,149	2,245	1,471	1,380
Non-controlling interests	52	(2)	142	35
Business operating profit	2,097	2,247	1,328	1,345

¹ The Global Life segment includes approximately USD 603 million and USD 936 million of gross written premiums and future life policyholders' benefits for certain universal life-type contracts in the ZIC Group's Spanish operations for the years ended December 31, 2012 and 2011, respectively (see note 3).

	Farmers		Other Operating Businesses		Non-Core Businesses		Eliminations		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	-	-	-	-	114	150	-	-	44,550	41,864
	4,361	3,529	116	141	113	144	(175)	(220)	6,734	5,884
	4,361	3,529	116	141	227	294	(175)	(220)	51,285	47,748
	-	-	-	-	248	300	-	-	2,692	2,452
	4,361	3,529	116	141	475	594	(175)	(220)	53,977	50,200
	-	-	(50)	(59)	(21)	(704)	175	220	(6,481)	(6,550)
	4,361	3,529	66	82	454	(110)	-	-	47,496	43,650
	56	(545)	-	1	1	2	-	-	(741)	(751)
	4,418	2,984	66	83	455	(108)	-	-	46,755	42,899
	2,846	2,767	-	-	-	-	-	-	2,846	2,767
	124	133	396	536	328	1,008	(613)	(792)	7,654	8,267
	124	133	396	536	260	320	(613)	(792)	6,674	7,142
	-	-	-	-	68	688	-	-	980	1,125
	-	-	-	-	565	4	-	-	10,268	(3,544)
	101	64	911	920	105	85	(1,497)	(1,516)	1,660	1,488
	7,489	5,948	1,373	1,539	1,452	989	(2,110)	(2,307)	69,182	51,876
	(37)	(35)	(1,142)	(1,296)	(56)	(62)	2,110	2,307	-	-
	3,198	2,105	56	58	380	475	-	-	33,752	33,080
	3,198	2,105	(1)	1	27	(622)	(3)	3	23,769	22,465
	-	-	56	57	353	1,097	3	(3)	9,983	10,615
	-	-	-	-	694	133	-	-	11,479	(2,685)
	-	-	-	-	-	-	-	-	194	(242)
	1,383	902	-	16	2	9	(9)	(20)	10,014	8,516
	1,334	1,290	1,131	1,131	106	159	(1,466)	(1,472)	7,534	7,177
	-	-	4	10	39	41	(3)	(7)	460	463
	3	(10)	(42)	(21)	-	1	-	-	(265)	(397)
	5,918	4,288	1,149	1,193	1,221	818	(1,478)	(1,499)	63,169	45,911
	1,571	1,660	224	345	232	171	(632)	(809)	6,012	5,965
	53	56	15	14	-	4	-	-	210	190
	100	118	79	94	-	-	-	-	873	804
	3	-	1,007	1,083	30	77	(632)	(809)	571	616
	1,414	1,486	(876)	(845)	201	90	-	-	4,359	4,355
	66	48	(21)	-	1	1	-	-	241	82
	1,348	1,438	(855)	(846)	200	89	-	-	4,118	4,273

Consolidated financial statements *continued*

Table 29.2

in USD millions, for the years ended December 31

Reconciliation of
BOP to net income
after income taxes

	General Insurance		Global Life	
	2012	2011	2012	2011
Business operating profit	2,097	2,247	1,328	1,345
Revenues/(expenses) not included in BOP:				
Net capital gains/(losses) on investments and impairments, net of policyholder allocation	1,051	526	352	407
Net gain/(loss) on divestments of businesses	(38)	(5)	3	16
Restructuring provisions	(114)	(145)	(83)	(69)
Net income/(expense) on intercompany loans ¹	(21)	(49)	(2)	(14)
Other adjustments	22	(45) ²	(28)	(48) ³
Add back:				
Business operating profit attributable to non-controlling interests	52	(2)	142	35
Net income before shareholders' taxes	3,049	2,528	1,712	1,672
Income tax expense/(benefit) attributable to policyholders	–	–	194	(242)
Net income before income taxes	3,049	2,528	1,906	1,431
Income tax expense				
attributable to policyholders				
attributable to shareholders				
Net income after taxes				
attributable to non-controlling interests				
attributable to shareholders				

¹ The impact on Group level relates to foreign currency translation differences.² Includes USD 85 million as of December 31, 2011 of software impairments related to a restructuring program impacting several European countries (see notes 17 and 19).³ Includes USD 67 million related to a voluntary settlement of an insurance liability in Italy.

	Farmers		Other Operating Businesses		Non-Core Businesses		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
	1,348	1,438	(855)	(846)	200	89	4,118	4,273
	18	(12)	(128)	246	41	37	1,333	1,203
	-	-	1	(5)	-	-	(34)	6
	(1)	(9)	(11)	-	-	-	(209)	(222)
	-	-	23	65	-	-	-	2
	5	(1)	(55)	(86)	-	1	(56)	(178)
	66	48	(21)	-	1	1	241	82
	1,435	1,464	(1,046)	(625)	242	128	5,392	5,167
	-	-	-	-	-	-	194	(242)
	1,435	1,464	(1,046)	(625)	242	128	5,587	4,926
							(1,485)	(982)
							(194)	242
							(1,290)	(1,224)
							4,102	3,944
							139	72
							3,963	3,871

Consolidated financial statements *continued*

Assets and liabilities by business segment	General Insurance		Global Life	
	2012	2011	2012	2011
Assets				
Total Group Investments	89,557	84,514	113,311	104,649
Cash and cash equivalents	10,795	8,267	3,096	3,342
Equity securities	5,716	5,413	4,473	5,398
Debt securities	65,556	63,097	79,626	69,502
Real estate held for investment	2,827	2,911	5,334	5,130
Mortgage loans	1,460	1,472	7,934	8,177
Other loans	3,197	3,350	12,779	13,035
Investments in associates and joint ventures	7	6	69	65
Investments for unit-linked contracts	–	–	113,349	102,768
Total investments	89,557	84,514	226,660	207,418
Reinsurers' share of reserves for insurance contracts	13,901	13,660	1,983	2,079
Deposits made under assumed reinsurance contracts	46	71	29	19
Deferred policy acquisition costs	3,543	3,482	14,466	13,584
Deferred origination costs	–	–	770	824
Goodwill	852	827	435	413
Other intangible assets	1,375	1,484	4,366	4,856
Other assets ¹	15,642	14,934	6,669	7,167
Total assets (after cons. of investments in subsidiaries)	124,916	118,972	255,378	236,360
Liabilities				
Liabilities for investment contracts	–	–	58,131	50,958
Reserves for insurance contracts, gross	82,693	81,029	158,533	148,076
Reserves for losses and loss adjustment expenses, gross	66,542	64,311	–	39
Reserves for unearned premiums, gross	16,023	15,356	–	970
Future life policyholders' benefits, gross	96	92	78,718	75,432
Policyholders' contract deposits and other funds, gross	32	1,269	17,572	14,300
Reserves for unit-linked contracts, gross	–	–	62,243	57,337
Senior debt	6,625	5,354	289	466
Subordinated debt	617	1,038	334	333
Other liabilities ²	13,915	13,200	18,067	18,502
Total liabilities	103,850	100,621	235,354	218,335
Equity				
Shareholders' equity				
Non-controlling interests				
Total equity				
Total liabilities and equity				
Supplementary information				
Additions and capital improvements to property, equipment and intangible assets	331	368	150	176

¹ As of December 31, 2012 the General Insurance, the Global Life and Farmers segments included assets held for sale amounting to USD 36 million, USD 22 million and USD 31 million, respectively, relating to land and buildings formerly classified as real estate held for investment and the General Insurance segment also includes assets held for sale amounting to USD 10 million, relating to land and buildings formerly classified as real estate held for own use. As of December 31, 2011, the General Insurance and Global Life segments included assets held for sale amounting to USD 38 million and USD 17 million, respectively, relating to the sale of a company in Bolivia (see note 5).

² As of December 31, 2011, the General Insurance and Global Life segments included liabilities held for sale amounting to USD 41 million and USD 14 million, respectively, relating to the sale of a company in Bolivia (see note 5).

	Farmers		Other Operating Businesses		Non-Core Businesses		Eliminations		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	3,881	4,267	18,834	19,598	10,400	11,059	(27,522)	(26,644)	208,460	197,443
	377	580	8,545	8,809	2,135	2,209	(16,249)	(14,509)	8,699	8,697
	96	93	2,037	1,838	376	219	–	–	12,698	12,961
	1,274	1,295	4,707	4,563	5,911	6,795	(1,819)	(962)	155,255	144,289
	101	132	43	42	256	258	–	–	8,561	8,472
	–	–	–	–	–	–	–	–	9,394	9,649
	2,033	2,168	3,493	4,340	1,633	1,495	(9,455)	(11,174)	13,681	13,214
	–	–	9	6	89	84	–	–	172	161
	–	–	–	–	11,877	11,508	–	–	125,226	114,276
	3,881	4,267	18,834	19,598	22,277	22,566	(27,522)	(26,644)	333,687	311,719
	–	–	–	–	4,042	4,509	(174)	(656)	19,753	19,592
	2,319	2,141	–	–	194	508	–	(28)	2,588	2,711
	337	352	–	–	–	1	–	–	18,346	17,420
	–	–	–	–	–	–	–	–	770	824
	819	819	–	–	–	–	–	–	2,107	2,060
	1,407	1,434	300	286	–	–	–	–	7,447	8,061
	1,071	1,009	1,718	1,895	1,252	1,186	(2,102)	(1,909)	24,251	24,282
	9,834	10,023	20,852	21,778	27,766	28,771	(29,798)	(29,236)	408,948	386,668
	–	–	–	–	–	–	–	–	58,131	50,958
	2,841	2,728	36	39	21,303	21,972	(174)	(637)	265,233	253,207
	1,580	1,410	27	28	1,969	2,559	(131)	(586)	69,986	67,762
	1,262	1,318	4	4	20	22	(9)	(9)	17,300	17,661
	–	–	6	6	5,020	5,097	(33)	(42)	83,807	80,584
	–	–	–	–	2,420	2,787	–	–	20,024	18,356
	–	–	–	–	11,874	11,507	–	–	74,117	68,844
	214	125	24,581	22,827	1,838	2,134	(26,181)	(23,841)	7,366	7,065
	–	–	5,788	5,432	23	23	(901)	(1,350)	5,861	5,476
	1,325	1,635	2,060	3,343	2,977	2,719	(2,542)	(3,408)	35,801	35,990
	4,380	4,488	32,465	31,640	26,141	26,848	(29,798)	(29,236)	372,392	352,696
									33,885	31,229
									2,672	2,743
									36,556	33,972
									408,948	386,668
	120	171	150	124	–	–	–	–	751	840

Consolidated financial statements *continued*

Table 29.4

in USD millions, for the years ended December 31

General Insurance –
Revenues by region

	Gross written premiums and policy fees from external customers		of which Global Corporate	
	2012	2011	2012	2011
North America				
United States	12,223	11,494		
Canada	928	930		
Bermuda	10	–		
North America	13,160	12,424	3,343	2,838
Europe				
United Kingdom	3,899	3,878		
Germany	3,110	3,387		
Switzerland	3,243	3,408		
Italy	1,879	2,122		
Spain	1,438	1,671		
Rest of Europe	2,718	2,750		
Europe	16,287	17,215	4,279	4,150
Latin America				
Argentina	393	278		
Brazil	920	571		
Chile	470	270		
Mexico	600	291		
Venezuela	257	244		
Rest of Latin America	34	34		
Latin America	2,674	1,687	–	–
Asia-Pacific				
Australia	1,178	1,114		
Hong Kong	210	182		
Japan	780	736		
Taiwan	129	126		
Rest of Asia-Pacific	420	288		
Asia-Pacific	2,717	2,446	581	590
Middle East	183	118	121	80
Africa				
South Africa	460	539		
Morocco	125	130		
Africa	585	669	19	–
Total	35,607	34,559	8,342	7,659

General Insurance –
Non-current assets
by region

Table 29.5

in USD millions, as of December 31

	Property/equipment and intangible assets	
	2012	2011
North America		
United States	223	247
Canada	4	6
Bermuda	24	–
North America	252	254
Europe		
United Kingdom	213	199
Germany	210	210
Switzerland	593	589
Italy	34	49
Spain	346	501
Rest of Europe	605	609
Europe	2,001	2,158
Latin America		
Argentina	11	15
Brazil	234	207
Chile	34	32
Mexico	263	261
Venezuela	16	13
Rest of Latin America	5	5
Latin America	561	534
Asia-Pacific		
Australia	74	79
Hong Kong	13	6
Japan	27	33
Taiwan	9	18
Rest of Asia-Pacific	4	4
Asia-Pacific	128	140
Middle East	43	35
Africa		
South Africa	15	19
Morocco	32	31
Africa	46	50
Total	3,032	3,170

Consolidated financial statements *continued*

Table 29.6				
Global Life – Revenues by region	in USD millions, for the years ended December 31			
	Gross written premiums and policy fees from external customers		Life insurance deposits	
	2012	2011	2012	2011
North America				
United States	823	793	235	298
North America	823	793	235	298
Latin America				
Chile	900	348	–	–
Argentina	78	36	47	44
Bolivia	–	12	–	12
Mexico	352	73	–	–
Venezuela	65	57	–	–
Brazil	1,606	148	2,462	218
Uruguay	5	–	–	–
Latin America	3,005	674	2,508	274
Europe				
United Kingdom	1,773	1,539	6,339	6,359
Germany	2,920	3,273	1,966	2,234
Switzerland	2,047	1,964	141	106
Ireland ¹	479	573	2,497	2,036
Spain	906	1,344	163	1,560
Italy	408	361	488	841
Portugal	30	31	42	53
Austria	135	212	49	55
Europe	8,698	9,296	11,685	13,244
Asia-Pacific and Middle East				
Hong Kong	86	89	133	146
Taiwan	–	–	3	–
Indonesia	1	1	2	–
Australia	332	304	83	79
Japan	99	101	21	22
Malaysia	263	85	–	–
Zurich International Life ²	130	108	1,395	1,525
Asia-Pacific and Middle East	912	687	1,636	1,771
Other				
Luxembourg ¹	5	4	605	541
International Group Risk Solutions ³	92	66	–	–
Other	97	70	605	541
Total	13,535	11,520	16,670	16,127

¹ Includes business written under freedom of service and freedom of establishment in Europe.

² Mainly includes business written through licenses into Asia-Pacific and Middle East.

³ Includes business written through licenses into all regions.

Global Life –
Non-current assets
by region

Table 29.7

in USD millions, as of December 31

	Property/equipment and intangible assets	
	2012	2011
North America		
United States	165	174
North America	165	174
Latin America		
Chile	472	490
Argentina	96	113
Mexico	256	277
Brazil	965	1,156
Latin America	1,789	2,036
Europe		
United Kingdom	426	415
Germany	743	816
Switzerland	81	60
Ireland ¹	2	3
Spain	1,759	1,833
Italy	122	244
Austria	32	6
Europe	3,164	3,378
Asia-Pacific and Middle East		
Hong Kong	8	7
Indonesia	3	3
Japan	3	3
Singapore	1	–
Malaysia	124	109
Zurich International Life	20	5
Asia-Pacific and Middle East	158	127
Other		
Luxembourg ¹	4	4
Other	4	4
Total	5,280	5,719

¹ Includes assets relating to business written under freedom of services and freedom of establishment in Europe.

Consolidated financial statements *continued*

30. Significant subsidiaries

Significant subsidiaries	Table 30 as of December 31, 2012					Nominal value of common stock (in local currency millions)
	Domicile	Segment ¹	Voting rights %	Ownership interest %		
Australia						
Zurich Australia Limited	Sydney	Global Life	100	100	AUD	0.5
Zurich Australian Insurance Limited	Sydney	General Insurance	100	100	AUD	6.6
Zurich Financial Services Australia Limited	Sydney	General Insurance	100	100	AUD	22.8
Austria						
Zürich Versicherungs-Aktiengesellschaft	Vienna	General Insurance/ Global Life	99.98	99.98	EUR	12.0
Bermuda						
Centre Group Holdings Limited	Hamilton	Non-Core Businesses	100	100	USD	0.3
CMSH Limited	Hamilton	Non-Core Businesses	100	100	USD	0.3
ZCM Holdings (Bermuda) Limited	Hamilton	Non-Core Businesses	100	100	USD	137.0
Zurich International (Bermuda) Ltd.	Hamilton	General Insurance	100	100	USD	9.9
Brazil						
Zurich Santander Brasil Vida e Previdência S.A. ²	São Paulo	Life Insurance	51	51	BRL	1,659.2
Zurich Minas Brasil Seguros S.A.	Belo Horizonte	General Insurance/ Global Life	100	100	BRL	684.1
Chile						
Chilena Consolidada Seguros de Vida S.A.	Santiago	Global Life	98.98	98.98	CLP	24,484.0
Zurich Santander Seguros de Vida Chile S.A. ²	Santiago	Global Life	51	51	CLP	108,638.5
Cyprus						
Zurich Insurance Holding (Cyprus) Ltd. ³	Nicosia	General Insurance	100	100	RUB	5.6
Germany						
Deutscher Herold Aktiengesellschaft ⁴	Bonn	Global Life	79.83	79.83	EUR	18.4
Zürich Beteiligungs-Aktiengesellschaft (Deutschland)	Frankfurt	General Insurance	100	100	EUR	152.9
Zurich Deutscher Herold Lebensversicherung Aktiengesellschaft	Bonn	Global Life	86.37	86.37	EUR	68.5
Ireland						
Zurich Life Assurance plc	Dublin	Global Life	100	100	EUR	17.5
Zurich Insurance plc	Dublin	General Insurance	100	100	EUR	8.2
Zurich Holding Ireland Limited	Dublin	Other Operating Businesses	100	100	EUR	0.1
Italy						
Zurich Investments Life S.p.A.	Milan	Global Life	100	100	EUR	164.0
Zurich Life and Pensions S.p.A.	Milan	Global Life	100	100	EUR	40.5
Zurich Life Insurance Italia S.p.A.	Milan	Global Life	100	100	EUR	85.8
Luxembourg						
Zurich Eurolife S.A.	Bertrange	Global Life	100	100	EUR	27.0
Zurich Finance (Luxembourg) S.A.	Luxembourg	Other Operating Businesses	100	100	EUR	2.1
Malaysia						
Zurich Insurance Malaysia Berhad	Kuala Lumpur	General Insurance/ Global Life	100	100	MYR	579.0

Significant
subsidiaries
(continued)

Table 30

as of December 31, 2012

	Domicile	Segment ¹	Voting rights %	Ownership interest %	Nominal value of common stock (in local currency millions)	
Mexico						
Zurich Santander Seguros México, S.A. ²	Mexico City	General Insurance/ Global Life	51	51	MXN	190.0
South Africa						
Zurich Insurance Company South Africa Limited ⁵	Johannesburg	General Insurance	84.05	84.05	ZAR	3.0
Spain						
Bansabadell Pensiones, E.G.F.P, S.A.	Barcelona	Global Life	50	50	EUR	7.8
Bansabadell Seguros Generales, S.A. de Seguros y Reaseguros	Barcelona	General Insurance	50	50	EUR	10.0
Bansabadell Vida S.A. de Seguros y Reaseguros	Barcelona	Global Life	50	50	EUR	43.9
Zurich Latin America Holding S.L. – Sociedad Unipersonal ²	Barcelona	Other Operating Businesses	100	100	EUR	43.0
Zurich Santander Holding (Spain), S.L. ²	Madrid	Global Life	51	51	EUR	94.3
Zurich Santander Holding Dos (Spain), S.L. ²	Madrid	Global Life	51	51	EUR	40.0
Zurich Santander Insurance America, S.L. ²	Madrid	Global Life	51	51	EUR	177.0
Zurich Vida, Compañía de Seguros y Reaseguros, S.A. – Sociedad Unipersonal	Madrid	Global Life	100	100	EUR	56.4
Switzerland						
Genevoise Real Estate Company Ltd	Geneva	Global Life	100	100	CHF	20.4
Zurich Life Insurance Company Ltd ⁶	Zurich	Other Operating Businesses	100	100	CHF	60.0
"Zurich " Investment Management AG	Zurich	Other Operating Businesses	100	100	CHF	10.0
Taiwan						
Zurich Insurance (Taiwan) Ltd.	Taipei	General Insurance	99.73	99.73	TWD	2,000.0
Turkey						
Zurich Sigorta A.S.	Istanbul	General Insurance	100	100	TRY	147.8
United Kingdom						
Allied Zurich Holdings Limited	Jersey, Channel Islands	Other Operating Businesses	100	100	GBP	90.7
Eagle Star Insurance Company Limited	Fareham, England	Non-Core Businesses	100	100	GBP	25.0
Sterling ISA Managers Limited	Swindon, England	Global Life	100	100	GBP	92.9
Zurich Assurance Ltd	Swindon, England	Global Life	100	100	GBP	236.1
Zurich Financial Services (UKISA) Limited	Swindon, England	Other Operating Businesses	100	100	GBP	1,492.1
Zurich Holdings (UK) Limited	Fareham, England	Other Operating Businesses	100	100	GBP	137.3
Zurich International Life Limited	Douglas, Isle of Man	Global Life	100	100	GBP	105.6
Zurich Specialties London Limited	Fareham, England	Non-Core Businesses	100	100	GBP	150.0

Consolidated financial statements *continued*

Table 30

as of December 31, 2012

Significant subsidiaries (continued)

	Domicile	Segment ¹	Voting rights %	Ownership interest %	Nominal value of common stock (in local currency millions)	
United States of America						
Farmers Group, Inc. ⁷	Reno, NV	Farmers	87.90	95.38	USD	0.001
Farmers New World Life Insurance Company ⁷	Mercer Island, WA	Global Life	87.90	95.38	USD	6.6
Farmers Reinsurance Company ⁷	Los Angeles, CA	Farmers	87.90	95.38	USD	58.8
Farmers Services LLC ⁸	Wilmington, DE	Farmers	100	100	USD	–
Zurich American Corporation	Wilmington, DE	Non-Core Businesses	100	100	USD	0.00001
Zurich American Life Insurance Company	Schaumburg, IL	Non-Core Businesses	100	100	USD	2.5
ZFS Finance (USA) LLC V ⁸	Wilmington, DE	Other Operating Businesses	100	100	USD	–
Zurich American Insurance Company (and subsidiaries)	New York, NY	General Insurance	100	100	USD	5.0
Zurich Finance (USA), Inc.	Wilmington, DE	Other Operating Businesses	100	100	USD	0.000001
Zurich Holding Company of America, Inc.	Wilmington, DE	Other Operating Businesses	100	100	USD	0.02

¹ The segments are defined in the notes to the Consolidated financial statements, note 29, Segment information.

² Relates to Zurich Santander (see note 5).

³ Zurich Insurance Holding (Cyprus) Limited indirectly holds 99.9% of Zurich Insurance Company Limited in Russia which is a wholly owned subsidiary of the ZIC Group.

⁴ In addition buy out options exist which allow the minority shareholders to sell 15.17 percent of the shares of Deutscher Herold Aktiengesellschaft to the ZIC Group.

⁵ Listed on the Johannesburg Stock Exchange. On December 31, 2012, the company had a market capitalization of ZAR 3,04 billion (ISIN Number 000094496).

⁶ The results of the operating activities are included in the Global Life segment, whereas the headquarter's activities are included in Other Operating Businesses.

⁷ The ownership percentages in Farmers Group, Inc. and its fully owned subsidiaries have been calculated based on the participation rights of ZIC Group in a situation of liquidation, dissolution or winding up of Farmers Group, Inc.

⁸ These entities are LLCs and have no share capital.

31. Events after the balance sheet date

On February 26, 2013, the Zurich Insurance Group announced the successful placement of EUR 788 million of dated subordinated notes. The subordinated notes will mature in October 2043 and are first callable in October 2023. The transaction was primarily targeted at European institutional investors. The notes will be issued by Zurich Insurance Company Ltd. The annual coupon is fixed at 4.25% until the first call date. Thereafter, the holders of the notes will receive a floating coupon.

Report of the statutory auditor

Report of the Statutory Auditor

To the General Meeting of Zurich Insurance Company Ltd

Report of the statutory auditor on the Consolidated financial statements

As statutory auditor, we have audited the Consolidated financial statements of Zurich Insurance Company Ltd, which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of cash flows, consolidated statement of changes in equity, and notes (pages 16 to 50 and 53 to 165), for the year ended December 31, 2012.

Board of Directors' responsibility

The Board of Directors is responsible for the preparation and fair presentation of the Consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) and the requirements of Swiss law. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation and fair presentation of Consolidated financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these Consolidated financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards as well as the International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the Consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation and fair presentation of the Consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the Consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Consolidated financial statements for the year ended December 31, 2012 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.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO and article 11 AOA) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of Consolidated financial statements according to the instructions of the Board of Directors.

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

PricewaterhouseCoopers AG

Richard Burger
Audit expert
Auditor in charge

Stephen O'Hearn
Global relationship partner

Zurich, March 6, 2013

Financial statements – statutory accounts

Board of Directors and auditors, as of December 31, 2012

Board of Directors and auditors	Residence	Expiration of current term of office
Board of Directors		
Josef Ackermann, Chairman	Zurich, Switzerland	2015
Tom de Swaan, Vice Chairman	Amsterdam, Netherlands	2014
Susan Bies	Landrum, SC, USA	2013
Alison Carnwath	Devon, UK	2014
Victor L. L. Chu	Hong Kong, China	2013
Rafael del Pino	Madrid, Spain	2014
Thomas Escher	Uitikon, Switzerland	2015
Fred Kindle	London, UK	2014
Armin Meyer	Erlenbach, Switzerland	2013
Don Nicolaisen	Califon, NJ, USA	2015
Rolf Watter	Thalwil, Switzerland	2013
Adrian Peyer, Corporate Secretary		
Auditors		
PricewaterhouseCoopers Ltd		

Fritz Gerber is the Honorary Chairman of Zurich Insurance Company Ltd. He was chairman of Zurich Insurance Company Ltd between 1977 and 1995 and its Chief Executive Officer between 1977 and 1991. In recognition of his leadership and services to the Company, he was appointed Honorary Chairman. Such designation does not confer Board membership or any Director's duties or rights, nor does it entitle him to any Director's fees.

Principal activity and review of the year

Zurich Insurance Company Ltd (ZIC or the Company) was incorporated on November 1, 1872, and is the principal operating insurance company of the Zurich Insurance Group (the Group). As well as being an insurance company, it also acts as the holding company for all subsidiaries and other affiliates of the Group except for the Group's banking business.

The results of ZIC include the direct non-life business in Switzerland and its branches mainly located in Canada, Japan and Hong Kong as well as assumed reinsurance business from its subsidiaries.

With effect from January 1, 2012, ZIC merged with its former subsidiary ZG Investments Ltd., incorporated in Hamilton (Bermuda), absorbing all the assets and liabilities of this company as of January 1, 2012. In 2011, ZIC had already merged with its three former subsidiaries ZG Investments II Ltd., ZG Investments III Ltd. and ZG Investments IV Ltd., all incorporated in Hamilton (Bermuda).

Under its Euro Medium Term Note Programme (EMTN Programme), ZIC issued a 1.5% CHF 400 million senior note and a 3.375% EUR 500 million senior note in June 2012. A 8.25% USD 500 million perpetual capital note had been issued in January 2012.

At the General Meeting of shareholders on March 29, 2012, a dividend in the amount of CHF 2.4 billion was approved and paid out of retained earnings on April 5, 2012.

Financial statements – statutory accounts *continued*

Key figures	in CHF millions, for the years ended or as of December 31, respectively	2012	2011
		Gross written premiums and policy fees, direct business	4,551
Gross written premiums and policy fees, assumed reinsurance	16,511	14,903	
Total gross written premiums and policy fees	21,062	19,265	
Net written premiums and policy fees	18,310	16,917	
Net earned premiums and policy fees	18,192	16,329	
Insurance benefits and losses, net of reinsurance	(12,507)	(12,202)	
Underwriting and policy acquisition costs, administrative and other operating expense	(5,743)	(5,205)	
Underwriting result, net	(133)	(1,169)	
Net investment income	2,440	3,620	
Net income after taxes	2,085	2,425	
Total investments	71,047	70,185	
Insurance reserves, net	35,962	35,677	
Shareholder's equity (after proposed appropriation of available earnings)	17,396	17,511	

Net income after taxes

Net income after taxes decreased by CHF 340 million to CHF 2,085 million or by 14 percent. The underwriting result, net, increased by CHF 1.0 billion to a reduced loss of CHF 0.1 billion, due to a positive underwriting development. The net investment income decreased by CHF 1,180 million to CHF 2,440 million, mainly due to lower dividend income from investments in subsidiaries of CHF 1,218 million, which amounted to CHF 1,341 million compared with CHF 2,559 million in 2011. In 2012, the merger with ZIC's former subsidiary ZG Investments Ltd. resulted in a write-down of CHF 89 million. ZIC's 2011 merger with its former subsidiaries ZG Investments II Ltd., ZG Investment III Ltd. and ZG Investments IV Ltd. resulted in a write-down of CHF 263 million.

The combined ratio decreased by 6 percentage points to 101 percent in 2012. The reason for this improvement was a lower loss ratio whereas the expense ratio remained at the previous year's level.

Gross written premiums and policy fees

Gross written premiums and policy fees increased by CHF 1,797 million or 9 percent to CHF 21,062 million for the year ended December 31, 2012. In local currency, gross written premiums and policy fees increased by 6 percent.

Direct business gross written premiums and policy fees increased by 4 percent to CHF 4,551 million. Assumed reinsurance gross written premiums and policy fees increased by 11 percent or CHF 1,608 million to CHF 16,511 million mainly due to the participation change to the All Lines Quota Share reinsurance agreement with Farmers Exchanges.

Shareholder's equity

Shareholder's equity decreased by CHF 315 million to CHF 19,596 million as of December 31, 2012, from CHF 19,911 million as of December 31, 2011. The decrease was a result of the dividend paid of CHF 2,400 million in 2012, which was mainly offset by the net income after taxes.

Income statements

Income statements	in CHF millions, for the years ended December 31	Notes	2012	2011
Revenues				
	Gross written premiums and policy fees		21,062	19,265
	Less premiums ceded to reinsurers		(2,752)	(2,348)
	Net written premiums and policy fees		18,310	16,917
	Net change in reserves for unearned premiums		(118)	(588)
	Net earned premiums and policy fees		18,192	16,329
	Net investment income	4	2,440	3,620
	Net realized capital gains/losses, write-ups and write-downs on investments	5	499	651
	Other income	6	1,218	1,186
	Total revenues		22,348	21,786
Benefits, losses and expenses				
	Insurance benefits and losses, net of reinsurance	7	(12,507)	(12,202)
	Policyholder dividends and participation in profits, net of reinsurance		(111)	(89)
	Underwriting and policy acquisition costs, net of reinsurance		(4,812)	(4,398)
	Administrative and other operating expense		(931)	(807)
	Other expense	8	(1,088)	(1,101)
	Interest expense on debt		(666)	(552)
	Other interest expense		(28)	(59)
	Total benefits, losses and expenses		(20,143)	(19,208)
	Net income before taxes		2,205	2,578
	Taxes		(119)	(153)
	Net income after taxes		2,085	2,425

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

Financial statements – statutory accounts *continued*

Balance sheets

Assets	in CHF millions, as of December 31	Notes	2012	2011
Investments				
	Cash and cash equivalents		3,847	3,916
	Equity securities		2,387	2,113
	Debt securities		29,920	29,332
	Real estate		1,360	1,349
	Mortgage loans		1,268	1,309
	Other loans		2,670	2,170
	Investments in subsidiaries and associates	9	28,519	28,688
	Other investments		1,076	1,308
	Total investments		71,047	70,185
Other assets				
	Deposits made under assumed reinsurance contracts		3,877	3,950
	Accrued assets		747	551
	Receivables from agents and outstanding premiums		305	338
	Receivables from insurance and reinsurance companies		1,558	1,455
	Other receivables		1,130	1,242
	Furniture and equipment	10	59	71
	Intangible assets	11	573	623
	Other assets		21	67
	Total other assets		8,270	8,297
	Total assets		79,317	78,482

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

Liabilities and
shareholder's
equity

in CHF millions, as of December 31		Notes	2012	2011
Short-term liabilities				
Deposits received under ceded reinsurance contracts			529	544
Amounts due to reinsurance and other insurance companies			1,021	975
Prepaid premiums and other creditors			1,647	1,776
Bank overdrafts			115	15
Accrued liabilities			987	821
Other liabilities			750	743
Total short-term liabilities			5,048	4,874
Long-term liabilities				
Provisions	12		695	754
Senior debt	13		10,839	10,543
Subordinated debt	13		7,175	6,723
Total long-term liabilities			18,710	18,020
Insurance reserves, net	14		35,962	35,677
Total liabilities			59,721	58,571
Shareholder's equity (before appropriation of available earnings)				
Share capital (fully paid)	15		825	825
Profit sharing certificates			p.m.	p.m.
Legal reserves				
<i>General legal reserve</i>			485	485
<i>Capital contribution reserve</i>			5,570	5,570
General free reserve			4,272	4,272
Retained earnings:				
<i>Beginning of year</i>			8,759	7,835
<i>Dividend paid</i>			(2,400)	–
<i>Extraordinary dividend paid</i>			–	(1,500)
<i>Net income after taxes</i>			2,085	2,425
Retained earnings, end of year			8,444	8,759
Total shareholder's equity (before appropriation of available earnings)			19,596	19,911
Total liabilities and shareholder's equity			79,317	78,482

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

Financial statements – statutory accounts *continued*

Notes to the financial statements

1. Basis of presentation

The Company's financial statements are presented in accordance with the Swiss Code of Obligations and relevant insurance supervisory law.

All amounts in the financial statements, unless otherwise stated, are shown in CHF, rounded to the nearest million with the consequence that the rounded amounts may not add to the rounded total in all cases.

2. Summary of significant accounting policies

a) Investments

Equity securities which are quoted on a stock exchange are carried at the average stock exchange price during the month of December. Material holdings in quoted equity securities held for strategic reasons as well as unquoted equity securities are carried at a maximum of the acquisition cost with a deduction for necessary impairments.

Debt securities are carried at amortized cost using the effective interest rate method. Debt securities held by branches located outside Switzerland were valued at the lower of cost or market value. Starting in 2012, debt securities held by branches outside Switzerland are carried at amortized cost which leads to a non-recurring write-up in 2012.

Real estate held for investment and for own use is carried at local statutory values that are valid in the country where the real estate is located.

Investments in subsidiaries and associates are held at acquisition cost less necessary impairments.

Mortgage and other loans are valued at a maximum of their nominal value less any necessary impairments.

Derivative financial instruments held for economic hedging are carried at fair value.

Realized capital gains/losses on investments occur when the sale price or redemption value is higher or lower than the carrying value at the time of sale. The gain/loss is determined from the difference between carrying value and the sale price.

Write-downs and write-ups on investments include losses arising from a decrease in the fair value below cost or carrying value at the previous year end of equity securities and necessary impairments on debt securities and investments in subsidiaries and associates. Write-ups on investments are gains on quoted equity securities as a result of changes in the average stock exchange price during December and the lower book value at the beginning of the year. Write-ups also include gains as a result of the reversal of impairments on unquoted equity securities up to the acquisition cost value.

b) Accrued assets

This amount relates primarily to interest income accruals, other prepaid expenses and other accrued income.

c) Deposits made under assumed reinsurance contracts

Reinsurance deposits consist of funds deposited with ceding insurers to guarantee contractual liabilities for assumed reinsurance.

d) Insurance reserves

Reserves for losses and loss adjustment expenses represent reserves for reported claims and provisions for losses incurred but not yet reported (IBNR). In addition, equalization reserves are included where these are accepted by the regulator in the country where such reserves are held. 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. Any changes in estimates are reflected in the results of operations in the period in which estimates are changed.

Reserves for unearned premiums represent the portion of the premiums written relating to the unexpired term of insurance coverage as of the balance sheet date. In many insurance contracts, the insurance period for which the insurance company assumes a risk against a premium paid does not correspond to the Company's financial year. Thus, an amount equivalent to the unearned portion of the premium is set up as a reserve at the end of the financial year.

Financial statements – statutory accounts *continued*

3. Exchange rates

The presentation currency for ZIC and its branches is Swiss franc. Several ZIC branches operate outside Switzerland with different functional currencies. A functional currency is the currency of the primary economic environment in which the branch operates. Assets and liabilities of those branches with functional currencies other than Swiss franc are translated into the presentation currency at end-of-period exchange rates, except for investments in subsidiaries and associates where historical exchange rates are used. Revenues and expenses are translated using the average exchange rate of the year. The resulting exchange differences are recorded in income.

The table below summarizes the principal exchange rates that have been used for translation purposes.

Principal exchange rates	CHF per foreign currency unit	Balance sheets		Income statements	
		12/31/2012	12/31/2011	2012	2011
		Canadian dollar	0.92	0.92	0.94
Euro	1.21	1.22	1.21	1.23	
British pound	1.49	1.46	1.49	1.42	
US dollar	0.92	0.94	0.94	0.88	

4. Net investment income

Net investment income	in CHF millions, for the years ended December 31	2012	2011
		Cash and cash equivalents	17
Equity securities		56	26
Debt securities		814	827
Real estate		83	83
Mortgage loans		31	33
Other loans		103	73
Investments in subsidiaries and associates		1,341	2,559
Other investments		(6)	(11)
Total net investment income¹		2,440	3,620

¹ Total net investment income includes investment expenses of CHF 31 million and CHF 35 million for the years ended December 31, 2012 and 2011, respectively, reported under Other investments.

Total net investment income decreased by CHF 1,180 million or 33 percent to CHF 2,440 million in 2012. Dividend income from subsidiaries and associates decreased by CHF 1,218 million to CHF 1,341 million in 2012, as the Company's subsidiaries Zurich Holding Ireland Limited, Zürich Beteiligungs-Aktiengesellschaft (Deutschland) and Allied Zurich Holdings Limited did not pay any dividends in the year 2012. The net investment income for the other items remained mostly unchanged compared with 2011.

5. Net realized capital gains/losses, write-ups and write-downs on investments

Net realized capital gains/losses, write-ups/write-downs on investments	in CHF millions, for the years ended December 31							
	Realized capital gains		Realized capital losses		Write-ups and write-downs		Totals	
	2012	2011	2012	2011	2012	2011	2012	2011
Equity securities	112	117	(26)	(44)	62	(68)	147	4
Debt securities	618	327	(116)	(203)	374	–	876	123
Real estate	6	5	(1)	(5)	–	(7)	5	(6)
Other loans	–	–	(1)	–	–	–	(1)	–
Investments in subsidiaries and associates	–	13	–	(2)	(402)	(287)	(402)	(276)
Other investments	50	836	(176)	(31)	–	–	(127)	805
Total net realized capital gains/losses, write-ups and write-downs on investments	785	1,298	(321)	(285)	34	(363)	499	651

Realized capital gains decreased by 40 percent to CHF 785 million, and realized capital losses increased by 13 percent to CHF 321 million in 2012. In 2012, realized gains on debt securities increased by 89 percent to CHF 618 million due to a strategic portfolio reallocation. The decrease in realized capital gains on other investments from CHF 836 million in 2011 to CHF 50 million in 2012 is mainly due to lower realized capital gains on derivatives.

Write-ups and write-downs increased by CHF 397 million from a loss of CHF 363 million in 2011 to a gain of CHF 34 million in 2012. This increase is mainly driven by an extraordinary write-up of CHF 371 million on debt securities due to an accounting policy change in 2012. The write-down on investments in subsidiaries and associates of CHF 402 million in 2012 mainly includes a write-down of CHF 250 million on Zurich Holding Company of America, Inc., and a write-down of CHF 89 million in connection with the merger of ZGI Investments Ltd. In the previous year, the write-down in connection with several ZG Investment units amounted to CHF 263 million.

6. Other income

Other income includes interest income on reinsurance deposits as well as other technical and other non-technical income.

7. Insurance benefits and losses

Insurance benefits and losses	in CHF millions, for the years ended December 31	
	2012	2011
Loss payments, annuities and loss adjustment expenses, gross	(13,446)	(12,385)
Reinsurers' share	1,542	1,488
Loss payments, annuities and claims handling expenses, net	(11,904)	(10,897)
Change in reserves for losses and loss adjustment expenses, net	(602)	(1,305)
Total insurance benefits and losses, net of reinsurance	(12,507)	(12,202)

Total insurance benefits and losses increased by CHF 305 million to CHF 12,507 million mainly as a result of the participation increase to the All Lines Quota Share reinsurance agreement with Farmers Exchanges effective December 31, 2011. Storm Sandy impacted ZIC's insurance benefits and losses, net of reinsurance, negatively by CHF 369 million in 2012.

8. Other expense

Other expense includes foreign currency transaction gains and losses, other non-technical expenses, gains/losses on derivatives and amortization and impairments on software. Net results on foreign currency transactions amounted to a loss of CHF 267 million in 2012 compared with CHF 113 million in 2011. Other non-technical expenses increased by CHF 31 million to CHF 833 million compared with 2011. Gains/losses on derivatives amount to CHF 200 million which is CHF 139 million higher than 2011. Amortization/impairments on software reduced by CHF 58 million to CHF 188 million compared with 2011.

Financial statements – statutory accounts *continued*

9. Investments in subsidiaries and associates

The table below shows the significant subsidiaries of ZIC with a carrying value of at least CHF 500 million and/or net income exceeding CHF 100 million. The carrying value of the listed subsidiaries and associates represents 88 percent of the total investments in subsidiaries and associates of CHF 28,519 million.

Significant subsidiaries	as of December 31, 2012				Nominal value of common stock (in local currency millions)
	Domicile	Voting rights %	Ownership interest %		
Bermuda					
CMSH Limited	Hamilton	100	100	USD	0.3
Zurich International (Bermuda) Ltd.	Hamilton	100	100	USD	9.9
Cyprus					
Zurich Insurance Holding (Cyprus) Ltd ¹	Nicosia	100	100	RUB	5.6
Germany					
Zürich Beteiligungs-Aktiengesellschaft (Deutschland)	Frankfurt/Main	82.6	82.6	EUR	152.9
Ireland					
Zurich Holding Ireland Limited	Dublin	100	100	EUR	0.1
Zurich Insurance plc	Dublin	4.5	4.5	EUR	8.2
Italy					
Zurich Investments Life S.p.A. ²	Milan	100	100	EUR	164.0
Switzerland					
Zurich Life Insurance Company Ltd	Zurich	100	100	CHF	60.0
United Kingdom					
Allied Zurich Holdings Limited	Jersey, Channel Islands	100	100	GBP	90.7
Zurich International Life Limited	Isle of Man	100	100	GBP	35.6
United States of America					
Farmers Group, Inc. ³	Reno, NV	87.9	95.4	USD	0.0
Zurich Holding Company of America, Inc.	Wilmington, DE	99.2	99.2	USD	0.0

¹ In 2011 nominal value of common stock was RUB 4.0 million.

² In 2011 nominal value of common stock was EUR 74.0 million.

³ The ownership percentage in Farmers Group, Inc. has been calculated based on the participation rights of ZIC in a situation of liquidation, dissolution or winding up of Farmers Group, Inc.

10. Furniture and equipment

		2012	2011
Furniture and equipment	in CHF millions, as of December 31		
	Furniture and equipment	325	330
	Accumulated amortisation	(266)	(259)
	Total furniture and equipment	59	71

The decrease in furniture and equipment is mainly due to lower expenditures in Switzerland.

11. Intangible assets

		2012	2011
Intangible assets	in CHF millions, as of December 31		
	Brand names, patents, trademarks etc.	156	213
	Software	417	410
	Total intangible assets	573	623

The decrease in brand names, patents and trademarks resulted from regular amortization charges in the year.

12. Provisions

This position consists mainly of provisions to cover obligations relating to administrative and sales staff. These reserves were created in view of expected, estimated or perceived expenditures or exposures.

13. Debt

a) Senior debt

		2012	2011	
Senior debt	in CHF millions, as of December 31			
	Issuances to capital markets under Euro Medium Term Note Programme	3.375% EUR 500 million, due June 2022	603	–
	Issuances to capital markets under Euro Medium Term Note Programme	2.375% CHF 525 million, due November 2018	525	525
	Issuances to capital markets under Euro Medium Term Note Programme	3.75% CHF 500 million, due September 2013	500	500
	Issuances to capital markets under Euro Medium Term Note Programme	2.25% CHF 500 million, due July 2017	500	500
	Issuances to capital markets under Euro Medium Term Note Programme	1.5% CHF 400 million, due June 2019	400	–
	Issuances to capital markets under Euro Medium Term Note Programme	2.875% CHF 250 million, due July 2021	250	250
	Senior debt with Zurich Insurance Group	various	8,061	8,768
	Total senior debt		10,839	10,543

Financial statements – statutory accounts *continued*

b) Subordinated debt

Subordinated debt		2012	2011
in CHF millions, as of December 31			
Zurich Insurance Group Ltd	6.30% CHF 4,832 million perpetual loan	4,832	4,832
Issuances to capital markets under Euro Medium Term Note Programme	4.25% CHF 700 million perpetual notes, first call date May 26, 2016	700	700
Issuances to capital markets under Euro Medium Term Note Programme	7.5% EUR 425 million subordinated notes, first call date July 24, 2019, due July 2039	513	517
Issuances to capital markets under Euro Medium Term Note Programme	4.625% CHF 500 million perpetual notes, first call date May 16, 2018	500	500
Issuances to capital markets under Euro Medium Term Note Programme	8.25% USD 500 million perpetual capital notes, first call date January 18, 2018	457	–
Issuances to capital markets under Euro Medium Term Note Programme	12% EUR 143 million perpetual capital notes, first call date July 15, 2014	173	174
Total subordinated debt		7,175	6,723

14. Insurance reserves gross and ceded

Insurance reserves		2012	2011
in CHF millions, as of December 31			
Gross			
Reserves for losses and loss adjustment expenses		31,011	30,061
Reserves for unearned premiums		5,229	5,137
Future life policyholders' benefits		5,478	5,607
Policyholders' contract deposits and other funds		5	1,069
Reserve for premium refunds and other insurance reserves		479	421
Total insurance reserves, gross		42,202	42,296
Ceded			
Reserves for losses and loss adjustment expenses		(5,182)	(5,672)
Reserves for unearned premiums		(964)	(849)
Future life policyholders' benefits		(94)	(96)
Policyholders' contract deposits and other funds		–	(2)
Total insurance reserves, ceded		(6,240)	(6,618)
Net			
Reserves for losses and loss adjustment expenses		25,829	24,389
Reserves for unearned premiums		4,265	4,289
Future life policyholders' benefits		5,384	5,511
Policyholders' contract deposits and other funds		5	1,067
Reserve for premium refunds and other insurance reserves		479	421
Total insurance reserves, net		35,962	35,677

Total insurance reserves, net, increased by 1 percent to CHF 35,962 million, mainly due to decreases in the insurance reserves of ceded business. The decrease in policyholders' contract deposits and other funds, net, is due to the reclassification of the reserves for non-life annuities, which amounted to CHF 1,064 million as of December 31, 2011. These reserves are in 2012 disclosed under the reserves for losses and loss adjustment expenses, net.

15. Share capital

Share capital and profit sharing certificates	number of shares, as of December 31	
	2012	2011
Contingent and issued share capital, CHF 10 par value	86,000,000	86,000,000
Issued share capital, CHF 10 par value	82,500,000	82,500,000
Profit sharing certificates (Genussscheine) ¹	2	2

¹ These profit sharing certificates confer on their holder the right to receive a dividend if and to the extent the General Meeting decides. However, they do not confer on their holder any voting rights or rights associated thereto, any rights to subscribe for new shares, or any rights to liquidations proceeds.

a) Issued share capital

As of December 31, 2012 and 2011, ZIC had issued share capital of CHF 825,000,000, consisting of 82,500,000 issued and fully paid registered shares of CHF 10 par value each.

b) Contingent share capital

At the General Meeting of Shareholders on June 11, 1997, contingent share capital of CHF 35,000,000, or 3,500,000 shares with a par value of CHF 10 each, was created, of which 2,500,000 shares can be issued in connection with the granting of conversion and/or option rights, and 1,000,000 shares can be issued for the purpose of employees' share ownership plans. None of the contingent shares have been issued as of December 31, 2012.

c) Profit sharing certificates

As of December 31, 2012 and 2011, ZIC had issued two profit sharing certificates with no par value.

d) Shareholders

As of December 31, 2012 and 2011, 100 percent of the registered shares of Zurich Insurance Company Ltd were owned by Zurich Insurance Group Ltd.

16. Assets and liabilities relating to companies within the Zurich Insurance Group

Assets and liabilities relating to companies within the Zurich Insurance Group	in CHF millions, as of December 31	
	2012	2011
Assets¹		
Cash and cash equivalents	1,566	2,068
Debt securities	14	14
Other loans	2,481	2,083
Other investments	368	312
Deposits made under assumed reinsurance contracts	1,628	1,818
Accrued assets	241	227
Receivables from agents and outstanding premiums	1	2
Receivables from insurance and reinsurance companies	872	842
Other receivables	299	327
Total assets	7,470	7,693
Liabilities²		
Deposits received under ceded reinsurance contracts	1	2
Amounts due to reinsurance and other insurance companies	662	684
Prepaid premiums and other creditors	369	274
Accrued liabilities	320	337
Other liabilities	449	433
Senior debt	8,061	8,768
Subordinated debt	4,832	4,832
Insurance reserves, net	26,742	26,178
Total liabilities	41,436	41,508

¹ The amounts receivable from Zurich Insurance Group Ltd in 2012 are CHF 4 million compared with CHF 206 million in 2011.

² The amounts due to Zurich Insurance Group Ltd in 2012 are CHF 5,686 million compared with CHF 5,535 million in 2011.

Financial statements – statutory accounts *continued*

17. Supplementary information

Supplementary information	in CHF millions, as of December 31	
	2012	2011
Guarantees, indemnity liabilities and pledges in favor of third parties	24,025	24,539
Pledged assets in respect of securities lending agreements (at book value)	2,393	2,459 ¹
Leasing obligations not recorded on the balance sheet	48	57
Security deposits	12,536	12,283
Fire insurance value of real estate, furniture and equipment	2,165	2,170
Personnel expenses (included in underwriting and policy acquisition costs, administrative and expense lines of the income statements)	1,091	1,021

¹ Pledged assets in respect of securities lending agreements disclosed at market value in 2011 (CHF 2,571 million).

Guarantees, indemnity liabilities and pledges in favor of third parties include three guarantees of USD 3,000 million (CHF 2,745 million) each in favor of subsidiaries to provide funds under certain circumstances. The total maximum exposure under these guarantees amounted to USD 1,419 million (CHF 1,298 million) as of December 31, 2012, and USD 2,412 million (CHF 2,261 million) as of December 31, 2011.

In addition to the guarantees listed above, the Company has provided unlimited guarantees in support of various subsidiaries belonging to the Zurich Insurance Group.

According to regulatory requirements, as of December 31, 20 percent of total investments are attributed to tied assets for both 2012 and 2011.

To secure the insurance reserves of the assumed reinsurance business, investments with a value of CHF 12,536 million and CHF 12,283 million as of December 31, 2012 and 2011, respectively, were deposited in favor of ceding companies.

18. Net release of hidden reserves

There has been no material net release of hidden reserves in 2012.

19. Information on the risk assessment process

Refer to the disclosures in the Risk Review on pages 15 to 50 of this Annual Report.

20. Subsequent events

On February 26, 2013, the Group announced the successful placement of dated subordinated notes in an amount of EUR 788 million. The subordinated notes will mature in October 2043 and are first callable in October 2023. The transaction was primarily targeted at European institutional investors.

Appropriation of available earnings as proposed by the Board of Directors

as of December 31	2012	2011
Dividend-paying registered shares		
Dividend-paying shares	82,500,000	82,500,000

in CHF, as of December 31	2012 (Proposed)	2011 (Approved)
Appropriation of available earnings as proposed by the Board of Directors		
Balance brought forward	6,359,114,314	7,834,583,115
Extraordinary dividend paid	–	(1,500,000,000)
Net income after taxes	2,085,369,525	2,424,531,199
Available earnings	8,444,483,839	8,759,114,314
Dividend	(2,200,000,000)	(2,400,000,000)
Balance carried forward	6,244,483,839	6,359,114,314

The Board of Directors proposes to the shareholder at the Annual General Meeting on April 4, 2013, to pay out a dividend of CHF 2,200,000,000 and to carry forward available earnings of CHF 6,244,483,839 as shown in the above table.

As the general reserves (consisting of the general legal reserve and the capital contribution reserve) exceed 100 percent of fully paid-in share capital, no further allocation to the general reserves is required by Swiss Code of Obligations and article 28a of the Company's articles of incorporation.

On behalf of the Board of Directors of Zurich Insurance Company Ltd

Dr. Josef Ackermann

Chairman

Zurich, March 6, 2013

Report of the statutory auditor

Report of the Statutory Auditor

To the General Meeting of Zurich Insurance Company Ltd, Zurich

As statutory auditor, we have audited the financial statements of Zurich Insurance Company Ltd, which comprise the income statement, balance sheet and notes (pages 171 to 182), for the year ended December 31, 2012.

Board of Directors' responsibility

The Board of Directors is responsible for the preparation of the financial statements in accordance with the requirements of Swiss law and the Company's articles of incorporation. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements for the year ended December 31, 2012, comply with Swiss law and the Company's articles of incorporation.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of financial statements according to the instructions of the Board of Directors.

We further confirm that the proposed appropriation of available earnings (page 183) complies with Swiss law and the Company's articles of incorporation. We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers Ltd

Richard Burger

Emel Can-Harrison

Audit expert

Audit expert

Auditor in charge

Zurich, March 6, 2013

Key data of Zurich Insurance Company Ltd

Key data of Zurich Insurance Company Ltd

Key data 2003–2012	in CHF millions, for the years ended or as of December 31, respectively	2012	2011
	Gross written premiums and policy fees, direct business	4,551	4,362
	Gross written premiums and policy fees, assumed reinsurance	16,511	14,903
	Total gross written premiums and policy fees	21,062	19,265
	Net written premiums and policy fees	18,310	16,917
	Net earned premiums and policy fees	18,192	16,329
	Insurance benefits and losses, net of reinsurance	(12,507)	(12,202)
	Underwriting and policy acquisition costs, administrative and other operating expense	(5,743)	(5,205)
	Underwriting result, net	(133)	(1,169)
	Net investment income	2,440	3,620
	Net income after taxes	2,085	2,425
	Dividend	2,200 ¹	2,400
	Dividend per share, nominal value CHF 10.– (in Swiss francs)	26.67 ¹	29.09
	Total investments	71,047	70,185
	Insurance reserves, net	35,962	35,677
	Shareholder's equity (after proposed appropriation of available earnings)	17,396	17,511

¹ Proposed

² Restated figures, implementation of new and revised accounting standards in 2005, in particular applying new definitions of insurance contracts.

	2010	2009	2008	2007	2006	2005 ²	2004	2003
	4,511	6,625	11,410	12,252	26,770	25,511	23,337	22,351
	18,951	18,400	15,195	13,164	333	305	305	484
	23,462	25,025	26,605	25,415	27,103	25,816	23,642	22,835
	21,126	22,497	24,063	22,645	22,695	21,088	19,772	18,770
	20,401	21,512	22,869	22,504	22,768	21,371	19,759	18,388
	(14,231)	(15,663)	(17,172)	(16,395)	(15,631)	(16,061)	(13,858)	(13,570)
	(6,120)	(6,376)	(6,331)	(6,392)	(5,848)	(5,242)	(4,929)	(4,962)
	(61)	(737)	(714)	(222)	1,247	82	615	(510)
	4,287	2,318	3,967	4,173	2,910	2,067	2,268	2,125
	4,141	1,790	656	1,401	2,437	969	1,048	524
	–	–	–	1,900	1,300	–	–	–
	–	–	–	23.03	15.76	–	–	–
	68,948	70,962	78,520	73,179	72,013	64,177	55,459	50,249
	33,886	38,314	43,729	45,275	42,651	38,856	32,647	30,690
	18,986	14,844	11,805	8,929	9,428	8,291	7,322	6,274

Disclaimer and cautionary statement

Certain statements in this document are forward-looking statements, including, but not limited to, statements that are predicated on or indicate future events, trends, plans or objectives of Zurich Insurance Company Ltd or the Zurich Insurance Company Group (ZIC Group). Forward-looking statements include statements regarding ZIC Group's targeted profit, return on equity targets, expenses, pricing conditions, dividend policy and underwriting and claims results, as well as statements regarding ZIC Group's understanding of general economic, financial and insurance market conditions and expected developments. 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 plans and objectives of Zurich Insurance Company Ltd or ZIC Group 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 key markets; (ii) the risk of a global economic downturn; (iii) performance of financial markets; (iv) levels of interest rates and currency exchange rates; (v) frequency, severity and development of insured claims events; (vi) mortality and morbidity experience; (vii) policy renewal and lapse rates; and (viii) changes in laws and regulations and in the policies of regulators may have a direct bearing on the results of operations of Zurich Insurance Company Ltd and ZIC Group and on whether the targets will be achieved. Zurich Insurance Company Ltd 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.

All references to "Farmers Exchanges" mean Farmers Insurance Exchange, Fire Insurance Exchange, Truck Insurance Exchange and their subsidiaries and affiliates. The three Exchanges are California domiciled interinsurance exchanges owned by their policyholders with governance oversight by their Boards of Governors. Farmers Group, Inc. and its subsidiaries are appointed as the attorneys-in-fact for the Farmers Exchanges and in that capacity provide certain non-claims administrative and management services to the Farmers Exchanges. Neither Farmers Group, Inc., nor its parent companies, Zurich Insurance Company Ltd and Zurich Insurance Group Ltd, have any ownership interest in the Farmers Exchanges. Financial information about the Farmers Exchanges is proprietary to the Farmers Exchanges, but is provided to support an understanding of the performance of Farmers Group, Inc. and Farmers Reinsurance Company.

It should be noted that past performance is not a guide to future performance. Persons requiring advice should consult an independent advisor.

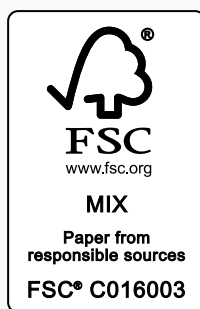
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