Zurich Life Insurance Company Ltd

Financial Condition Report 2017

Zurich Life Insurance Company Ltd

Contents[1]

[1] The SST calculation for the year ended December 31, 2017, have been filed with FINMA in the 2018 SST reporting on April 30, 2018. In line with the normal timeline for FINMA reporting, the ZLIC 2018 SST reporting remains subject to regulatory review. The restated SST calculation for the year ended December 31, 2016 has not been subject to further regulatory review by FINMA.

All amounts are shown in Swiss francs 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 amounts rather than the rounded amounts.

This footnote has been amended on July 25, 2018 to clarify the scope of FINMA's regulatory review of SST calculation.

Overview

Business profile

Zurich Life Insurance Company (ZLIC), a life insurance company domiciled in Zurich, Switzerland, is operating primarily in Switzerland and through its main branches in Japan, Hong Kong and Dubai. ZLIC is 100 percent owned by Zurich Insurance Company Ltd (ZIC), which in turn is fully owned by ZIG.

CHF 1.9 billion Gross written premiums (GWP) and policy fees

CHF 276 million Operating result

CHF 21.8 billion Total investments

System of governance

ZLIC has a strong corporate governance framework implemented in it's daily business, which enables ZLIC to create sustainable value for all its stakeholders.

Our enterprise risk management framework (ERM) supports achievement of ZLIC's strategy and helps protect our policyholder, capital, liquidity, earnings and reputation.

Risk profile

Taking risk is inherent to the insurance business, but such risk taking needs to be made in an informed and disciplined way, and within a pre-determined risk appetite and tolerance. This is the primary objective of Zurich's risk management.

We use our Total Risk Profiling™ process to monitor both external and internal risks to our strategy and financial plan. Among the risks we identified in 2017 were uncertainties related to macroeconomic developments, reserve adequacy, cyber risk (data protection and security), and risks to execution of our business transformation plan.

The significant risks for ZLIC, as measured by economic capital metrics, are market risk including credit risk, biometric risks and business risks.

Financial condition

CHF 2.6 billion Total shareholder's equity

251% Swiss Solvency Test ratio as of December 31, 2017

Acronyms

AG	Aktiengesellschaft
AGM	Annual General Meeting
ALM	asset liability management
ALMIC	Asset Liability Management and Investment Committee
ARC	Audit & Risk Committee
Board	Board of Directors
bn	billion
BU	business unit
BVG	Occupational Retirement, Survivors' and Disability Provision
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CHF	Swiss franc
CLP	Corporate Life & Pension
Company	Zurich Life Insurance Company Ltd
CRO	Chief Risk Officer
ERM	Enterprise Risk Management
EUR	Euro
FCR	Financial Condition Report
FINMA	Financial Market Supervisory Authority
GA	Group Audit (internal audit)
GBP	Great Britain pound
Group	Zurich Insurance Group Ltd and its subsidiaries
GWP	gross written premium and policy fees
HR	Human Resources
IFSR	Insurer Financial Strength Rating
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IMEP	internal model enhancement process
ISA	Swiss Insurance Supervision Act
ISL	Swiss Insurance Supervision Law
ISO	Swiss Insurance Supervision Ordinance
IT	information technology
JV	joint-venture
LEM	loss event management
Ltd	limited
m	million
MCBS	market consistent balance sheet
MCEV	market consistent embedded value
MVM	market value margin
ORSA	Own Risk and Solvency Assessment
PwC	PricewaterhouseCoopers AG
Q	quarter
SAA	strategic asset allocation
SAV	Swiss Association of Actuaries
SCAF	Supplier Compliance Assurance Framework
SFCR	Solvency & Financial Conditions Report
SNB	Swiss National Bank
SIA	Swiss Insurance Association
SST	Swiss Solvency Test
TDS	top-down scenario
TRP	Total Risk Profiling™
TVOG	time value of options and guarantees
USD	U.S. dollar
ZBAG	Zürich Beteiligungs-Aktiengesellschaft (Deutschland) AG
ZEL	Zurich Eurolife S.A., Luxembourg
ZGEBS	Zurich Global Employee Benefits Solutions
ZIC	Zurich Insurance Company Ltd
ZICS	Zurich International Corporate Solutions
ZIG	Zurich Insurance Group Ltd (holding company)
ZIGRS	Zurich International Group Risk Solutions
ZILL	Zurich Insurance Life Ltd
ZIMRE	Zurich IMRE AG
ZIP	Zurich Insurance plc
ZLIC	Zurich Life Insurance Company Ltd
ZRP	Zurich Risk Policy
Zurich	Zurich Insurance Group

Introduction

Introduction

Zurich Life Insurance Company Ltd's (ZLIC) financial condition report is prepared in compliance with art. 111a Swiss Insurance Supervision Ordinance (ISO) and FINMA's Circular 2016/2 'Disclosure - insurers' and is not audited. The report focuses on the 2017 financial year, and should be read in conjunction with ZLIC's annual report 2017 (available on: www.zurich.com/en/investor-relations/results-and-reports/other-statutory-filings). Wherever applicable, this report makes reference to the Zurich Insurance Group's Financial Condition Report or the Zurich Insurance Group's Annual Report refer to these reports for more information.

The ZLIC FCR is a standalone report reflecting the actual situation of ZLIC. The results thereof will be consolidated into the Zurich Insurance Group Financial Condition Report.

1. Executive summary

The Financial Condition Report was produced in accordance with FINMA Circular 2016/2 Public Disclosure for Insurers: Fundamental principles in reporting the financial position. The management summary provides general insights and focuses on important developments in 2017, but also gives background information and explanations where necessary.

Business activities

ZLIC is part of the Zurich Insurance Group which maintains a strong capital position. As of December 31, 2017, the Insurer Financial Strenght Rating (IFSR) of Zurich Insurance Company (ZIC) was rated 'AA-/Stable' by Standard and Poor's, 'Aa3/ Stable' by Moody's and 'A+(Superior)/Stable by A.M. Best. Furthermore, Zurich Insurance Group filed with FINMA an SST ratio of 216 percent as of January 1, 2018. The European Commission granted Switzerland and its SST requirements full equivalence relative to the Solvency II regulation in 2015 for an indefinite period.

ZLIC serves two main customer segments (individual life insurance called 'Retail', and Corporate Life & Pensions) operating primarily in Switzerland with branches in Japan, Hong Kong and Dubai.

Performance

ZLIC reported a net income after taxes of CHF 276 million in 2017, which is an increase of CHF 242 million compared to the prior year's result of CHF 34 million. Key drivers for the increase were strengthening of technical reserves in the prior year not recurring in 2017 and realized capital gains from real estate sales.

GWP decreased by 6 percent to CHF 1.8 billion compared to 2016 mainly driven by the strategic decision to transfer our international corporate life business managed by ZICS (Zurich International Corporate Solutions) and ZGEBS (Zurich Global Employee Benefits Solutions) to Zurich Insurance Company Ltd (ZIC) in order to further simplify the legal structure of ZLIC.

Investment income increased by CHF 393 million or 50 percent to CHF 1.2 billion in 2017 from CHF 788 million in 2016, mainly due to an increase in write-ups on debt securities and due to increased realized capital gains on real estate.

Corporate governance & risk management

Several governance bodies exist in ZLIC with the aim of ensuring sufficient oversight of ZLIC. In line with legal and regulatory requirements, ZLIC has a Board of Directors (Board), an Audit & Risk Committee (ARC) at Board level, and a Management Board. These bodies meet regularly to ensure appropriate oversight and control (including activities on branch/business and subsidiary level). There are also quarterly branch/business oversight meetings to support the oversight and control process on a Board and Management Board level.

Introduction *continued*

ZLIC has established an approach on three lines of defense aimed at clearly identifying, assessing, owning, and managing risks.

- As the first line of defense, business management (the Board and Management Board) engages in risk taking through business activities and is responsible for day-to-day risk management.
- The risk management function (the second line of defense) oversees the overall risk management framework, and also helps manage risk. Issues, when they arise, based on their relevance, are escalated to the Management Board and the Board. ZLIC's Risk Appetite Statement establishes risk limits. Compliance also has a specialist function within the second line of defense ensuring adherence to laws and regulation and internal guidelines. For certain risks, for which there is zero or very low tolerance, Compliance provides specialized assistance to the risk owner(s) through risk-specific policies, risk evaluations, process and control analysis and advice, training and awareness, designing controls and monitoring operations.
- Internal audit (the third line of defense) provides independent assurance regarding the effectiveness of the Enterprise Risk Management (ERM) framework, risks and controls.

Other governance and control functions, such as Legal and Actuarial, help business management to manage and control specific types of risks.

An internal control system is in place to reveal issues and inefficiencies.

Risk profile and Solvency

FINMA established the Swiss Solvency Test (SST) to quantitatively measure risk. ZLIC files the SST ratio annually with FINMA. ZLIC's largest risk is market risk, which constitutes approximately 46 percent of the total risk of CHF 2.9 billion target capital. Morbidity is an emerging risk in line with growth in portfolios in Switzerland and Japan. There is also longevity risk related to Swiss annuities. Once a year, ZLIC's key risks including operational risks are also assessed during a risk assessment (TRP) session. Mitigation actions are defined and tracked, where necessary.

For the reporting of SST, assets and liabilities are valued on a market consistent basis and are then matched to calculate the risk-bearing capital in ZLIC's market consistent balance sheet (MCBS). In 2017 the risk-bearing capital for ZLIC increased by CHF 1.4 billion compared with 2016.

ZLIC's capital management is governed by SST and tied asset requirements, which ZLIC follows in accordance to FINMA guidelines. For tied assets, reserves are calculated on a prudent statutory basis.

ZLIC's SST ratio increased from 199 percent on December 31, 2016 to 251 percent on December 31, 2017. Despite a continued low-interest rate environment, ZLIC's capitalization remains strong as measured by SST. The increased SST ratio was driven by a combination of favourable economic variance, strong value creation from new business, positive assumption changes and benign operating experience variance.

The data, methods, and results of the Swiss Solvency Test for ZLIC are produced in accordance with the Insurance Supervision Ordinance (ISO, art. 41 seqq.). ZLIC's SST is calculated using the SST Opt-In standard model.

Dividend

ZLIC did not pay any dividends in 2017. ZLIC Annual General Meeting (AGM), that took place on April 10, 2018, decided to distribute 1) a dividend in kind consisting of two 100 percent owned investments in subsidiaries, Zurich Vida, Compañía de Seguros y Reaseguros, SA (Spain Life Company) and Zurich Latin America Holding SL (LatAm Holding Company), of the 90 percent interest in Zurich Eurolife SA (Luxembourg Life Company) as well as of 99.99 percent of ZLIC's shares of Zurich Companhia de Seguros Vida SA (Portugal Life Company) in order to achieve ZLIC's strategic objective to predominantly focus on life business in the Swiss market and 2) a further cash dividend of CHF 200 million. Both components of the dividend were reflected in the SST solvency ratio.

2. Approval of the Financial Condition Report

The 2017 ZLIC FCR was reviewed by the ZLIC Chief Financial Officer (CFO) and ZLIC Chief Executive Officer (CEO), reviewed by ZLIC's Management Board and ZLIC's Audit & Risk Committee and then approved by the Board.

A. Business activities

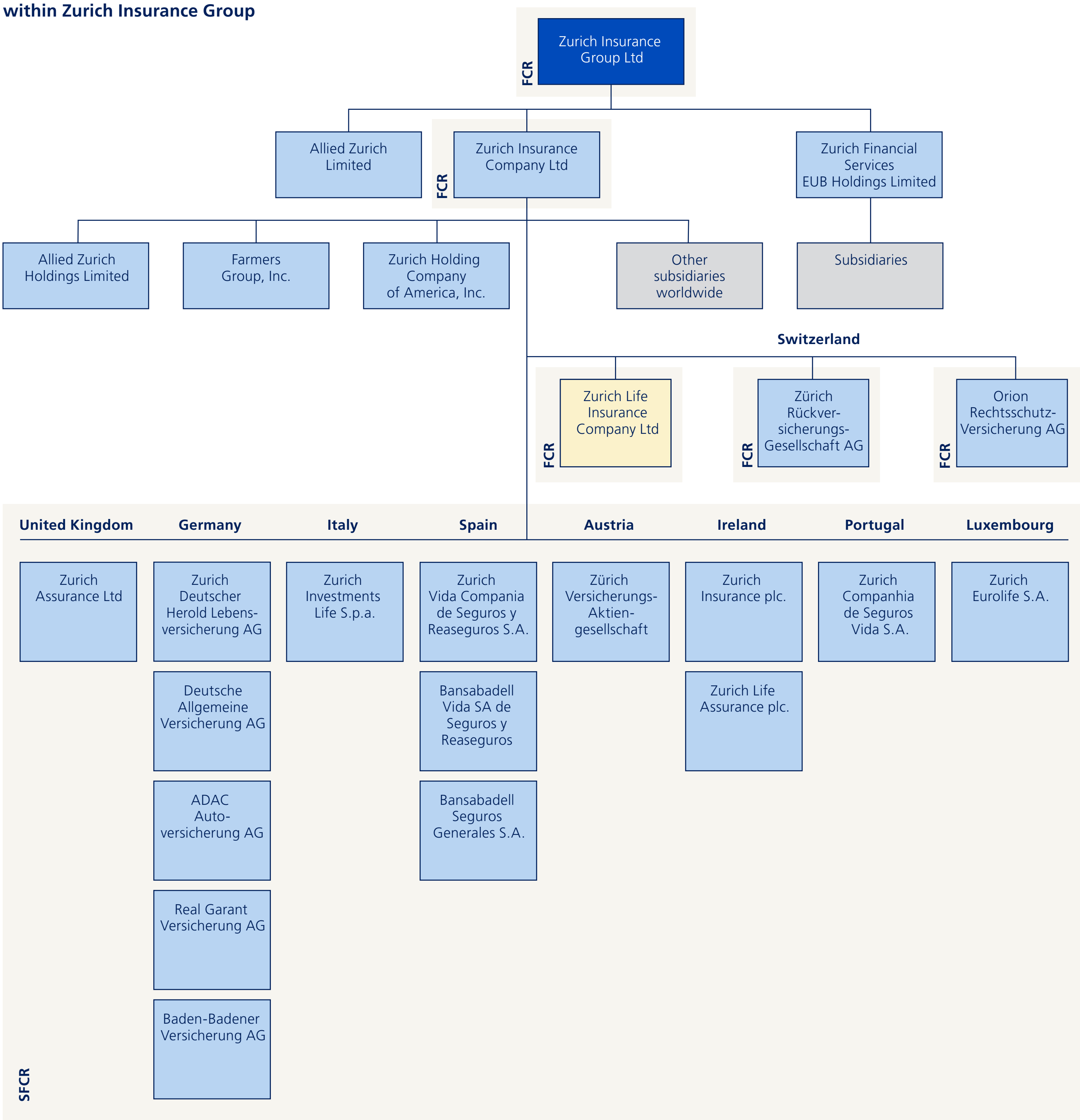
A.1 Legal structure and major subsidiaries and branches

ZLIC is part of the Zurich Insurance Group ('Zurich' or 'the Group'). In addition to the capital and liquidity held within ZLIC, Zurich holds substantial amounts of capital and liquidity centrally at Group level. This centrally held capital can be deployed into subsidiaries if needed, providing resilience to absorb potential losses caused by very large risk events. The solvency and financial condition of ZLIC must therefore be understood in the context of the resilience and stability of the Group.

The Group discloses more information on its risk and capital management in its risk review, an integral part of Zurich Insurance Group's annual report that is available on www.zurich.com.

A. Business activities *continued*

Chart 1: Public reporting on solvency and financial condition within Zurich Insurance Group



SFCR: Solvency and Financial Condition Report (Solvency II; from 2016) **FCR:** Financial Condition Report (Swiss regulation; from 2017)

Subsidiary Group of subsidiaries Current disclosure

Note: The purpose of the chart above is to provide a simplified overview of the Group's major subsidiaries (as reported at April 30, 2018), with special focus on the public reporting of their solvency and financial condition. Please note that this is a simplified representation showing entities that must publish such a report and therefore it may not comprehensively reflect the detailed legal ownership structure of the entities included in the overview. The ordering of the legal entities under each country is not indicative of ownership; these are independent legal entities.

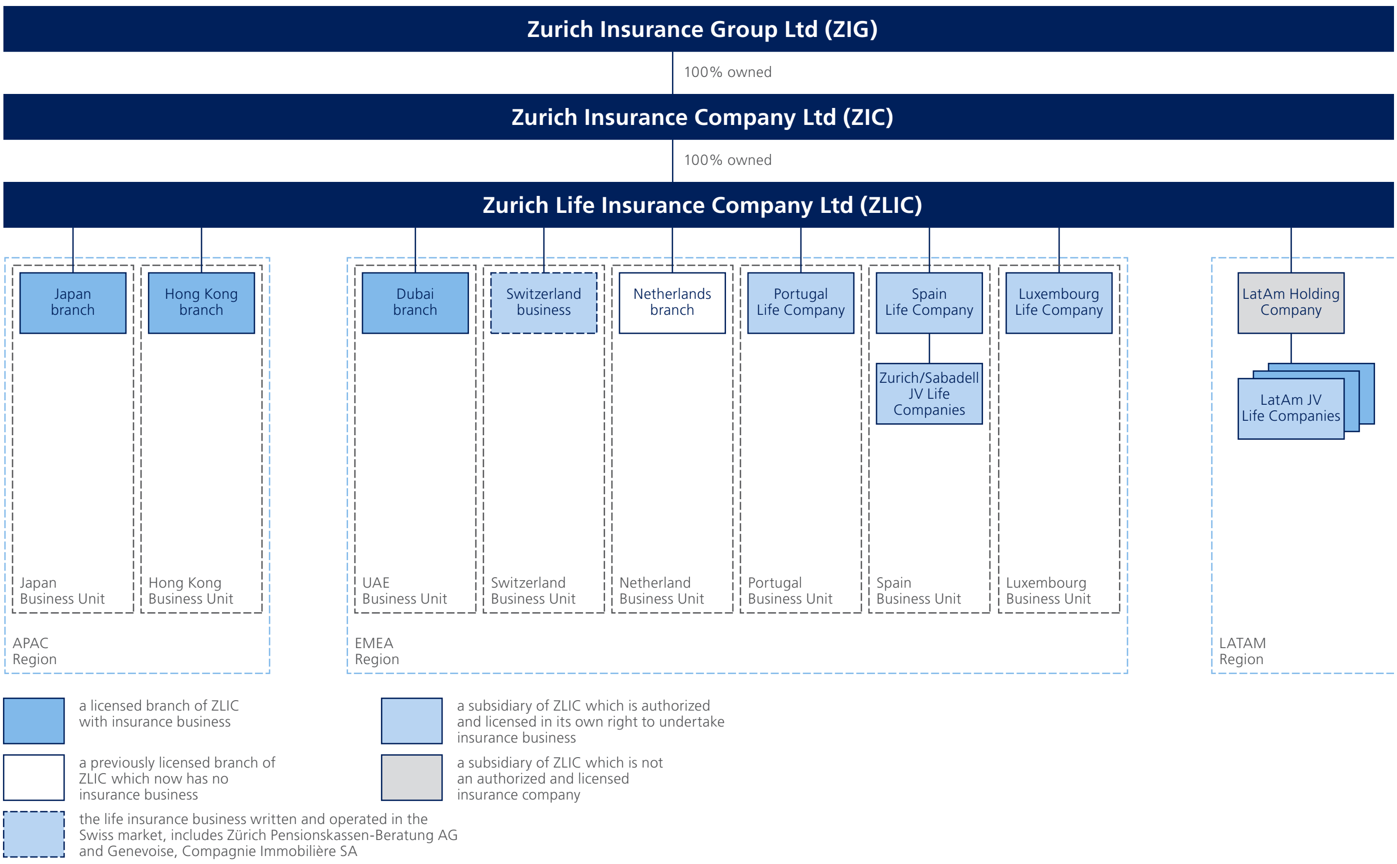
ZLIC, a life insurance company domiciled in Zurich, Switzerland, is operating primarily in Switzerland and through its main branches in Japan, Hong Kong and Dubai. Further, ZLIC has its main investments in subsidiaries and affiliates in Spain, Luxembourg, Portugal and indirectly in Latin America (Zurich Santander). ZLIC is 100 percent owned by ZIC, which in turn is fully owned by ZIG.

ZLIC's focus is on life business in the Swiss market. Simplify the structure of ZLIC and to reduce complexity, the ZLIC Board of Directors decided to transfer all non-Swiss subsidiaries of ZLIC to ZIC in 2017. The transfer of these subsidiaries is planned to be executed in the form of a dividend in kind in 2018 as described in below section, headed 'ZLIC simplification'.

ZLIC entity structure before simplification:

The chart below shows the ZLIC entity structure as of December 31, 2017:

ZLIC entity structure (simplified)



Listing of branches or businesses with a significant share of the business in relation to ZLIC:

- Switzerland generated a GWP of CHF 1.6 billion in 2017, which represents roughly 84.6 percent of the overall ZLIC GWP for 2017.
- Japan generated a GWP of CHF 242 million in 2017, which represents roughly 12.9 percent of the overall ZLIC GWP for 2017.
- Hong Kong generated a GWP of CHF 47 million in 2017, which represents roughly 2.5 percent of the overall ZLIC GWP for 2017.

A. Business activities *continued*

Listing of significant subsidiaries and shareholdings showing the qualitative and quantitative shareholding structure:

- ZLIC has significant subsidiaries, both direct and indirect, as detailed in the following tables.
- ZLIC's assets representing its interests in subsidiaries and affiliates amounted to CHF 1.5 billion, as of December 31, 2017.

1) Significant direct subsidiaries

The following table shows the significant direct subsidiaries and affiliates that ZLIC holds directly. Subsidiaries and affiliates of ZLIC with an ownership interest of less than 50 percent are not listed in the following table.

Significant direct subsidiaries

as of December 31, 2017	Registered office	Voting rights %	Ownership interest %	Registered office	Share capital in million units of local currency
Zurich Latin America Holding S.L. – Sociedad Unipersonal, Spain[1]	Barcelona	100.0	100.0	EUR	43.0
Genevoise Real Estate Company Ltd, Switzerland[2]	Geneva	100.0	100.0	CHF	20.4
SOCIETE AVENUE LOUIS CASAI 86 SA[2]	Geneva	100.0	100.0	CHF	0.1
Zurich Vida, Compañía de Seguros y Reaseguros, S.A. – Sociedad Unipersonal, Spain[3]	Madrid	100.0	100.0	EUR	56.4
Zurich Companhia de Seguros Vida, S.A., Portugal[3]	Lisbon	100.0	100.0	EUR	20.7
Zurich Eurolife S.A., Luxembourg[3]	Leudelange	90.0	90.0	EUR	39.0

[1] Statutory purpose: Holding company
[2] Statutory purpose: Service company
[3] Statutory purpose: Insurance company

2) Significant indirect subsidiaries

The following table shows the most significant indirectly-held subsidiaries of ZLIC with a net asset value exceeding USD 200 million (based on IFRS values) and an ownership interest of more than 50 percent.

Significant indirect subsidiaries

as of December 31, 2017	Registered office	Parent company	Voting rights %	Ownership interest %
Bansabadell Vida S.A. de Seguros y Reaseguros[1]	Barcelona	Zurich Vida, Compañía de Seguros y Reaseguros S.A., Spain	50.0	50.0
Zurich Santander Brasil Seguros e Previdência S.A.	Sao Paolo	Zurich Santander Holding (Spain), S.L.	50.8	50.8

[1] Bansabadell Vida S.A de Seguros y Reaseguros is a joint venture with Banco de Sabadell S.A.

Quantitative and qualitative information about special purpose vehicles (e.g., risk transfer and capital transfer companies) and joint ventures.

ZLIC does not currently hold any special-purpose vehicles.

Zurich Latin America Holding S.L. - Sociedad Unipersonal, which is 100 percent owned by ZLIC, has a joint venture (JV) with Banco Santander. The JV was established and signed in 2011 and sells life insurance, pension and general insurance products through Banco Santander's branch network in Brazil, Mexico, Chile, Argentina and Uruguay on an exclusive basis. Zurich effectively acquired a 51 percent participation in Zurich Santander Insurance America, S.L., which controls Banco Santander's insurance business in Brazil, Mexico, Chile, Argentina and Uruguay (via Zurich Santander Holding (Spain), S.L. and Zurich Santander Holding Dos (Spain), S.L.). The exclusive distribution agreement will be in force for 25 years and can be extended beyond the initial period.

While Zurich has management control of the jointly owned companies and fully consolidates them, Banco Santander continues to be a 49 percent stakeholder, which demonstrates its commitment and strong interest to develop the insurance business.

Through this JV, Zurich is the fourth-largest overall insurer in Latin America in terms of GWP, deriving approximately 68 percent of GWP from life protection products, 30 percent from property and casualty products, and 2 percent from savings products.

The following table provides an overview of the key quantitative metrics for 2017 and 2016 related to the JV with Banco Santander as published in the Zurich Insurance Group Annual Report 2017:

Non-controlling interests

in USD millions, as of December 31	**Zurich Santander America, S.L. and its subsidiaries**	
	2017	2016
Non-controlling interests percentage	49%	49%
Total Investments	14,224	12,780
Other assets	3,390	3,260
Insurance and investment contract liabilities[1]	14,736	13,207
Other liabilities	1,194	1,204
Net assets	**1,684**	**1,631**
Non-controlling interests in net assets	**825**	**799**
Total revenues	3,447	3,342
Net income after taxes	417	369
Other comprehensive income	71	101
Total comprehensive income	**488**	**470**
Non-controlling interests in total comprehensive income	**239**	**230**
Dividends paid to non-controlling interests	205	124

[1] Includes reserves for premium refunds, liabilities for investment contracts, deposits received under ceded reinsurance contracts, deferred front-end fees and reserves for insurance contracts.

Zurich Vida, Compañía de Seguros y Reaseguros, S.A., which is 100 percent owned by ZLIC, has a JV with Bansabadell Vida S.A. The JV was established in 2008 and sells life insurance, pension and general insurance products through Banco Sabadell's extensive branch network on an exclusive basis. Zurich effectively acquired a 50 percent participation in Bansabadell Vida S.A. de Seguros y Reaseguros (Bansabadell Vida), Bansabadell Pensiones E.G.F.P., S.A., and Bansabadell Seguros Generales, S.A. de Seguros y Reaseguros (Bansabadell Seguros Generales). The exclusive distribution agreement signed in 2008 will be in force for 25 years and can be extended beyond the initial period.

While Zurich has management control of the jointly-owned companies and fully consolidates them, Banco Sabadell continues to be a 50 percent stakeholder, which demonstrates its commitment and strong interest to develop the insurance business.

In 2014, Zurich signed a new agreement with Banco Sabadell to broaden and strengthen the JV relationship. The agreement will ultimately give the JV companies exclusive rights to sell life, pension and general insurance products across Banco Sabadell's branch network in Murcia, Valencia and the Balearic Islands, Spain. This network was part of Banco Sabadell's acquisition of Caja de Ahorros del Mediterraneo in 2011.

The following table provides an overview of the key quantitative metrics for 2017 and 2016 related to the JV with Bansabadell as published in the Zurich Insurance Group Annual Report 2017:

A. Business activities *continued*

Non-controlling interests

in USD millions, as of December 31	Bansabadell insurance entities	
	2017	2016
Non-controlling interests percentage	50%	50%
Total Investments	10,368	8,680
Other assets	1,927	2,757
Insurance and investment contract liabilities[1]	10,434	9,335
Other liabilities	370	498
Net assets	**1,491**	**1,603**
Non-controlling interests in net assets	**745**	**802**
Total revenues	3,022	5,144
Net income after taxes	89	61
Other comprehensive income	238	(53)
Total comprehensive income	**327**	**7**
Non-controlling interests in total comprehensive income	**163**	**4**
Dividends paid to non-controlling interests	120	–

[1] Includes reserves for premium refunds, liabilities for investment contracts, deposits received under ceded reinsurance contracts, deferred front-end fees and reserves for insurance contracts.

ZLIC simplification

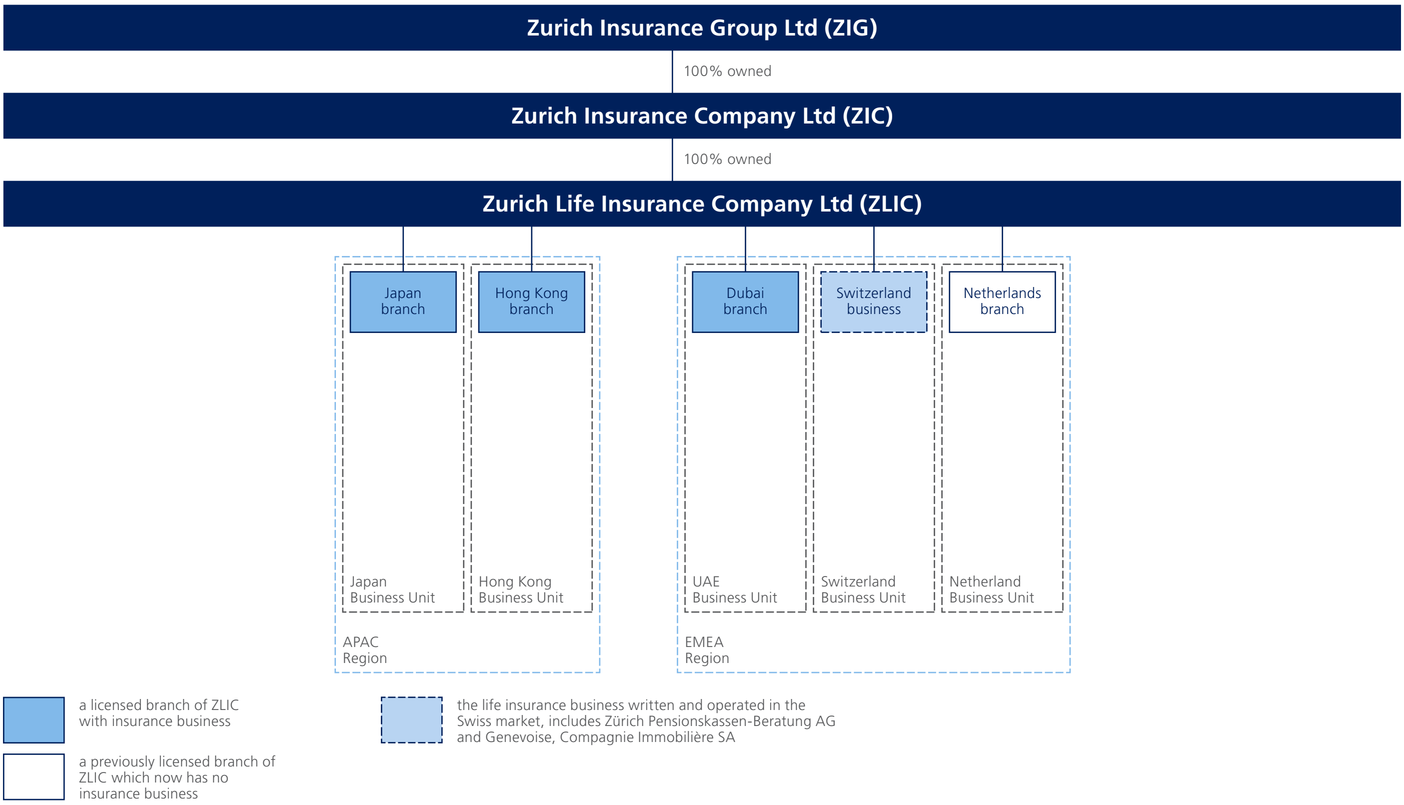
ZLIC's strategic objective is to focus on life business in the Swiss market. In order to simplify the structure and complexity of ZLIC the following restructuring activities were decided:

- On April 10, 2018, the AGM of ZLIC decided to distribute a dividend in kind consisting of two 100 percent owned investments in subsidiaries, Zurich Vida, Compañía de Seguros y Reaseguros, SA (Spain Life Company) and Zurich Latin America Holding SL (LatAm Holding Company), of the 90 percent interest in Zurich Eurolife SA (Luxembourg Life Company) as well as of 99.99 percent of ZLIC's shares of Zurich Companhia de Seguros Vida SA (Portugal Life Company). The legal transfer of such shares was completed on April 17, 2018.
- It has been decided to novate the reinsurance ZLIC currently provides to Zurich Deutscher Herold Lebensversicherung Aktiengesellschaft to ZIC with effect from January 1, 2018.
- As of January 1, 2017 ZLIC's economic exposure to the Zurich Global Employee Solutions business was transferred to ZIC through a 100 percent quota share retrocession arrangement. The underlying contracts have been altered to no longer pass through ZLIC.
- ZICS business will in general no longer pass through ZLIC from January 1, 2018, with reinsurance cover of ZILL and ZEL provided by ZIC instead of ZLIC. The residual portion of business remaining on the ZLIC balance sheet is not material and has been transferred to ZIC via 100 percent quota share on January 1, 2018.

ZLIC entity structure after simplification of structure

The chart below shows the ZLIC entity structure anticipated to be in place by the second quarter of 2018. Given the forward-looking nature of these transactions, this is the basis upon which the remainder of this report has been prepared.

ZLIC entity structure after simplification



A.2 Information about the company's strategy, objectives and key business segments

ZLIC strategy is derived from, and consistent with, the Group Strategy. In 2017 ZLIC developed a new strategy for 2018, with five strategic cornerstones outlined below:

- **ZLIC entity:** Protect the balance sheet, maintain stability and continue to monitor key risks.
- **ZLIC in Switzerland:** Become the best Swiss insurer in terms of service quality and customer satisfaction.
- **ZLIC business & branches:** Focus on rationalizing the ZLIC structure.
- **ZLIC subsidiaries:** Cease functioning as a subsidiary holding by dividending subsidiaries into ZIC, hence accomodating simplification of the Group structure; establish narrow criteria for acceptance of new subsidiaries depending on strategic fit and adherence to risk appetite.
- **ZLIC legal & regulatory:** Maintain legal and regulatory compliance of ZLIC as a legal entity by a governance structure that supports an efficient and effective oversight and control.

The ZLIC strategy is reviewed on an annual basis.

A. Business activities *continued*

ZLIC is a life insurance provider serving both retail and corporate customers, primarily in Switzerland as well as through branches in Japan, Hong Kong and Dubai.

Switzerland:

- ZLIC is a major life insurer in the Swiss market, serving both retail and corporate life and pensions (CLP) customers. ZLIC's business is focused on Switzerland which contributes 98 percent of ZLIC's overall business as measured by reserves. Retail products include protection and savings products. The CLP business includes domestic protection and pension solutions.
- Switzerland continued to move to a more efficient, simple, customer-focused organization. We measure customer satisfaction through new business, claims, complaints handling and customer service metrics. We focus on intelligent protection and capital-light savings products, leveraging a semi-autonomous model, and maintaining a strict underwriting discipline on guarantees. We continue to strengthen our distribution partnership relationships and interfaces. From an operational perspective, we are centralizing our IT to increase efficiency and customer satisfaction.

ZICS (Zurich International Corporate Solutions) and ZGEBS (Zurich Global Employee Benefits Solutions):

- ZICS provides group life and disability cover for International Mobile Employees. ZGEBS offers captive, international program and pooling solutions for the employee benefits coverage of multinational companies.
- In line with ZLIC's strategic ambition to predominantly focus on Switzerland, ZICS business was transferred to ZIC as of January 1, 2018. ZLIC retains only the business written by ZICS in Switzerland, which is fully reinsured by ZIC. As of January 1, 2017, all business written by ZGEBS was fully reinsured by ZIC and ZGEBS was fully transferred to ZIC by December 31, 2017.

Japan:

- Japan's retail business focuses on protection products and experienced strong growth in 2017. Over the past years, the business has achieved a sustainable niche position and successfully implemented a multi-channel distribution model. Japan is making additional investments in distribution to further grow in target segments.

Hong Kong:

- Hong Kong retail business was placed in run-off as of December 31, 2013.

Subsidiaries:

- To further simplify the subsidiary structure, the ZLIC Board of Directors decided to distribute a dividend in kind of our significant subsidiaries operating in Latin America, Spain, Luxembourg and Portugal paid to Zurich Insurance Company Ltd (ZIC) in April 2018.
- As of January 1, 2018, ZLIC switched to the SST standard model, reflecting its focus on Swiss business after the simplification of its structure. On this basis, the SST results in this report show the SST standard model results for the fourth quarter 2016 and the fourth quarter 2017 after allowing for the simplification of ZLIC's corporate structure.

Sourcing of critical functions

ZLIC outsourced to ZIC all business, management and control functions' services (excluding non-transferable tasks, board duties and branch business), based on the outsourcing agreement between ZLIC and ZIC dated June 12, 1997 (1997 Outsourcing Agreement).

In order to improve the governance structure, ZLIC has started to analyze its outsourcing regime in 2017 taking into account recent regulatory developments. As a result, ZLIC and ZIC established an intra-group staffing agreement ('Personalverleihvertrag') and a new outsourcing agreement.

On July 19, 2017, this staffing agreement became effective. The staffing agreement insources to ZLIC the staff to fill the roles and responsibilities of the members of ZLIC Management Board, the appointed actuary and the heads of Risk Management and Compliance as per FINMA requirements. All other critical functions of ZLIC remained outsourced to ZIC under the 1997 Outsourcing Agreement.

In addition, as per January 1, 2018, the revised outsourcing agreement between ZIC and ZLIC replaced the existing 1997 Outsourcing Agreement and strengthened ZLIC's outsourcing regime.

Information about the company's external auditors as per Article 28 ISA 8

ZLIC's external auditors for 2017 were PricewaterhouseCoopers AG. ZLIC's Annual Report 2017 including the Auditor's opinion is available on https://www.zurich.com/en/investor-relations/%20results-and-reports/other-statutory-filings.

A.3 Significant unusual events

For significant events during 2017 and thereafter, please refer to the Annual Report 2017 of Zurich Life Insurance Company and Zurich Insurance Group, respectively, as well as to the news releases available at https://www.zurich.com/en/media/news-releases. No other significant events are to be reported.

B. Performance

B.1 Underwriting performance

B.1.1 Gross written premiums and policy fees

Gross written premiums decreased by 6 percent to CHF 1.9 billion compared with 2016 mainly due to strategic decision to transfer our corporate foreign business managed by ZICS (Zurich International Corporate Solutions) and ZGEBS (Zurich Global Employee Benefits Solutions) to Zurich Insurance Company Ltd (ZIC) in order to further simplify the legal structure of ZLIC.

Gross written premiums and policy fees by type of business

in CHF millions, for the years ended December 31	**2017**	2016
Group insurance Switzerland	812	798
Group insurance abroad	–	25
Individual insurance Switzerland	632	628
Individual insurance abroad	46	49
Health insurance abroad	242	188
Reinsurance assumed	144	300
Gross written premiums and policy fees	**1,875**	**1,989**

Gross written premiums and policy fees by country

in CHF millions, for the years ended December 31	**2017**	2016
Switzerland	1,587	1,726
Hong Kong	47	70
Japan	242	188
Dubai	(1)	5
Gross written premiums and policy fees	**1,875**	**1,989**

B.1.2 Claims paid, annuities and loss adjustments expenses, gross of reinsurance

Total claims paid, annuities and loss adjustment expenses increased by CHF 123 million to CHF 2.1 billion from CHF 1.9 billion in 2016.

Claims paid, annuities and loss adjustment expenses, gross

in CHF millions, for the years ended December 31	**2017**	2016
Maturity benefits	(665)	(610)
Death benefits	(324)	(290)
Annuity payments	(413)	(409)
Disability and health benefits	(234)	(217)
Surrenders	(419)	(406)
Claims paid, annuities and loss adjustment expenses, gross	**(2,055)**	**(1,932)**

B.2 Investment performance

B.2.1 Investment income

Investment income increased by CHF 0.4 billion or 50 percent to CHF 1.2 billion in 2017 from CHF 0.8 billion in 2016, mainly due to an increase in write-ups on debt securities and due to increased realized capital gains on real estate.

Investment income by country

in CHF millions, for the years ended December 31	**2017**	2016
Switzerland	1,163	773
Netherlands	5	5
Japan	2	2
Hong Kong	10	8
Investment income	**1,180**	**788**

Investment income by category

in CHF millions, for the years ended December 31	**Current income**		**Realized capital gains**		**Write-ups**		**Totals**	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Real estate	126	133	148	–	–	–	274	133
Investments in subsidiaries and associates	10	11	–	–	–	–	10	11
Debt securities	89	93	11	3	565	306	665	401
Policyholders' loans and other loans	11	10	–	4	–	–	11	14
Mortgage loans	47	49	–	–	–	–	47	49
Equity securities	9	15	51	24	107	134	166	174
Other investments	6	5	–	–	–	–	6	5
Investment income	**299**	**317**	**210**	**31**	**672**	**440**	**1,180**	**788**

B.2.2 Investment expenses

Investment expenses increased by CHF 19 million to CHF 112 million in 2017 from CHF 93 million in 2016. The main driver for the higher investment expenses was the increase in write-downs on real estate, mainly due to the restructuring of the headquarter building in Zurich.

Investment expenses by category

in CHF millions, for the years ended December 31	**Realized capital losses**		**Write-downs**		**Totals**	
	2017	2016	**2017**	2016	**2017**	2016
Real estate	(3)	(2)	(46)	(6)	(50)	(8)
Investments in subsidiaries and associates	–	–	–		–	–
Debt securities	(2)	(1)	(1)		(3)	(1)
Policyholders' loans and other loans	–	–	–		–	–
Mortgage loans	–	–	–		–	–
Equity securities	(2)	(27)	(4)	(7)	(6)	(34)
Other investments	–	–	–	–	–	–
Other investment expenses	n.a.	n.a.	n.a.	n.a.	(53)	(49)
Investment expenses	**(8)**	**(30)**	**(51)**	**(13)**	**(112)**	**(93)**

B. Performance *continued*

B.3 Performance of other activities

B.3.1 Administrative and other expenses

Administrative and other expenses increased by CHF 287 million from CHF 403 million in 2016 to CHF 691 million in 2017. The main driver for this change was gains and losses on foreign currencies, on which a net loss of CHF 332 million resulted in 2017 compared with a net loss of CHF 27 million in 2016. Further, the provision for value fluctuations of investments (mortgages) had been increased by CHF 120 million in 2017. Additionally, there was an overstatement of operating and administrative expenses by CHF 93 million in 2016 as noted in below section B.3.2.

Administrative and other expense

in CHF millions, for the years ended December 31	**2017**	2016
Operating and administrative expenses	(356)	(365)
Gains and losses on foreign currency derivatives	(306)	(4)
Foreign currency transaction gains and losses	(26)	(23)
Amortisation of software	(6)	(9)
Depreciation of equipment	–	–
Restructuring costs	4	(2)
Administrative and other expense	**(691)**	**(403)**
of which personnel expenditure	(72)	(119)

B.3.2 Other income

Other income decreased by CHF 287 million in 2017, mainly due to the partial release of the provision for value fluctuations of investments of CHF 180 million in 2016, as well as due to inconsistencies in the design of the gross-up process, leading to an overstatement of other income by CHF 93 million in 2016 (offset in administrative and other expense with no impact on the net income after taxes).

B.3.3 Comments to the income statement in appendix 1: Quantitative templates

Net income before taxes:
Our net income before taxes was higher than in the financial year 2016. The main reasons for the increase were the impact of unwinding reserves in individual life and group life (visible in change in reserves), and capital gains realized from real estate sales (visible in investment income). All other line items in the income statement were relatively stable and showed similar results as in 2016.

Gross written premiums and policy fees:
In total, gross written premiums decreased by 6 percent to CHF 1.9 billion compared with 2016. Gross written premiums and policy fees in individual life, group life and unit-linked business were generally stable, although individual life experienced a slight decline due to lower business volume. The main reason for the decrease in gross written premiums and policy fees in group life was ZGEBS (Zurich Global Employee Benefits Solutions) business, which was transferred to ZIC in 2017.

Investment income:
As mentioned, capital gains realized from real estate sales were one of the key drivers behind increases in investment income. Another reason for the increase in investment income were write-ups on our single investor funds due to foreign currency valuation. Derivative financial instruments, which largely neutralized the foreign exchange impact are included in administrative and other expenses. This applies to both individual life and group life.

Unit-linked business:
Total technical income was very stable compared with 2016. Taking into account insurance benefits and losses, the business achieved a slight increase in income as a result of two portfolios which matured. Investment income increased due to favorable market conditions during the reporting period.

See income statement in appendix 1: Quantitative templates.

C. Corporate governance and risk management

C.1 Corporate governance

ZLIC is subject to insurance supervision by FINMA. The Swiss insurance supervision law (ISL) requires Swiss insurance companies to establish and maintain governance and risk management systems, and effective internal control systems appropriate to their business activities. It prescribes the calculation of a risk-based solvency margin at legal entity level pursuant to the SST. In addition to the supervision exercised by FINMA, ZLIC and its branches are supervised according to the requirements of relevant local supervisory authorities.

The principles of corporate governance are incorporated and reflected in a number of corporate documents, in particular the Articles of Incorporation, the Organizational Rules, the charter of the ARC of the Board and the ZLIC Governance Framework. ZLIC has established an approach based on three lines of defense aimed at clearly identifying, assessing, owning, managing and monitoring risks:

- The first line of defense consists of business management that takes risks and is responsible for day-to-day risk management.
- The second line of defense consists of the two control functions, Risk Management and Compliance. The second line provides the frameworks to manage risks, independent challenge, oversight, monitoring and advice to support the first line in managing risks.
- The third line of defense consists of the assurance function, Audit. The third line provides independent and objective assurance regarding the adequacy and effectiveness of the risk management, internal controls and governance processes.

C.1.1 Board of Directors

The Board is responsible for the overall management of ZLIC, as well as for the supervision of management. In particular, it is responsible for taking actions in the following areas:

- ZLIC strategy: The Board regularly reviews and discusses ZLIC’s business portfolio including its target market, customer and intermediaries strategy and its human resources strategy.
- Finance: The Board annually approves the financial and operating plan, establishes guidelines for capital allocation and financial planning. The Board also reviews and approves the annual and quarterly financial statements.
- Structure and organization of ZLIC: The Board determines and regularly reviews the basic principles of the structure and major changes within the management, including major changes of management functions. The Board also reviews the corporate governance framework with regard to these changes. The Board also adopts and regularly reviews basic principles of conduct, compliance and risk management. Its duties include convening the shareholders’ meeting and submitting proposals to the shareholders meetings, it reviews the dividend policy and the Board’s proposal for the payment of dividends. The Board also makes resolutions on capital increases, and obtains the certification necessary for capital increases and related proposals presented at the shareholders meetings and respective amendments to the articles of incorporation.
- Business development: The Board regularly discusses and approves major developments, pertaining, for example, to acquisitions and disposals of businesses and assets, investments, new businesses opportunities, mergers, joint-ventures, co-operations and restructurings of business units (BU) or books of business, as necessary.

Audit & Risk Committee (ARC)

The ARC serves as a focal point for discussion and communication of matters regarding the oversight of financial reporting, internal controls, compliance and risk management.

The ARC’s role is to oversee the company, whereas management is responsible for preparing ZLIC’s financial statements, risk management, developing and maintaining internal controls and ensuring appropriate governance processes. The ARC is responsible for the oversight of the external auditors.

In particular, the ARC purpose is to:

- Assist the Board in carrying out its responsibilities with regard to:
  - Oversight of ZLIC’s financial statements and other significant financial disclosures to FINMA, e.g. SST;
  - Ensuring an effective system of risk identification and mitigation; and the maintenance of sound internal controls and of the governance of ZLIC
  - In accordance with law and regulations.

C. Corporate governance and risk management *continued*

- Provide oversight and guidance to ZLIC and its management with regard to the above matters and to assists in identifying issues requiring management's attention.
- Give sufficient attention to presented issues and information to determine what might require further review, additional attention and reporting to the Board.

The ZLIC's ARC receives regular information about important audit findings, including adverse opinions, mitigation actions and management concerns. Internal Audit, Risk Management and Compliance functions and ZLIC's management ensure that issues affecting ZLIC's operations are brought to ARC's attention, and that action is taken as necessary.

Composition of Board and Audit Committee (as of December 31, 2017)

Name	Residence	Position held
Urban Angehrn	Greifensee, Switzerland	Chairman of the Board Member of the Audit & Risk Committee
Christian Felderer	Zurich, Switzerland	Member of the Board (Independent)
Erica Arnold	Zurich, Switzerland	Member of the Board Member of the Audit & Risk Committee
Gary Shaughnessy	Kilchberg, Switzerland	Member of the Board
Robert David Campbell	Edinburgh, United Kingdom	Member of the Board (Independent) Chairman of the Audit & Risk Committee

Changes to composition of Board and Audit & Risk Committee in 2017
Joseph Deiss stepped down from the Board as of June 27, 2017. Erica Arnold joined as new Board member on April 4, 2017. Christian Felderer joined the Board on June 30, 2017.

The Audit Committee of Zurich Life Insurance Company Ltd as of January 1, 2017, consisted of Urban Angehrn and David Campbell (Chairperson). As of April 4, 2017, the purpose and tasks of the Audit Committee were amended by risk matters and hence named in Audit & Risk Committee. Erica Arnold was appointed as a member of the Audit & Risk Committee on April 12, 2017.

C.1.2 Executive Management
In accordance with the articles of incorporation and the organizational rules of ZLIC, the Board appointed a CEO for the company and delegated authorities to him. The CEO is responsible for managing the business and representing the company, subject to the organizational rules enacted by the Board.

The Board also appointed the members of the executive management (ZLIC Management Board).

Under the supervision of the CEO, the Management Board members are individually responsible for the business functions assigned to them.

The ZLIC's Management Board tasks include:

- Implementing the overall strategy and developing individual units, subject to any overriding directives and to the principles of a decentralized management organization.
- Achieving the strategic and operational objectives of the individual business units.
- Supporting and supervising the heads of the individual business units as required, taking into account their needs and their level of competence.
- Promoting know-how transfer within the Group and, in particular, within their respective business units.
- Representing the interests of their business unit, geographic regions and their respective business units vis-à-vis other business units/regions and superordinate bodies or functions.
- Coordinating the activities in countries with more than one business unit.
- Reporting regularly to the CEO. Upon invitation of the CEO or the Chairman, the members of the Management Board also present their reports at the meetings of the Board.

Composition of Management Board (as of December 31, 2017)

Name	Residence	Position held
Joachim Masur	Küsnacht, Switzerland	CEO
Bettina Bornmann	Zurich, Switzerland	CFO
Sandro Meyer	Horgen, Switzerland	Head CLP and Life Technical Functions
Peter Hirs	Hong Kong, Hong Kong	Head Finance APAC
Eric Erixon	Richterswil, Switzerland	Chief Life Actuary

Changes to composition of the Management Board in 2017
Simon Foster resigned from the Management Board as of June 30, 2017. Erik Erixon joined the Management Board on April 4, 2017.

C.2 Risk management

C.2.1 Risk management framework

The ERM is embedded in the system of governance. The ERM is designed to support the decision-making procedures by providing consistent, reliable and timely risk information and protecting Zurich's capital from risks that exceed established risk tolerances. These risk tolerances define maximum willingness and ability to take risk overall and with respect to specific risk types. Actions are defined where necessary to mitigate potential negative consequences.

ZLIC has a defined risk appetite. The risk appetite is fixed through existing limits e.g., severity categories for the TRP and various limits defined in the ZRP. ZLIC's risk appetite statement is reviewed by the Management Board and signed off by the Board at least annually, and adjusted if necessary. As part of the ERM, the risk management function calculates annual risk tolerance limits and evaluates actual and potential breaches. Overall responsibility, however, lies with the Management Board (refer to the tasks of Management Board). The risk management function and other functions, such as compliance, legal, actuarial and finance, develop and operate methodologies to identify, manage and mitigate all types of risks. Escalation procedures are in place for all risk types. The risk management function monitors overall risks, including specific risk types, and escalates any risk that exceeds the level of defined risk tolerance, in line with the governance system.

The risk management framework is based on a governance process that defines clear responsibilities for taking, managing, monitoring and reporting risks. The ZRP is the Group's main risk governance document. It specifies the 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. During 2017 the ZRP was streamlined and restructured. As before, the ZRP articulates the Group's approach to risks and sets standards for effective risk management throughout the Group. It describes the Group's risk management framework, identifies our principle risk types, and defines the Group's appetite for risks at the Group level. The major difference is that the details to implement the ZRP are now contained in risk policy manuals, organized by risk type and owned by the functions and businesses responsible for the risk type. A new adherence monitoring process was introduced to reflect the new ZRP set-up. More detailed monitoring of risk policy manuals will be introduced in 2018.

An Own Risk and Solvency Assessment (ORSA) for ZLIC is completed annually. The ZLIC ORSA was submitted to the regulator at the beginning of 2018. To ensure the Board is adequately involved in the ORSA process, ZLIC's CRO provides a quarterly update, thus allowing the Board to challenge findings and consider its views in its decision-making process.

C.2.2 Risk management organization

The ZLIC Chief Risk Officer (CRO) leads the ZLIC Risk Management function, which aims to ensure that risks are identified, measured, managed, monitored and reported throughout the entity. The ZLIC Chief Risk Officer is responsible for oversight of risks across the legal entity. The CRO regularly reports to the Chief Executive Officer, Management Board and the ARC of the Board on matters pertaining to risk.

The ZLIC risk management team is part of Zurich's Group Risk Management organization, which consists of central functions at Group level and a decentralized risk management network at regional, BU and functional levels.

C. Corporate governance and risk management *continued*

C.2.3 Risk assessment and reporting

Risk profile reports are generated regularly at local respectively branch and ZLIC levels. ZLIC has procedures (e.g., ZLIC Risk Appetite Statement, Total Risk Profiling™ (TRP)) to identify and report risks to senior management and the Board in a timely way. To foster transparency about risk, the ARC receives an Integrated Assurance and a Risk Report quarterly and other, additional updates.

ZLIC assesses risks systematically and from a strategic perspective through its proprietary Total Risk Profiling™ (TRP) process, which allows ZLIC to identify and evaluate the probability and severity of a risk scenario. As part of the TRP process, mitigation actions are defined and executed by the business, while risk management monitors improvements. The TRP process is integral to how Zurich deals with change, including changes to the business environment and other factors that could affect its business, and is particularly suited to evaluating strategic risks as well as risks to Zurich's reputation. This process is conducted annually, reviewed quarterly and is closely tied to the planning process.

C.3 Internal control system

At Zurich, various governance and control functions help to identify and appropriately manage risks. Internal controls are in place and Zurich seeks to ensure that they operate effectively. This coordinated effort to ensure that ZLIC's controls work appropriately is referred to as 'integrated assessment and assurance'. The Board is ultimately responsible for supervising these assurance activities. Although each party in the process maintains its distinct mandate and responsibilities, those involved work closely together, regularly exchange information, and engage in planning and other activities. This approach supports management in its responsibilities and provides confidence that risks are appropriately addressed and that adequate mitigation actions are implemented.

With regard to internal controls, ZLIC follows the framework and guidelines prescribed by the Group. The Board has overall responsibility to determine the strategy and set out the goals of the internal control system. In particular, the Board regulates and supervises the internal control system. The Board has appointed the ARC to review and submit for approval to the Board the strategy and goals of the Company's internal control system; the Board receives and reviews periodic reports from the internal audit, risk management and compliance functions with regard to the internal control system. The Management Board and the Board review and approve the strategy and scope of the internal control system on an annual basis.

ZLIC considers controls to be key instruments for monitoring and managing financial reporting and operational risks. The internal control system for ZLIC aims to ensure the reliability of ZLIC's financial reporting, make operations more effective and ensure legal and regulatory compliance. ZLIC bases its internal control system on the Zurich Insurance Group's internal control system methodology:

- The internal control system is designed to manage rather than eliminate the material risk related to business objectives. It can provide only reasonable, not absolute assurance against material financial misstatements or loss.
- The Group encourages risk awareness and understanding of controls with communication and training. Primary frameworks for risk management and internal control systems are established at Group level and implemented Group-wide.

Based on the Group minimum requirements, ZLIC enhances the scope of the internal control system, taking into account its risk appetite and risks that are not adequately covered by the Group's basic, minimum requirements. That includes especially controls over statutory and regulatory reporting and local operational key controls to ensure regulatory compliance. The scope of the internal control system takes into consideration the inherent risk to the operation, for example, due to processes, systems and people. Wherever technology permits, and where it makes sound economic sense, automated controls are preferred over manual ones.

C.4 Compliance

ZLIC's core values are founded on the principle that it acts lawfully and seeks to do what is right. Sound compliance in everything ZLIC does helps to protect Zurich's reputation and supports the achievement of the Group's ambitious goals.

ZLIC's compliance function, which consists of compliance professionals, is overseen by the ZLIC Compliance Officer, who reports to the ZLIC General Counsel and regularly provides reports to the ZLIC ARC. The ZLIC Compliance Officer has access to the Chairman of the ARC and the Chairman of the Board.

ZLIC's compliance function provides, within its mandate, policies and guidance, business advice, training and assurance that appropriate compliance controls are in place. The compliance function also supports Zurich's management in maintaining and promoting a culture of compliance and ethics consistent with Zurich's code of conduct. This compliance framework relies on an ongoing global compliance risk assessment to support a risk-based monitoring regime. The results of this assessment underpin the compliance function's strategic planning, which is conducted in consultation with business partners in each branch. Through a comprehensive program, the compliance function implements, embeds and monitors internal compliance policies and guidance. As part of that program, compliance officers provide new employees with an introduction to rules that apply to their roles. To help employees understand their responsibilities under Zurich's code of conduct and internal compliance policies, all employees receive yearly ethical and compliance training, focusing on Zurich's code of conduct and its 12 key rules of conduct. Local business units may, where appropriate, supplement this module with additional training courses and high-risk compliance topics. ZLIC's compliance function also takes a leading role in internal ethical and regulatory conduct awareness campaigns. Each year, Zurich employees affirm that they understand and comply with Zurich's code of conduct and internal policies. Zurich encourages its employees to speak up and report improper conduct that they believe is illegal, unethical, or violates the code of conduct or our Group policies. Employees are free to report their concerns to management, Human Resources, the legal department, the compliance function, or through the Zurich Ethics Line (or a similar local channel). These services are phone and web-based and run by an external specialized provider. Zurich does not tolerate retaliation against any employee who reports such concerns in good faith.

C.5 Internal audit

The internal audit function, Group Audit (GA), is responsible for providing independent and objective assurance to the Board, the ARC, the CEO and Management, on the adequacy and effectiveness of the Group's risk management, internal control and governance processes.

GA's approach is to develop and deliver an annual risk based audit plan, which is updated as risks change. The audit plan takes into account the full spectrum of business risks, including concerns and issues raised by the ARC, Management and other stakeholders. The ARC approves the annual plan and any changes to it.

GA executes the plan in accordance with the GA principles-based engagement standards, which incorporate and comply with the International Standards for the Practice of Internal Auditing, issued by the Institute of Internal Auditors (IIA).

Audit staff are expected to be independent and objective in all assignments and to do nothing that might prejudice or be perceived as prejudicing independence or objectivity. No GA employee reports to or is directly accountable to a business unit or function.

GA is authorized to review all areas and has full, free and unrestricted access to all activities, accounts, records, property and personnel necessary to fulfill its duties. In the course of its work, GA takes into consideration the work of other assurance functions. In particular, GA coordinates its activities with the external auditors, sharing risk assessments, work plans, audit reports and updates on audit actions.

GA is responsible for ensuring that issues which it identifies that could impact ZLIC's operations are communicated to the responsible Management, CEO and the ARC. GA issues periodic reports to Management and the ARC, summarizing audit findings, the status of corrective actions and the status of plan execution. A member of GA attends each ARC meeting.

The ARC assesses the independence of GA and reviews its activities, plans and organization, the quality of its work and its cooperation with the external auditors. As required by the IIA International Standards, an independent qualified assessor reviews the quality of Group Audit at least every five years. This review was conducted most recently in 2016. The results confirmed that GA's practices conform with all IIA Standards.

C. Corporate governance and risk management *continued*

C.6 Actuarial function

The ZLIC actuarial function provides actuarial governance and reporting in line with Swiss laws and insurance regulations.

Within ZLIC, the ZLIC Chief Life Actuary coordinates the work of the ZLIC actuarial function. The ZLIC actuarial function prepares the tied assets, SST and ORSA reporting in addition to meeting the actuarial reporting requirements of the Group. The ZLIC appointed actuary reports to the ZLIC Chief Life Actuary and is responsible for ensuring the adequacy of local statutory reserves. The ZLIC appointed actuary is, in addition, responsible for adequate pricing assumptions, for ZLIC governance of acceptance of new business and reinsurance, for the technical business plan and for the adherence to regulatory requirements referring to tied assets.

The ZLIC actuarial function also follows the governance, reporting and process standards set by the Group Actuarial function. The Actuarial function at Group level is led by the Group Chief Actuary, reporting directly to the Group Chief Financial Officer. The Group Chief Actuary reports regularly to the Audit Committee on behalf of the Group Actuarial function.

D. Risk profile

D.1 Introduction and ZLIC's key risks

ZLIC is fully integrated into Zurich's Group-wide risk assessment process. For more information on ZLIC's approach to risk management, please refer to the risk review section in the Zurich Insurance Group Annual Report 2017, which describes the Group's risk management framework and risk governance, reports on capital management and capital adequacy, and presents an analysis of the main risks. As mentioned in chapter A.1, ZLIC's financial strength is enhanced by being part of Zurich.

The significant risks for ZLIC, as measured by capital metrics, are market risk, business risk, life liability risk, and investment credit risk (see definitions in the following table). Insurance risks related to participations in general insurance business are considered minor.

The figures shown for SST reflect the structure of ZLIC following simplification activities leading to increased focus on ZLIC's business in Switzerland. As a result of this change in risk profile, ZLIC uses the SST standard model. Both 2017 and restated 2016 figures reflect these changes. The current information on solvency shown in the report corresponds to the information submitted to FINMA as of April 30, 2018.

Capital required for various types of risk:

Target capital by risk type

in CHF millions, for the years ended December 31	**2017**	2016	Change
Derivation of target capital			
Insurance risk	941	870	70
Market risk	1,341	1,304	37
Diversification effects	(652)	(608)	(44)
Credit risk	643	591	52
Risk margin and other effects on target capital	585	512	73
Target capital	**2,858**	**2,669**	**188**

The figures shown in the table above reflect diversification within each risk type. There is no diversification of credit risks under the SST standard model used by ZLIC. Thus the diversification effects shown in the table above reflect diversification purely between insurance and market risk.

ZLIC uses its assessment processes and tools, including the TRP process, to reduce the unintended risks of strategic business decisions. Critical key risks identified and assessed during the TRP conducted in fall 2017 included:

- Macroeconomic disruption (market shock, unemployment, recession etc.) [market risk]: Investment management monitors this on a continuous basis, in order to ensure portfolio resilience in the event of such market movements.
- Reserve adequacy [life insurance risk]: Developments in financial markets, biometric assumptions and in other areas such as FINMA and SAV requirements pose significant risks to ZLIC.
- Outdated and complex IT applications landscape [operational risk]: Business applications in use are built on an enormous variety of underlying technologies. Complexity, run and maintenance costs, as well as change costs are driven by this heterogeneity. Projects PAKT and DACH Hub are executed addressing these issues.
- Data protection and security [operational risk]: In order to preventatively address the risks in connection with information and data security, leakage of information assets, and inappropriate use or abuse of confidential customer or corporate data all employees have to complete the Information Security Awareness Training annually. This topic is proactively addressed by Integrated Information Security Baseline that assesses the security risks of our interconnected IT infrastructure as well as by Project Aegis that ensures that the increased demands of digitalization regarding employee and customer data triggered by the revised Swiss Data Protection that is expected to come into force on January 1, 2019 can be met.
- SST methodology risk [operational risk]: As of January 1, 2018, ZLIC switched to the SST standard model, reflecting its predominant focus on Swiss business after the anticipated simplification of its structure. This helps reduce the uncertainty faced by ZLIC's previous participation in the SST internal model approval process. According to FINMA's rules, further changes to the SST standard model can be made by FINMA only with at least six months' notice and after due consultation with the industry.

D. Risk profile *continued*

To reduce the likelihood or severity of key risks, plans have been developed and implemented to provide appropriate actions necessary to reduce the likelihood or severity of key risks. The status of these plans is monitored on a quarterly basis, including reviewing key risks and assessing the exposure.

The remainder of this section considers in turn each of the key categories of risk faced by ZLIC. ZLIC holds capital under SST for life insurance risk, market risk and credit risk.

D.2 Life insurance risk

As a life insurance company, ZLIC is in the business of assuming others' risks with regard to mortality, longevity and morbidity/disability. In the course of doing business ZLIC may be exposed to greater than expected current and future outgo resulting from taking on those risks, either due to changes or inadequacy of the accounting principles applied. In addition, unexpected changes in expenses, policyholder behavior – in particular lapses - and fluctuations in new business volumes can likewise have an impact on ZLIC earnings and capital. The focus of life insurance risk is on changes in the expected value of provisions.

Life insurance risk is actively monitored, primarily by the ZLIC actuaries. In calculating premiums and reserves, the actuaries rely on the mortality and disability tables of the Swiss Insurance Association (SIA), as well as on tables developed internally, and use forecasting tools to estimate how the business book will likely develop. They may take measures as appropriate, as developments can have a critical impact on customers and/or ZLIC's profitability. Their analyses are presented to the ZLIC Management Board to determine if proposed measures are adequate to counter negative developments.

Concentration risk arises if a company engages in single or highly correlated risks that have a significant damage or loss potential for life insurance in the area of underwriting and investment. Internal outsourcing is managed in accordance with the rules stipulated in the ZRP.

Due to diversification, concentration risk in underwriting is very low. Large risks are passed on to reinsurers. There are effective accumulation controls in place.

D.3 Market risk

Market risk is the risk of a loss or an adverse development in ZLIC's financial situation, resulting directly and/or indirectly from volatility in market prices of assets, liabilities and financial instruments. In line with the investment strategy, the following sub-risks are specifically considered: interest rate risk, equity risk, property risk, credit spread risk including credit rating migration risk, credit default risk, currency risk and concentration risk.

For ZLIC, when considering total risk capital requirements within the SST, the market risk is very significant. The biggest market risks are interest rate, credit spread and real estate risk. The interest rate risk is of particular relevance to ZLIC, due to the characteristics of life insurance liabilities. Risks may include a lack of fixed income securities with maturities sufficient to match ZLIC's liabilities: both assets and liability values are significantly affected by changes in the yield curve. Interest rate risk arises if the market value of assets declines more or increases by less than the market value in liabilities, resulting in lower risk-bearing capital for shareholders. Changes in interest rate risk, especially in environments where interest rates remain low, also puts pressure on net investment income, and may lead to changes in liabilities to which ZLIC is committed.

The interest rate sensitivity of the investments is regularly reviewed as part of ALM analysis and in the local ALMIC and where necessary, managed by taking the appropriate measures. Investment Management is of particular importance in this regard, as outlined in the ZRP. Duration and convexity gaps between investment portfolio and insurance liabilities must be addressed through consistent ALM analysis. It is also important to actively review the market environment to identify potential opportunities to further reduce interest rate risk. Transactions with derivative financial instruments are undertaken exclusively for hedging purposes.

The risk of price changes that may have a material impact on ZLIC's capital and earnings can be mitigated through rigorously-defined asset class targets and limits, as well as interest rate sensitivity targets and limits, which are regularly monitored, reported and reviewed in the local ALMICs. Investment Management makes every effort to achieve adequate asset diversification and good credit quality within the bond portfolio.

Risks pertaining to a single security are limited through a well-diversified investment portfolio, as well through an index-driven investment policy that includes specific tracking error targets.

ZLIC's total real estate portfolio on December 31, 2017, was valued at CHF 1.7 billion (according to Swiss local statutory reporting), of which CHF 1.6 billion were from Switzerland, CHF 19.3 million from the Japan branch and CHF 58.9 million from the Netherlands branch. ZLIC's Swiss real estate portfolio is monitored by Zurich IMRE AG (ZIMRE). Apart from adhering to ZRP rules and the FINMA investment directive, ZIMRE carries out an annual revaluation of the property portfolio and also takes into account any subsequent impairment.

For ZLIC, investment return is monitored as a key risk; Investment Management explores opportunities to enhance economic and accounting returns within economic capital (SST) guidelines and tied asset constraints. A potential change in real estate values represents another key risk. Investment Management reviews the real estate strategy for Switzerland to ensure portfolio resilience in the event of a market correction.

Potential concentration risk in investments is limited by the appropriate level of diversification. The SAA aims to diversify investments across different asset classes, as well as different sectors. For investments within each asset class, it is important to ensure a broad diversification. This applies both to individual issuers, as well as for countries. To further reduce the concentration risk, the investment guidelines, which follow FINMA guidelines, as well as Swiss Insurance Supervision Law, provide limits on sector and issuer, depending on asset class or issuer. Investment supervision and monitoring is done on a regular basis by the ALMIC.

To control concentration risk, ZLIC adheres to provisions as set out in the ZRP and also adhere to all regulatory related to mix and range of investments.

D.4 Credit risk

Credit risk is the risk associated with a loss (default) or potential loss due to counterparties failing to fulfill their financial obligations to ZLIC.

This risk to ZLIC can arise mainly in the following areas:

- Investments: The creditworthiness of counterparties in third-party investments is monitored on a regular basis by a forward-looking risk measure (duration times spread).
- Other credit risk comprises reinsurance credit risk, receivables credit risk and intragroup credit risk. These components form a relatively small part of the overall credit risk of CHF 118 million for the SST as of January 1, 2018.

There is a permanent exposure to this risk, and it is monitored on a continual basis.

The principles of strategic asset allocation (SAA) are strictly followed to manage investment credit risk. SAA is a portfolio strategy that involves setting target allocations for various asset classes, and includes periodically rebalancing the portfolio when positions deviate significantly from initial targets.

In cases in which credit risk deteriorates, receivables from policyholders are adjusted by a lump sum to avoid accumulating significant risk positions.

D. Risk profile *continued*

D.5 Operational risk

Zurich's operational risk defintion is: Operational is the risk risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events such as outsourcing, catastrophes, legislation, or external fraud. Operational risk includes legal risk, but excludes strategic and reputational risks.

ZLIC applies the following framework to assess operational risk:
Zurich has developed a comprehensive framework based on a common approach to identify, assess, quantify, mitigate, monitor and report operational risk within the Group, which ZLIC also applies. The core components of the operational risk management framework are:

- TRP: Identification and assessment of strategic and operational risks. Risks identified and assessed above a certain threshold must be mitigated and escalated. Plans for improvement actions are documented and tracked on an ongoing basis.
- Scenario based assessments: Top-down scenarios (TDS) for operational risk quantification and modeling.
- Loss event management (LEM): The ZRP requires documentation and evaluation of loss events above a threshold in a Group-wide database. To avoid recurring operational loss events, near misses and complaints, improvements are put in place.
- Reporting: Regular reports on the risk profile, current risk issues, adherence to risk policies and actions to make improvements are prepared both at ZLIC and on a Group level. There are procedures in place for referring risk issues to senior management.

In the ZRP there are extensive guidelines for managing operational risks, as well as security, information security, IT, business continuity management, investment activities, internal insurance, fraud, outsourcing and project risks.

Management actively and continuously monitors risks arising from intra-group outsourcing. These risks are then reviewed by the corresponding oversight bodies. External outsourcing agreements are reviewed according to a supplier compliance-assurance process defined in the Zurich Risk Policy manual for Outsourcing ("Rules for Managing Risk in Outsourcing")

Operational risks related to service operations by third parties are monitored on a systematic basis. This is done through risk assessments such as TRP, and, if necessary, by taking mitigating actions to reduce risk exposure. A review of mitigation actions must be conducted at least quarterly. Operational risk is managed by internal control systems, and carrying out regular controls.

Key operational risks comprise: outdated and complex IT applications landscape, data protection and security and SST methodology risk.

D.6 Liquidity risk

Liquidity risk is the risk that ZLIC may not have sufficient liquid financial resources to meet its obligations when they fall due, or would have to incur excessive costs to meet these obligations. ZLIC's policy is to maintain adequate liquidity and contingent liquidity to meet its liquidity needs under normal conditions and in time of stress.

ZLIC can draw on a cash pool that is shared by ZLIC and ZIC. This pool is divided into several smaller sub-pools and includes a mechanism that allows ZIC to grant overnight loans to provide ZLIC with short-term liquidity.

Application in life insurance
This risk arises from unexpected payment obligations in indemnification cases and on other payment obligations to contractors that cannot be covered promptly by asset sales due to financial market illiquidity, or can only be covered by asset sales at substantially reduced prices.

To mitigate liquidity risk, the volume of contingent payments is used to determine the required level of liquid funds. Liquidity risk is also mitigated by comprehensive, monthly liquidity planning, which reviews all relevant liquidity flows from assets and liabilities, as well as the related reinvestment risks or risks minimized by pre-expiry-date sales on a consolidated basis. Investment Management takes into account the marketability of the assets, as well as the expected net cash flows when planning asset transactions to cover the liquidity needs.

D.7 Other material risks

D.7.1 Strategic risk
Strategic risk arises as an unintended consequence of executing the business strategy. This risk can materialize due to poor strategic planning or by failing to properly implement a strategic plan. Changes in assumptions may also lead to an increase in strategic risk. In particular, strategic risk can arise due to strategic business decisions, and from business decisions that fail to take into account changes in the economic environment.

Executing a strategic plan implies risk-taking. This is necessary to make use of opportunities identified in the business plan, which assumes that the opportunities outweigh the corresponding risks. The annual ZLIC TRP supports the decision-making process in identifying and assessing strategic risks.

The TRP process is applied to identify, evaluate, control and monitor these risks. Mitigation actions are defined for key risks. The TRP is completed annually with management's participation. Tracking the actions taken, and providing updates on risks, is carried out quarterly. Risk management is responsible for managing the tasks on an ongoing and timely way as part of its regular quarterly activities.

Key strategic risks are: continuing low interest rate environment and further decreases in interest rates affecting the overall profitability and reserve adequacy of ZLIC, new, revised and upcoming legislation or regulatory developments and counterparty dependency.

D.7.2 Reputation risk
Reputation risk is the risk that arises from possible damage to the reputation of the company due to a negative perception by the public (e.g., customers, business partners, shareholders, government). Like strategic risk, reputational risk usually arises together with other risks.

Zurich provides a code of conduct that must be respected by all its employees throughout Zurich. An annual mandatory training session must be completed by all employees. Regular employee surveys provide another way to identify potential reputation risk.

Reputation risk can also occur in isolation. Specific reputation risks are evaluated as part of the TRPs, and if necessary addressed with appropriate mitigating measures. Currently there are no significant reputation risks.

E. Valuation

E.1 Overarching valuation principles

For SST calculations, all assets and liabilities are valued in accordance with economic principles in a market-consistent manner and their valuation is presented in the MCBS. In general, the MCBS applies the same fair value measurement and hierarchy as the Group IFRS annual financial statement, unless stated otherwise. In such cases, fair value is determined on a best estimate valuation using assumptions and parameters as defined by FINMA or based on management's judgment.

In summary, the following valuation hierarchy applies for assets:

i. Mark-to-market: for third-party assets, IFRS equity instruments and eligible capital instruments.
ii. Mark-to-model: In cases in which mark-to-market cannot be applied.
iii. IFRS carrying value.

Within asset classes, investments accounted for at fair value under IFRS will be valued the same in MCBS. This includes available-for-sale equity and debt instruments, real estate for investment, investment trusts, hedge funds, derivatives and unit-linked investments.

For investments accounted for at nominal value, at amortized cost or at equity method under IFRS, the market consistent value will not be equal to IFRS carrying value and will be determined using IFRS fair value principles. This includes hold-to-maturity bonds, real estate held for own use or for sale and mortgages.

Within the Zurich Insurance Group, the MCBS value of internal loans is symmetrical. It is based on IFRS carrying values and adjusted, as needed, to allow for valuation at risk-free interest rates. Investments in affiliates in MCBS are derived from the MCBS value of the interest held in the investee's equity, instead of the IFRS carrying value.

E.2 Market consistent balance sheet following SST principles

Asset valuation MCBS vs Swiss local stat.

in CHF millions, for the years ended December 31	**2017 (SST)**	2016 (SST)	Difference to 2016 (SST)	**2017 (Swiss local stat.)**	Difference SST to Swiss local stat.
Market-consistent value of investments					
Real estate	3,971	3,954	17	1,717	2,254
Shareholdings	–	–	–	1,544	(1,544)
Fixed-income securities	14,665	14,515	150	13,640	1,025
Loans	923	817	106	1,180	(257)
Mortgages	2,499	2,568	(69)	2,266	233
Equities	767	683	84	1,065	(298)
Other investments	1,279	1,302	(23)	414	865
Collective investment schemes	416	469	(53)	–	416
Alternative investments	447	431	16	–	447
Other investments	417	403	14	414	3
Total investments	**24,104**	**23,838**	**266**	**21,825**	**2,279**
Financial investments from unit-linked life insurance	956	947	9	938	18
Receivables from derivative financial instruments	462	478	(16)	54	408
Market-consistent value of other assets					
Cash and cash equivalents	1,579	1,872	(293)	1,656	(77)
Receivables from insurance business	108	111	(3)	224	(116)
Other receivables	104	199	(95)	110	(5)
Other assets	414	471	(57)	259	156
Total other assets	**2,206**	**2,653**	**(447)**	**2,248**	**(43)**
Total market-consistent value of assets	**27,728**	**27,916**	**(188)**	**25,066**	**2,662**

Liability valuation MCBS vs Swiss local stat.

in CHF millions, for the years ended December 31	**2017 (SST)**	2016 (SST)	Difference to 2016 (SST)	**2017 (Swiss local stat.)**	Difference SST to Swiss local stat.
Best estimate liabilities (BEL)					
Best estimate of provisions for insurance liabilities	(19,244)	(20,623)	1,379	(19,867)	623
Life insurance business	(18,366)	(19,731)	1,366	(18,940)	574
Non-life insurance business	–	–	–	–	–
Health insurance business	–	–	–	–	–
Unit-linked life insurance business	(878)	(892)	14	(927)	49
Reinsurers' share of best estimate of provisions for insurance liabilities	(33)	(86)	52	307	(341)
Market-consistent value of other liabilities					
Non-technical provisions	(9)	(29)	19	(269)	260
Interest-bearing liabilities	(621)	(568)	(54)	(1,333)	711
Liabilities from derivative financial instruments	(39)	(27)	(12)	(40)	1
Deposits retained on ceded reinsurance	(179)	(89)	(90)	(179)	0
Liabilities from insurance business	(542)	(550)	8	(127)	(415)
Other liabilities	(870)	(1,318)	448	(974)	104
Total BEL plus market-consistent value of other liabilities	**(21,538)**	**(23,289)**	**1,750**	**(22,482)**	**943**
Market-consistent value of assets minus total from BEL plus market-consistent value of other liabilities	**6,189**	**4,628**	**1,562**	**2,584**	**3,605**

E. Valuation *continued*

Assets

The Market Consistent Balance Sheet (MCBS) value of assets remained stable at CHF 28 billion throughout 2017. The value of investment assets increased slightly from CHF 23.8 billion to CHF 24.1 billion, while the value of non-investment assets fell slightly from CHF 2.7 billion to CHF 2.2 billion.

While assets are valued in a market-consistent manner in MCBS for SST calculations, assets are carried at amortized cost, at cost value less impairment, a the lower of cost or market value, or at nominal value less impairment under Swiss local statutory reporting. Furthermore, Swiss subsidiaries of ZLIC are valued for SST looking through to the underlying assets and liabilities. However for Swiss local statutory reporting subsidiaries are instead included only in the shareholdings line item at net equity value, and showing loans from the ZLIC legal entity to its Swiss subsidiaries as assets of ZLIC. These differences in approach can lead to large differences between the asset values as determined using IFRS, Swiss local statutory reporting or MCBS. This effect is observed in the differences in values of real estate, equities, mortgages, derivatives – in particular swaptions and fixed income securities. Other than shareholdings in subsidiaries, the aggregate value of investment and respective hedging assets is CHF 4.2 billion greater for SST than for Swiss local statutory reporting.

Although there are minor classification and valuation differences, the SST and Swiss local statutory reporting valuation approach for non-investment assets overall is similar, resulting in a similar valuation of CHF 2.2 billion for the year end 2017 on both bases.

Specifically for year end 2017, while the SST figures reflect the impact of the simplification to ZLIC's structure, the Swiss local statutory reporting figures reflect the situation before the dividend payment. As such the CHF 1.3 billion of the shareholdings in Zurich Insurance Group affiliates shown for Swiss local statutory reporting are not relevant for SST, which already reflects the fact that these have been paid as a dividend in kind by ZLIC to the Zurich Insurance Company Ltd (ZIC). As mentioned above the residual CHF 0.3 billion of the shareholdings in affiliates of ZLIC are shown in the other line items, following a look-through approach.

Overall the value of assets is thus CHF 2.7 billion greater on the market consistent SST basis than on the amortized cost value basis used for Swiss local statutory reporting.

Insurance liabilities

Liability cash-flows are projected based on best estimate demographic and policyholder behavior assumptions for SST. These assumptions are generally company specific, in particular for expenses, and when used to scale industry tables for demographic assumptions to match ZLIC's experience data. These assumptions are derived from experience analyses of historic values and industry data. Specific assumptions are described as follows:

- Demographics: Mortality, longevity, morbidity incidence and morbidity recovery assumptions are based on experience data analysis including Swiss and other industry statistics.
- Policyholder behavior: Policyholder behavior assumptions include surrenders, lapses and option take-up and are calibrated towards experience data.
- Company specific assumptions: Expenses are derived on the basis of CFO Forum Principles of experience analysis. No future improvements from efficiencies are considered, while one-off expenses are also excluded.
- Management actions, such as strategic asset allocation and policyholder participation principles, are modeled consistently in line with agreed practices.
- For Swiss Corporate Life & Pensions business, the run-off view prescribed by the FINMA Opt-In standard model is used. This excludes discretionary benefits and excludes future premiums after the second projection year. However, for the remainder of ZLIC's business, discretionary benefits are included. ZLIC is a participant in the FINMA SST 2018 field test which will explore alternative approaches to valuation of Swiss individual life business.

For SST, economic assumptions are used as provided by FINMA and are determined such that projected cash flows are valued in line with the prices of similar cash flows that are traded on the capital market. For Swiss individual life business, economic scenarios required for assessing the time value of options and guarantees (TVOG) are assessed on a risk-neutral basis, with risk-free yields calibrated to levels matching mid-market quoted government bond prices. Market consistent liabilities are calculated prior to shareholder tax.

Market consistent liabilities are best estimates. They differ from the local statutory liabilities, which correspond to liabilities valued according to prudent assumptions.

Life insurance liabilities gross of reinsurance are part of the MCBS. Overall ZLIC makes limited use of reinsurance as a proportion of overall liabilities. On a market consistent basis, projected best estimate cash flows in the favor of the reinsurer more than offset projected recoveries from the reinsurer.

The market value of insurance liabilities fell by CHF 1.4 billion from CHF 20.6 billion as of December 31, 2016 to CHF 19.2 billion as of December 31, 2017. Based on the cash flow projection underlying the Q4 2016 SST calculation, a CHF 0.6 billion reduction to the value of insurance liabilities is expected. The present value of the liabilities is further decreased by future profits in relation to new business both in Japan, contributing CHF 0.4 billion, and Switzerland contributing CHF 0.2 billion. The residual reduction in liabilities was driven by favorable updates to best estimate assumptions, and positive experience variance.

Valuations for Swiss local statutory reporting embed a degree of prudence in demographic assumptions. The valuation interest rate for Swiss local statutory reporting reserving is also set cautiously but is nevertheless reflective of the actual yield on the investment portfolio, which is higher than the current FINMA yield curve used for SST valuation. Nevertheless the overall Swiss local statutory reporting reserving basis is more conservative than the best estimate approach used for SST, and as such the overall value of best estimate liabilities is CHF 0.6 billion lower for SST than for Swiss local statutory reporting. On the other hand, Swiss local statutory reporting shows reinsurance assets CHF 0.3 billion in excess of SST, since SST fully reflects the reinsurer’s share in the present value of future profits.

Other liabilities

These liabilities include various positions valued at market value. They range from cash pooling liabilities and subordinated debt, to tax provisions. For SST the total other liabilities amounted to CHF 2.3 billion at the end of 2017, decreasing by CHF 0.3 billion.

ZLIC has two substantial subordinated debt liabilities, one valued at CHF 0.6 billion, the other at CHF 0.5 billion. However, only the smaller of the two is approved by FINMA as eligible for inclusion in SST risk-bearing capital, and so is not counted as a liability for purposes of SST. This is the main reason that other liabilities according to the SST calculations are CHF 0.7 billion lower than under Swiss local statutory reporting.

F. Capital management

ZLIC's capital management and planning approach is embedded in the overall capital management policy of Zurich Insurance Group. The approach is designed to maximize long-term shareholder value through an optimal capital allocation, while managing the balance sheet in accordance with regulatory and solvency requirements, including managing and monitoring of local statutory capital adequacy of ZLIC operations in Switzerland, as well as in its foreign branches.

As a legal entity, ZLIC is obliged to take into account its regulatory solvency position as part of its business plans. This includes, taking into account planned dividends and cash remittances, including possible risks to pay these in future.

The capital planning horizon is set in line with the overall planning cycle.

ZLIC must monitor that it remains within the solvency and capital requirement targets set in accordance to ZLIC's Risk Appetite Statement as described in this report and ensure adherence to local laws and regulations. In particular, ZLIC must ensure compliance with regulatory capital reporting standards such as correct classification and reporting of own fund items.

ZLIC is subject to the SST and tied asset regulations. Both are taken into account when planning capital or cash repatriations to the Group. Internal target ratios and/or thresholds, as defined in ZLIC's Risk Appetite Statement, are considered when assessing and defining the potential to repatriate capital or cash to Group.

Tied asset requirements are calculated and tracked according to FINMA guidelines and their development is analyzed on a monthly basis. From a risk appetite perspective, ZLIC's Board will be informed in the event that any transaction or business plan could cause ZLIC's tied asset ratio to fall below defined levels.

The following table shows the composition of shareholder's equity as of December 31, 2017 and 2016 respectively (according to Swiss local statutory reporting), and before appropriation of available earnings. The increase in equity capital in 2017 was driven by retaining earnings without paying a dividend.

Shareholder's equity

in CHF millions, as of December 31	**2017**	2016	Change
Share capital	60	60	–
Legal reserve	41	41	–
General free reserve	878	878	–
Retained earnings:			
Beginning of year	*1,329*	*2,080*	*(751)*
Dividend paid	*–*	*(785)*	*785*
Net income after taxes	*276*	*34*	*242*
Retained earnings, end of year	1,605	1,329	276
Total shareholder's equity	**2,584**	**2,308**	**276**

The Swiss local statutory shareholder's equity is CHF 3.4 billion lower than SST risk-bearing capital. After further excluding the value of the dividend in kind of subsidiaries from Swiss local statutory shareholder's equity, ZLIC's Swiss local statutory shareholder's equity is in fact CHF 4.7 billion lower than SST risk-bearing capital. As explained in further detail in the previous section, this difference is primarily due to the CHF 4.2 billion difference in asset valuation, together with CHF 0.5 billion eligible subordinated debt not treated as a liability under SST, and CHF 0.3 billion lower net insurance liabilities under SST, partially offset by the 0.2 billion cash dividend reducing SST risk-bearing capital but not local statutory shareholder's equity.

G. Solvency

ZLIC assesses its solvency under the Swiss Solvency Test (SST). In performing the SST, ZLIC assesses its solvency and financial condition, expressed as the SST ratio. The SST ratio must be calculated as per January 1 and must be submitted to FINMA. For business focused on Switzerland, FINMA typically requires the SST standard model to be used. ZLIC is now focused on Switzerland following simplification of the structure of ZLIC which took effect for SST for year end 2017. As a result ZLIC now uses the SST Opt-In standard model for SST. For comparability with year end 2017, year end 2016 SST figures have been restated to reflect ZLIC's simplified corporate structure and the switch to the SST standard model.[1]

ZLIC is part of the Zurich Insurance Group which maintains a strong capital position. As of December 31, 2017, the IFSR of Zurich Insurance Company (ZIC) was 'AA-/Stable' by Standard & Poor's, 'Aa3/Stable' by Moody's and 'A+(Superior)/ Stable by A.M. Best. Furthermore, Zurich filed with FINMA an SST ratio of 216 percent as of January 1, 2018.

Breakdown of target capital into essential components

ZLIC's implementation of the SST Opt-In standard model follows the design principles and requirements described by FINMA. In particular, the risks considered are market, credit and insurance risks. For ZLIC, the risks that are most material are the following:

- Market risk (ALM) covers the potential adverse change in net asset values due to movements in markets that affect, for example, interest rates, credit spreads, equity prices, real estate and foreign exchange rates, as well as respective volatilities.
- Life insurance risks comprise the risks of an adverse movement of in-force business due to developments in biometric experience relative to current expectations, or resulting from unanticipated adverse changes in maintenance expenses or persistency experience, or decrease in new business relative to current expectations.
- Credit risks comprise the risk of a decrease in the value of assets due to changes (migrations) in the credit quality of counterparties, including eventual default. The SST standard model allows for both third party investment credit risk, in which exposure consists mainly of bonds, mortgage-backed securities, mortgages, loans and cash; and other credit risks. Other credit risks include reinsurance credit risk in which the exposure consists of net reinsurance receivables; receivables credit risk; and intragroup credit risk.
- Following structural simplification already allowed for in the fourth-quarter 2017 SST reporting, ZLIC's business focuses primarily on life insurance, leaving only negligible property and casualty premiums, reserving and natural catastrophe risks.

As of December 31, 2017 and 2016 respectively, the break-down in target capital was as follows:

Solvency

in CHF millions, for the years ended December 31	2017	2016[1]	Change
Derivation of risk-bearing capital			
Assets	27,728	27,916	(189)
Liabilities	(21,538)	(23,289)	1,750
Market-consistent value of assets minus total from BEL plus market-consistent value of other liabilities	6,189	4,628	1,562
Deductions (proposed dividends)	(200)	–	(200)
Core capital	**5,447**	**4,096**	**1,352**
Supplementary capital (eligible subordinated debt)	542	532	10
Risk-bearing capital	**5,989**	**4,628**	**1,362**
Derivation of target capital			
Insurance risk	941	870	70
Market risk	1,341	1,304	37
Diversification effects	(652)	(608)	(44)
Credit risk	643	591	52
Risk margin and other effects on target capital	585	512	73
Target capital	**2,858**	**2,669**	**188**
SST ratio			
Risk-bearing capital/target capital (in %)	251%	199%	51%

[1] The restated SST calculation and SST ratio as of January 1, 2017 (after model change) were not subject to regulatory review by FINMA. This footnote has been included on July 25, 2018 for the purpose of further clarification.

G. Solvency *continued*

The values shown here already reflect diversification within each risk type with regard to individual risk drivers.

Comments on the SST ratio

The SST ratio increased from 199 percent on December 31, 2016 to 251 percent on December 31, 2017. Despite a continued low-interest rate environment, ZLIC's capitalization remains strong as measured by SST. The increased SST ratio was driven by a combination of favourable economic variance, strong value creation from new business, positive assumption changes and benign operating experience variance. Furthermore, no dividend was paid in 2017. In this context, risk-bearing capital grew strongly, while target capital remained relatively stable overall. The increase in target capital was driven by growth in insurance risk and corresponding risk margin for the Japanese business.

The data, methods, and results of the Swiss Solvency Test for ZLIC are produced in accordance with the Insurance Supervision Ordinance (ISO, art. 41 seqq.). ZLIC's SST is calculated using the SST Opt-In standard model.

Breakdown of market risk into essential components

The following chart shows the market risk broken down into its essential components.

- Interest rate risk refers to the risk of a reduction in risk-bearing capital due to movements in interest rates.
- Credit spread, equity risk and real estate risks refer to the risks that decline in market prices will reduce the value of debt, equity and real estate assets, respectively. For unit-linked business, such a decline would largely be reflected in reduced liability values. For the rest of ZLIC's business, the loss in market value due to a widening of credit spreads or a fall in equity or real estate prices would not be fully passed on to policyholders, reducing risk-bearing capital. Private equity and hedge funds risks are shown with equities.
- Volatility risk relates to the change in value of assets and/or liabilities in response to changes in implied volatilities.

Solvency – Market risk

in CHF millions, for the years ended December 31	2017	Adjustments previous year	2016	Change
Market risk derivation of target capital				
Interest rate risk	631		650	(19)
Spread risk	579		620	(41)
Exchange rate risk	391		375	16
Equity risk	322		351	(29)
Real estate risk	613		554	59
Volatility risk	55		52	4
Diversification	(1,250)		(1,297)	47
Total of market risk target capital	**1,341**		**1,304**	**37**

Investment credit risk related to migration or default of third-party debt investments remained stable at CHF 0.5 billion. Other credit risk, almost all of which is intragroup credit risk, remained stable at CHF 0.1 billion.

Breakdown of life insurance risk into essential components

The following table shows the life insurance risk broken down into its essential components.

- Mortality risk is the risk that liabilities increase through higher than expected mortality rates.
- Longevity risk is the risk that liabilities increase through lower than expected mortality rates for annuitants.
- Morbidity incidence risk is the risk that liabilities increase through higher than expected rates of morbidity inception.
- Morbidity recovery risk is the risk that liabilities increase through lower than expected rates of recovery.
- Lapse risk is the risk that more policyholders than expected allow their policies to lapse or surrender their policies to the disadvantage of ZLIC.
- Expense risk is the risk that the expenses of running the in-force business are higher than expected.

Solvency – Insurance risk

in CHF millions, for the years ended December 31	2017	Adjustments previous year	2016	Change
Insurance risk derivation of target capital				
Life insurance liabilities				
Mortality	69		61	8
Longevity	343		346	(3)
Morbidity incidence	515		431	84
Morbidity recovery	961		813	148
Business risk				
Expenses	457		482	(25)
Lapses	72		54	18
Option take-up	1		–	1
Diversification	(1,478)		(1,318)	(161)
Total of insurance risk target capital	**939**		**869**	**70**

Breakdown of risk-bearing capital into essential components

The following table shows a breakdown of the risk-bearing capital based on its essential components. The risk-bearing capital is calculated as assets less liabilities, as set out in the market consistent balance sheet. Subordinated debt with equity features approved by FINMA as eligible for inclusion in risk-bearing capital is thus excluded from liabilities. The core capital does not include subordinated debt, however, and is thus reduced relative to the risk-bearing capital.

Market-Consistent Balance Sheet

in CHF millions as of December 31	2017	2016	Change
Assets	27,728	27,916	(189)
Liabilities	(21,538)	(23,289)	1,750
Deductions (proposed dividends)	(200)	–	(200)
Core capital (= assets – liabilities – deductions – eligible subordinated debt)	**5,447**	**4,096**	**1,352**
Eligible subordinated debt	542	532	10
Risk-bearing capital	**5,989**	**4,628**	**1,362**

Appendix 1: Quantitative templates

Income statement Solo

in CHF millions for the years ended December 31

		Total		Individual Life	
		2016	**2017**	2016	**2017**
1	Gross written premiums and policy fees	1,989	1,875	436	417
2	Premiums ceded to reinsurers	(220)	(228)	(1)	(1)
3	Net written premiums and policy fees	1,769	1,646	435	416
4	Change in reserves for unearned premiums, gross	(1)	42	12	12
5	Change in reserves for unearned premiums, ceded	6	(23)	–	–
6	Net earned premiums and policy fees	1,774	1,665	447	428
7	Other income	300	14	76	3
8	**Total technical income**	**2,074**	**1,679**	**522**	**430**
9	Claims paid, annuities and loss adjustment expenses, gross	(1,932)	(2,055)	(851)	(842)
10	Claims paid, annuities and loss adjustment expenses, ceded	60	53	0	0
11	Change in insurance reserves, gross	(534)	329	(230)	356
12	Change in insurance reserves, ceded	74	66	(0)	(0)
13	Change in actuarial provisions for unit-linked contracts	3	(13)	–	–
14	Insurance benefits and losses, net of reinsurance	(2,328)	(1,619)	(1,081)	(486)
15	Underwriting & policy acquisition costs, gross	(278)	(257)	(39)	(36)
16	Underwriting & policy acquisition costs, ceded	129	150	–	–
17	Underwriting & policy acquisition costs, net of reinsurance	(149)	(107)	(39)	(36)
18	Administrative and other expense	(403)	(691)	(86)	(167)
19	**Total technical expense**				
20	Investment income	788	1,180	195	305
21	Investment expenses	(93)	(112)	(23)	(29)
22	**Net investment result**	**695**	**1,068**	**172**	**276**
23	Net investment result on unit-linked investments	14	101	–	–
24	Other financial income	186	6	47	1
25	Other financial expense	(9)	(6)	(2)	(2)
26	**Operating result**	**79**	**431**	**(468)**	**18**
27	Interest expense on debt and other interest expense	(51)	(50)		
28	Other income	–	–		
29	Other expense	–	–		
30	Extraordinary income/expense	–	–		
31	**Net income before taxes**	**29**	**380**		
32	Direct tax expenses	5	(105)		
33	**Net income after taxes**	**34**	**276**		

Line items 7, 18–26: LoB allocated according to GWP

Swiss business								Foreign business	
Group Life		Unit-linked		Other		Total		Total	
2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**
1,056	914	234	256	–	–	1,726	1,587	263	288
(104)	(60)	–	–	–	–	(105)	(62)	(115)	(167)
953	854	234	256	–	–	1,621	1,526	147	121
(18)	31	–	–	–	–	(6)	43	5	(1)
7	(23)	–	–	–	–	7	(23)	(1)	(0)
942	862	234	256	–	–	1,622	1,546	151	120
183	6	41	2	–	–	299	11	1	2
1,125	**868**	**274**	**258**	**–**	**–**	**1,921**	**1,557**	**152**	**122**
(891)	(921)	(84)	(170)	–	–	(1,827)	(1,933)	(105)	(122)
48	33	–	–	–	–	48	33	13	21
(244)	64	(10)	(3)	–	–	(484)	416	(50)	(87)
31	(18)	–	–	–	–	31	(18)	43	84
–	–	(2)	16	–	–	(2)	16	5	(30)
(1,057)	(842)	(96)	(157)	–	–	(2,234)	(1,485)	(94)	(134)
(66)	(54)	(36)	(34)	–	–	(140)	(123)	(138)	(134)
13	15	–	–	–	–	13	15	117	135
(53)	(38)	(36)	(34)	–	–	(128)	(108)	(21)	0
(209)	(365)	(46)	(102)	–	–	(342)	(634)	(61)	(57)
473	670	105	188	–	–	773	1,163	15	18
(55)	(63)	(12)	(18)	–	–	(91)	(110)	(2)	(2)
417	**606**	**92**	**170**	**–**	**–**	**682**	**1,052**	**13**	**16**
–	–	10	46	–	–	10	46	4	55
113	3	25	1	–	–	184	5	1	1
(5)	(4)	(1)	(1)	–	–	(9)	(6)	–	–
330	**228**	**222**	**181**	**–**	**–**	**85**	**427**	**(6)**	**3**

Appendix 1: Quantitative templates *continued*

Market-consistent balance sheet

In CHF millions, as of December 31	2017	Adjustments previous period	2016
Market-consistent value of investments			
Real estate	3,971		3,954
Shareholdings	(0)		0
Fixed-income securities	14,665		14,515
Loans	923		817
Mortgages	2,499		2,568
Equities	767		683
Other investments	1,279		1,302
Collective investments schemes	416		469
Alternative investments	447		431
Other investments	417		403
Total investments	**24,104**		**23,838**
Financial investments from unit-linked life insurance	956		947
Receivables from derivative financial instruments	462		478
Market-consistent value of other assets			
Cash and cash equivalents	1,579		1,872
Receivables from insurance business	108		111
Other receivables	104		199
Other assets	414		471
Total other assets	**2,205**		**2,653**
Total market-consistent value of assets	**27,728**		**27,916**
Best estimate of liabilities (BEL)			
Best estimate of provisions for insurance liabilities	**(19,244)**		**(20,623)**
Life insurance business	(18,366)		(19,731)
Non-life insurance business	–		–
Health insurance business	–		–
Unit-linked life insurance business	(878)		(892)
Other business			
Outward reinsurance: life insurance business			
Outward reinsurance: non-life insurance business			
Outward reinsurance: health insurance business			
Outward reinsurance: unit-linked life insurance business			
Outward reinsurance: other business			
Reinsurers' share of best estimate for insurance liabilities	**(33)**		**(86)**
Direct insurance: life insurance business	–		
Direct insurance: non-life insurance business			
Direct insurance: health insurance business			
Direct insurance: unit-linked life insurance business			
Direct insurance: other business			
Outward reinsurance: life insurance business	(33)		(86)
Outward reinsurance: non-life insurance business			
Outward reinsurance: health insurance business			
Outward reinsurance: unit-linked life insurance business			
Outward reinsurance: other business			
Market-consistent value of other liabilities			
Non-technical provisions	(9)		(29)
Interest-bearing liabilities	(621)		(568)
Liabilities from derivative financial instruments	(39)		(27)
Deposits retained on ceded reinsurance	(179)		(89)
Liabilities from the insurance business	(542)		(550)
Other liabilities	(870)		(1,318)
Total BEL plus market-consistent value of other liabilities	**(21,538)**		**(23,289)**
Market-consistent value of assets minus total from BEL plus market-consistent value of other liabilities	**6,189**		**4,628**

Solvency

in CHF millions, for the years ended December 31	2017	Adjustments previous year	2016[1]	Change
Derivation of risk-bearing capital				
Assets	27,728		27,916	(189)
Liabilities	(21,538)		(23,289)	1,750
Deductions (proposed dividends)	(200)		–	(200)
Core capital	**5,447**		**4,096**	**1,352**
Supplementary capital (eligible subordinated debt)	542		532	10
Risk-bearing capital	**5,989**		**4,628**	**1,362**
Derivation of target capital				
Insurance risk	941		870	70
Market risk	1,341		1,304	37
Diversification effects	(652)		(608)	(44)
Credit risk	643		591	52
Risk margin and other effects on target capital	585		512	73
Target capital	**2,858**		**2,669**	**188**
SST ratio				
Risk-bearing capital/target capital (in %)	251%		199%	51%

[1] The restated SST calculation and SST ratio as of January 1, 2017 (after model change) were not subject to regulatory review by FINMA. This footnote has been included on July 25, 2018 for the purpose of further clarification.

Appendix 2: Reference to the ZLIC Annual Report including Report of the statutory auditors

The Financial Condition Report is not audited.

The consolidated financial statements of Zurich Life 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 to the consolidated financial statements for the year ended December 31, 2017 are audited. Please refer to the report of the statutory auditor in ZLIC's Annual Report 2017, page 20:

https://www.zurich.com/en/investor-relations/results-and-reports/other-statutory-filings.

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