Company Participants

- George Quinn

MANAGEMENT DISCUSSION SECTION

George Quinn {BIO 15159240 <GO>}

Good morning or good afternoon. My name is George Quinn and I'm the Chief Financial Officer of the Zurich Insurance Group, and I will take you through a short summary of our Q1 results. Overall business operating profit for the group was $1.3 billion in the first quarter, and net income attributable to shareholders was $1.2 billion. These numbers are both around 5% lower than in the prior year period.

However, when comparing results this year with last, currency is a big feature. We report in US dollars, but only about half of our business is in this currency. And as a result, the strength of the US dollar against all relevant currencies has had a big impact on our results, and is likely to continue to do so over the course of 2015.

The impact of currency moves is mainly a translational issue for us, since we typically match local currency liabilities with local currency assets. In this respect, on a constant currency basis, BOP would have been broadly flat, and a 5% decline in gross premiums written in our GI business would have been a 5% increase.

In terms of our operating performance, we'd see this as a solid start to the year in terms of both the top line and BOP, albeit with results for both Q1 and the prior period benefiting from a very low level of catastrophe losses and a number of positive one-off items.

And now I'll take you through some of the results of our business in more detail. I will cover the operating performance of GI, Life and Farmers shortly, but I will briefly highlight four points on this slide.

First, the results of other operating businesses in both periods benefit from one-off gains, as well as from lower marketing and other costs in the first quarter in comparison to what we expect for the rest of the year. The one-off benefits relate to currency gains in Q1 2015 of around $50 million, while the prior period results for OOB included a $40 million gain, which was part of an overall pension curtailment gain for the group of $130 million.

Second, again within OOB, we are seeing the benefit of lower financing costs coming through our results, with external interest costs around $20 million lower for Q1 2015 compared to the prior period.

Third, in the walk we show from BOP to NIAS on this slide, we have realized gains of around $250 million. This breaks down as roughly $180 million on active fixed income realizations and $120 million in equities, with the balance being changes in mark to market positions and derivatives.

And fourth, we have a tax rate for the quarter of 24.5%, which is in line with our medium-term expectations.

Coming to the performance of General Insurance. Compared to the prior year period and at constant currency, gross premiums written grew by 5%, and net earned premiums were up by 2%. Overall rate increases on renewal for the quarter remained stable at 2%, for the fourth quarter in a row.

Compared to the previous quarter, we saw slightly higher rate increases in NAC. However, the overall picture remained very consistent, with continued pressure in our US property lines on one side, but more favorable rates in other areas such as commercial auto.

Looking at the top-line development for the different regions, Global Corporate reported an increase of 10% in local currency. This includes some timing effects and we see 3% to 4% as the underlying growth rate, with continued high retention levels in both Europe and the US. For NAC, gross premiums were up 2%, with continued execution of our strategic growth initiatives and an increase in retentions.

Looking at our European business, the top-line is up 1% in local currency. And excluding Russia Retail, growth was 2%, with expansion in Switzerland, Germany and Spain, offset by market related pressures in Italy and turnaround activity in South Africa.

In International markets, premiums increased by roughly 12% in local currency, and the majority of this growth is driven by the new extended warranty distribution agreement in Brazil. Other than that, the growth in our Latin American business is mainly driven by inflation in Venezuela. In APAC, a decline in premiums in Australia is offset by solid growth in Japan and Hong Kong.

Let's now move on to the combined ratio. The combined ratio for the first quarter was 96.7% compared to 95.9% in the first quarter of last year, and 96.8% for the full year of 2014. Results in 2014 benefited from the Swiss pension gain, which reduced the expense ratio in Q1 by 0.9%, and 0.2% for the full year.

Looking at the accident year combined ratio, excluding catastrophe losses, the Q1 2015 result of 96.8% is broadly flat in comparison to the prior year period on an adjusted basis. Within the accident year loss ratio, we have seen further improvement in the attritional loss ratio of roughly 1%, but there has also been a small uptick in large losses, offsetting most of this improvement.

The expense ratio for the first quarter is 31.4%. While 1.2% higher than in the prior year quarter, almost all the increase is due to the pension gain in 2014, and the amortization of the upfront payment for the new distribution agreement in Brazil, which had a 0.2% impact on the expense ratio.

In terms of catastrophes, the impact for the quarter was 1.4%, well below the expected level for Q1 of around 3%, despite a small impact from snowstorm Niklas in Europe. And prior year reserve movements were a benefit of 1.5%, with positive contributions from most regions.

Turning to the performance by region, the increased combined ratio in Global Corporate is mainly driven by the large losses I mentioned before, and a lower level of prior year reserve releases. The improvement in North America Commercial of roughly 1.8% is mainly driven by a reduction in the accident year ex-cat combined ratio.

EMEA's combined ratio is up 2.1%, but this is mainly due to the pension gain in Q1 2014, which had a 1.9% positive impact. Within the loss ratio, we saw the impact of several large losses in the UK, offset by a lower impact from catastrophes.

The combined ratio for our International Markets remained broadly flat. The expense ratio increased, mainly driven by $15 million in amortization costs from the upfront payment for the new distribution agreement in Brazil, offset by an improvement in the accident year ex-cat loss ratio.

The latter metric reduced by roughly 1.5% compared to Q1 and Q4 of last year, and 0.5% compared to full year 2014. While we see some improvement there, there remains much to do, especially in Brazil.

On the next slide, I'll show you the breakdown of our GI BOP. GI BOP was $706 million for the first quarter, 16% below the prior year in local currency. Q1 2014 results benefited from a number of one-off positives, such as $72 million from the Swiss pension gain and $50 million in currency gains, net of minority interests. Adjusting for these effects, GI's operating profits in local currency were broadly flat.

Investment income in Q1 2015 was down $20 million in local currency, or 4% compared to the prior period. This is in line with what we said at the year end and we continue to expect a decline in investment income of around $100 million for the full year compared to 2014, on a constant currency basis. And lastly, gains on our hedge fund portfolio were $61 million in Q1 2015.

With that let's move on to Global life business. Global life continues to demonstrate growth in APE, with Q1 up 24% in local currency compared to the prior period, and up by 8% in US dollars. This was primarily driven by Europe, Middle East and Africa, which grew 32% in local currency, and with all countries showing progress.

While we saw local currency growth in Latin America overall, a strong performance by Zurich Santander, with 16% growth in APE, was partially offset by a reduction in volumes in our Zurich branded life businesses.

And as expected, North America experienced a slight reduction in APE, reflecting exceptional volumes achieved in the prior year quarter. Analyzed by pillar, we saw double digit growth in each of the businesses in local currency, with Corporate Life and Pensions volumes increasing 23%, primarily driven by the UK, as well as 28% growth in our Bancassurance businesses and 19% in Retail.

New business value was down 5% in local currency year on year, as lower yields impacted our savings business in Europe. Other factors reducing the new business margin included lower margins in the US, and changes in business mix in a number of countries.

And finally, net inflows were above $1 billion for the quarter, primarily driven by our European and Latin American businesses.

Turning to Life profitability. Q1 business operating profit was up 13% in local currency, or flat in US dollars compared to the prior year quarter. This reflects the fact that the biggest contributors to our operating earnings tend to be our European operations, and given the 30% appreciation in the value of the dollar between Q1 2014 and Q1 2015.

BOP in Latin America was down 20% in local currency compared to the prior year period. And within this, Zurich Santander Life BOP for the quarter was up 19%, while Zurich branded Latin American earnings were lower than in the prior year period, due mainly to the run off of the SIS contract, which was not renewed in 2014, and some non-recurring positive items in Q1 2014.

In North America, earnings increased by $62 million, mainly due to the impact of a $56 million charge in the prior period, relating to the transfer of a closed portfolio to non-core business.

And Europe, Middle East and Africa saw an underlying increase of 16% in local currency earnings after adjusting for one-off effects in the current and prior year quarters. Increasing profits from protection and unit linked business, together with positive DAC true-ups, more than offset reducing margins on investment business driven by falling interest rates.

On the next slide, I will give you an update on the Farmers Exchanges, which we do not own but are relevant to the performance of our Farmers business segment. The Farmers Exchanges performed well in the first quarter.

Gross written premiums grew by around 2%, or 4% excluding 21st Century Direct Auto and Business Insurance sold through independent agents. This is very much in line with the previous quarter with one exception; policies-in-force slightly increased for the first time after shrinking for the previous 10 consecutive quarters. Within standard Auto business sold through exclusive agents, gross premiums grew by 5% and policies-in-force were up by 1%, continuing the positive trend seen in previous quarters.

Homeowners showed slightly lower growth, and was flat in terms of policies-in-force, partly due to modest rate filings over the last year and some caution regarding growth in some catastrophe prone areas. Business sold directly through 21st Century in contrast declined 9%, but in line with our expectations.

Customer satisfaction and retention continue to trend favorably. And while the head count of Farmers exclusive agents slightly declined, this is due to normal seasonal patterns, and we expect the agency force to increase over the year.

The combined ratio of the Farmers Exchanges was a very healthy 94% in the first quarter, 3 points better than in the prior year period. While catastrophe losses were benign in the first quarter, the majority of the improvement was due to lower loss adjustment expenses, favorable PYD and better underlying loss experience. While this is encouraging for the future, we wouldn't see 94% as sustainable, given the typically light first quarter in terms of catastrophe losses, and with frequency and severity trends in auto requiring some rate increases.

Given the strong underwriting result, the Farmers Exchanges surplus grew by over $200 million in the quarter, leading to a 0.4 point increase in the surplus ratio to around 39%, even with 13% higher net premiums. The surplus ratio is calculated on the basis of 12-month trailing net written premiums, which means that the reduction in the quota share is not fully factored into this number yet. The surplus ratio, this is expected to move back into the near term target range of 33% to 36% over the course of the year.

Let's look now at Farmers Management Services and Farmers Re. Farmers Management Services business operating profit declined 3%, with broadly flat management fees offset by slightly higher expenses. The managed gross earned premium margin for the quarter was 7%, in line with what we signaled at the time of the year end results.

Given the reduction in quota share reinsurance treaty participation, Farmers Re net earned premiums dropped 43%. The Farmers Re result was only slightly down on the prior period, due to the exceptionally low combined ratio of the Farmers Exchanges in the quarter.

Next, I'll provide you with an update on our balance sheet and on our capital position. Shareholders' equity increased by $0.7 billion over the quarter, as net income and higher unrealized gains on investments compensated for the negative currency impact triggered by the strengthening of the US dollar against the euro and most other currencies. And note that, as in the previous year, the dividend payment will be recorded in the second quarter.

With respect to solvency, both Z-ECM and SST ratios declined in the second half of last year. The Z-ECM ratio reduced from 126% at June 30 to 122% at December 31, with SST declining from 215% to 196% over the same period.

There are three main moving parts here. First, the impact of net market movements, mainly flatter and lower yield curves, which reduced Z-ECM by around 6 points, and SST by around 13 points.

Second, allowing for expected organic growth in the business in 2015, which had a 4 point negative impact on Z-ECM, and 5 points on SST.

Third, and for Z-ECM only, these factors were partially offset by a change in how we model certain investment risks. This had a benefit of around 6%.

Looking into developments since the end of 2014, we'd expect to see our Z-ECM ratio move lower in Q1, given the combined impact of currency movements and a further flattening and decline in bond yields, among other factors.

Our current best estimate is that we will see a ratio in the upper half of our target range. In other words, still at a very comfortable level. Given the levers we have at our disposal to manage our overall risks, this doesn't impact our view of the deployable capital that we hold.

Back in February, we told you about some of the factors that we expect to influence 2015, and based on our Q1 results, you can see that experience to date is tracking in line with these expectations.

In terms of where we stand now compared to February, the only real change we expect for the full year is in relation to currency, given further weakness of the euro against the US dollar. While this may have a slightly bigger impact compared to previous indications, we don't expect this to be significant.

In terms of our operating performance in Q1, business operating profit of $1.3 billion represents a solid start to the year, but we recognize that there are some positive one-offs in these results, and we also benefited from low catastrophe losses. We still have much to do to improve our ROE, particularly in terms of improving current year profitability in our General Insurance business, and we look forward to providing you an update on our progress and priorities for the next 18 months at our Investor Day on May 21.
